

**THE HON'BLE THE CHIEF JUSTICE ALOK ARADHE  
AND  
THE HON'BLE SRI JUSTICE J. SREENIVAS RAO**

**I.T.T.A. No. 319 of 2007**

**JUDGMENT:** (per the Hon'ble the Chief Justice Alok Aradhe)

Mr. Duvva Pavan Kumar, learned counsel appears for  
Mr. Y. Ratnakar, learned counsel for the appellant.

Mr. J.V. Prasad, learned Senior Standing Counsel for  
Income-tax Department appears for the respondent.

2. This appeal is filed by the assessee under Section 260A  
of the Income-tax Act, 1961, pertains to the assessment year  
2000-01. The appeal was admitted by a Bench of this Court on  
the following substantial questions of law.

“1. Whether on the facts and in the circumstances of the  
case, for the purpose of arriving at the accumulated profits  
u/S.2(22)(e) of the Income-tax Act whether deduction of  
depreciation as provided under the Income-tax Act is  
necessary or not for taxing any loan borrowed from the  
company, as deemed dividend?

2. Whether the loan borrowed by the appellant amounting  
to Rs.14,51,281/- is liable to tax as deemed divided  
u/S.2(22)(e) of the Income-tax Act on the facts and  
circumstances of the case?

The factual backdrop in which the aforesaid substantial questions of law arise for consideration need mention which is stated infra.

3. The assessee filed income tax return declaring the total income of Rs.1,95,880/-. The return was accepted by the Assessing Officer by an order passed under Section 143(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act'). Subsequently, the assessment was reopened and the notice dated 27.03.2003 under Section 148 of the Act was issued to the assessee. In response to the aforesaid notice, the assessee requested that the return filed on 29.06.2000 be treated as response to the notice under Section 148 of the Act. The Assessing Officer *inter alia* treated the loan taken by the assessee from M/s.Rajadhani Hotels Private Limited in which assessee was a shareholder, during the period from 01.04.1999 to 19.12.1999, as deemed dividend under Section 2(22)(e) of the Act. It was further held that the accumulated profits of M/s.Rajadhani Hotels Private Limited were more than the advance given to the appellant. The contention of the assessee that there are no accumulated profits and if the reworking of

profits is done by deducting the correct amount of depreciation, there would be a negative figure of Rs.19,75,068/- as against Rs.35,08,698/-, was rejected. The Assessing Officer by an order dated 26.03.2004 completed the assessment and made an addition of Rs.14,51,281/-.

4. Being aggrieved, the assessee filed an appeal before the Commissioner of Income-tax (Appeals). The Commissioner of Income-tax (Appeals) *inter alia* held that profits disclosed are subject to adjustment and depreciation as granted in accordance with the rates prescribed under the Act and therefore, the accumulated profits are to be computed taking into account the depreciation as per the Income-tax Rules. The Commissioner of Income-tax (Appeals) placed reliance on the decisions of Bombay High Court in **Navnit Lal C Javeri v. Commissioner of Income-tax, Bombay City**<sup>1</sup> and **Commissioner of Income-tax, Bombay City v. Jamnadas Khimji Kothari**<sup>2</sup> and by an order dated 23.09.2004 allowed the appeal.

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<sup>1</sup> (1971) 80 ITR 582 (Bom)

<sup>2</sup> (1973) 92 ITR 105 (Bom)

5. Being aggrieved, the Revenue filed an appeal before the Income Tax Appellate Tribunal. The Appellate Tribunal placed reliance on the decision of the Supreme Court in **P.K. Badiani v. Commissioner of Income tax, Bombay**<sup>3</sup> and held that accumulated profits occurring in Clause (e) of Section 2(22) means profits in the commercial sense and not taxable profits liable to tax as income under the Act. Accordingly, the Appellate Tribunal by an order dated 27.07.2007 set aside the order passed by the Commissioner of Income-tax (Appeals) and allowed the appeal preferred by the Revenue. Hence, this appeal.

6. Learned counsel for the assessee submitted that the issue involved in this appeal is squarely covered by the decisions of Bombay High Court in **Navnit Lal C Javeri** and **Jamnadas Khimji Kothari** (supra). It is further submitted that the decision of the Supreme Court in **P.K. Badiani** (supra) does not apply to the fact situation of the case and the Appellate Tribunal grossly erred in reversing the well-reasoned order passed by the Commissioner of Income-tax (Appeals). It is

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<sup>3</sup> (1976) 4 SCC 562

therefore submitted that the impugned order passed by the Appellate Tribunal be set aside.

7. On the other hand, learned counsel for the Revenue submitted that the Appellate Tribunal rightly relied on the decision of the Supreme Court in **P.K. Badiani** (supra). It is further submitted that the accumulated profits under Section 2(22)(e) of the Act means profit in the commercial sense and are liable to tax as income under the Act. It is contended that for the purposes of calculating accumulated profits, depreciation is not required to be calculated in accordance with the provisions of the Act.

8. We have considered the rival submissions made on both sides and have perused the record.

9. In **Navnit Lal C Javeri** (supra), Bombay High Court dealt with the issue as to what is the correct method for determination of accumulated profits under Section 2(6A)(e) of the Income-tax Act, 1922 and if there are any accumulated profits so determinable, what is the correct amount thereof.

The aforesaid issue was answered by the Division Bench of Bombay High Court in the following terms.

“....If the gross profits are treated as profits without provision of any depreciation, at the end of the useful life of the assets they will be lost completely. It is to provide for replacement of the capital assets so lost by reason of normal wear and tear that depreciation is allowed, so that at the end of the useful life of those assets a fund is available to replace those assets. In short, a provision for depreciation is of a capital nature and is intended to replace the capital which is lost by wear and tear. Now, the Income-tax Act does make a provision for allowing depreciation as a deduction, for example, under Section 10(2)(vii). In our opinion, therefore, for the purpose of calculating profits within the meaning of the phrase “accumulated profits” under section 2(6A)(e), an allowance of depreciation should be made by way of a deduction at the rates provided for by the Income-tax Act itself.....”

10. Another Division Bench of Bombay High Court in **Jamnadas Khimji Kothari** (supra) held as follows:

“As regard question No.2, the answer is:

The phrase “accumulated profits” does not mean profits as disclosed by the company’s balance-sheet. The profits disclosed would be subject to adjustment and the depreciation as granted in accordance with the rates prescribed by the Income-tax Act would have to be deducted for ascertaining the accumulated profits.”

11. The Supreme Court in **P.K. Badiani** (supra) dealt with the following issue.

“The main question for our determination in this appeal is whether the aggregate of the development rebates allowed to the company under Section 10(2)(vi-b) of the 1922 Act could be treated as accumulated profits in the hands of the company under Section 2(6-A)(e).”

12. The Supreme Court while answering the aforesaid issue neither referred to the decisions of the two Division Benches of Bombay High Court in **Navnit Lal C Javeri** and **Jamnadas Khimji Kothari** (supra) nor dealt with the issue which is involved in the present appeal. The issue involved in this appeal is answered by the two Division Benches of Bombay High Court and we concur with the view taken by the two Division Benches of Bombay High Court.

13. For the aforementioned reasons, the substantial questions of law framed by a Bench of this Court are answered in favour of the assessee and against the Revenue.

14. In the result, the order dated 27.07.2007 passed by the Income-tax Appellate Tribunal is set aside and the order dated

23.09.2004 passed by the Commissioner of Income-tax (Appeals) is restored.

15. Accordingly, the appeal is allowed.

Miscellaneous applications, if any pending, shall stand closed. There shall be no order as to costs.

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**ALOK ARADHE, CJ**

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**J. SREENIVAS RAO, J**

14<sup>th</sup> NOVEMBER, 2024.

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