ITA 232 OF 2007
IN THE HIGH COURT AT CALCUTTA
SPECIAL JURISDICTION (Income Tax)
ORIGINAL SIDE

G.G.L.Hotels and Resort Company Ltd.
Versus
Commissioner of Income Tax, West Bengal-II, Kolkata

BEFORE :

The Hon'ble Justice GIRISH CHANDRA GUPTA
The Hon'ble Justice ASHA ARORA
12th April, 2016.

For Appellant: Mr. R.K.Murarka,Advocate
Mrs. Sutapa Roychowdhury,Advocate

For Revenue: Mr. R.K.Sinha,Advocate

The Court : The subject matter of challenge is a judgement and order dated 25th January, 2007 passed by the learned Income Tax Appellate Tribunal, "A" Bench Kolkata in ITA No.664/Kol/2006 pertaining to the assessment year 2002-03, by which the learned Tribunal dismissed an appeal preferred by the assessee and upheld the order of the CIT(A). Aggrieved by the order the assessee has come up in appeal.

The question formulated at the time of admission of the appeal is as follows:-

"Whether on the facts and in the circumstances of the case and on a proper construction of agreement dated 9th March, 1999 between the appellant company and M/s. UTI Bank Limited, the Tribunal erred in law in holding that the payment of Liquidated

damages of Rs.50,71,328/- by the appellant Company to UTI Bank Ltd. was payment of Dividend and not allowable/deductible expenditure in the hands of the appellant company under the Income Tax Act, 1961 ?

The facts and circumstances of the case, briefly stated, are as follows:-

The assessee issued 30,00,000 (Thirty Lakhs) cumulative redeemable preference shares of Rs.10 each at par aggregating to a sum of Rs.3 Crores redeemable at par on 31st March, 2000 carrying assured dividend of 12% per annum. The case of the assessee is that it was unable to pay dividend to the shareholders as agreed. The shares were, therefore, redeemed before the prescribed time. After the shares were redeemed, in order to avoid, ruinous litigation, a sum of Rs.50,71,328/- was paid by the assessee to the former shareholders by way of liquidated damages.

The question was, whether the aforesaid sum paid on account of the liquidated damages was a deductible expenditure. The assessing officer answered the question in the negative by holding as follows :

"*From the copy of the agreement submitted it has been observed that the company agreed to allot 30,00,000 cumulative redeemable preference shares to UTI Bank Ltd. and the preference shares will carry dividend @ 12% per annum. It has been settled in the agreement that where due to inadequacy of profit or due to whatsoever reason the company is not able to declare the dividend, the company agrees to compensate the investor, such that the post-tax (and surcharge) return to the investor remains at 12%. It has been further agreed that in case of default the company shall pay liquidated damage at such rate as would provide a post-tax (and surcharge) return of 12% per annum to the investor. As the relation between the assessee and UTI Bank Ltd. is that of company and shareholder, the assessee was requested to explain why the liquidated damage paid should not be treated as dividend payment. In response, the assessee has submitted that the assessee has not declared any dividend, therefore, the said payment cannot be termed as dividend. It has been further stated that on the date of* *payment the preference shares had already been redeemed by the company. It has been further argued that damage paid cannot be termed as penalty and may be allowed as normal business expenditure. The argument of the assessee cannot be accepted because the payment has been made for default in making dividend payment and as the dividend payment is not an allowable deduction under the Income Tax Act, 1961 any damage paid in respect of dividend payment cannot be allowed because it acquires the same character. The argument that on the date of payment of damage the preference shares were redeemed does not hold good as the payment was made in connection with the preference shares which were redeemed earlier. The relationship between the bank and the assessee cannot be termed as one of loan creditor and loan debtor and the assessee has not borrowed any fund from the bank, hence, there is no question of treating the damage paid by the assessee as interest payment. The damages have been paid to the preference shareholder in lieu of the dividend payment. It is clear from the agreement that the preference shareholder, i.e. UTI Bank Ltd., has sought sure return of 12% on the preference shares and the nomenclature of dividend has been changed to liquidated damage by the parties. As the dividend payment to the preference shareholder is not an allowable expenditure, any amount paid in lieu of dividend, whether termed as damage or otherwise, cannot be allowed as a business expense. Moreover, even though the preference shareholders have preference in the matter of receipt of dividend under the Companies Act, 1956, they are treated as the owners of the company and any payment made to the owners has to be shown in the appropriation column and cannot be treated as an expense for earning the revenue. In view of the above discussion, liquidated damage is being treated as dividend payment to the preference shareholder amounting to Rs.50,71,328/- and, therefore, is being added back to the total income of the assesssee and has also been considered for computing the book profit of the assessee u/s.115JB"*

In an appeal preferred by the assessee, the CIT(|A) upheld the order of the assessing officer. He opined as follows:-

"The said amount of dividend was payable by the appellant at 12% per annum on preference shares held by the UTI Bank Ltd. as on 31.03.2001. As the appellant could not make the dividend payment to UTI Bank Ltd., the appellant company made this payment in lieu of dividend during the Financial Year in question. As the

payment of dividend is not on allowable expenditure, any payment in lieu of said dividend – as in the instant case – cannot be allowed as revenue expenditure.

In view of the above the observation of the Assessing Officer that dividend payment to the preference shareholder is not an allowable expenditure, any amount paid in lieu of dividend, whether termed as (liquidated) damages or otherwise cannot be allowed as a business expense is in accordance with law and requires no interference."

In a further appeal preferred by the assessee, the learned Tribunal upheld the order of the CIT(A) by observing as follows :

"6) We have carefully considered the argument of both the sides and perused the material placed before us. As per the finding recorded by the Assessing Officer, which is not disputed by the ld. Counsel, the assessee has allotted 30,00,000 cumulative redeemable preference shares to UTI Bank and which carried dividend @ 12% per annum. As per agreement if the assessee is not able to declare the dividend, it will compensate the investor so that the investor gets 12% return on investment. It was further agreed that in case of default, the company shall pay liquidated damages on such rate as would provide post tax return of 12% per annum to the investor. Admittedly the assessee has not declared the dividend and, therefore, as per the above agreement the UTI Bank has asked the assessee to make the payment of liquidated damages. It would be evident from the debit note issued by the UTI Bank which reads as under:-

"Sub : 12% Redeemable Cumulative Preference Shares aggregating Rs. 3.00 crores

DEBIT NOTE

Particulars	*Amount in Rs.*
Liquidated damages in terms of Clause 14.1 of the Subscription Agreement dated 9-3-1999	*50,71,328.00*
Total	*50,71,328.00*

(Rupees Fifty Lakhs Seventy One Thousand Three Hundred Twenty Eight only)

We confirm that the above payment will extinguish the liability of GGL Hotel & Resort Company Ltd. relating to our investment in the 12% redeemable cumulative preference shares of the Company"

7. From the above it is evident that the liquidated damages was claimed by the UTI Bank on 12% redeemable cumulative preference shares as per subscription agreement dated 9-3-1999. Thus the liquidated damages were compensation in lieu of dividend which assessee failed to declare on the preference shares. In the debit note itself the UTI Bank has mentioned that the above payment of liquidated damages will extinguish the liability of the assessee relating to investment in 12% redeemable cumulative preference shares. Thus the liquidated damages were paid in lieu of the dividend which the assessee has assured to pay on 12% redeemable cumulative preference allotted by it to the UTI Bank. Therefore, the treatment of the liquidated damages would be similar to the dividend which the assessee was liable to pay on the preference shares. It is an admitted position that the payment of dividend is not allowable expenditure in the hands of the company declaring dividend. Accordingly, we uphold the order of the lower authorities on this point and reject the grounds no.1 to 5 of the assessee's appeal."

Mr. Murarka, learned advocate for the assessee advanced the following submissions :

a) On the day when the liquidated damages were paid by the company to UTI Bank, the latter was no longer a shareholder because the preference shares issued had already been redeemed.

b) The payment of a sum of Rs.50,71,328/- was not on account of the dividend but on account of the liquidated damages and therefore, should have been allowed as a deductible expense.

C) Mr.Murarka relied on a passage from Ramaiya on the Companies Act, 16th Edition, Vol.1, Page-1105, - "*The company becomes liable to pay dividend on preference shares only when it declares dividend, and if in the meanwhile the preference shares are redeemed, the right of the preference shareholders to dividend, in the absence of any specific stipulation in this regard, does not continue after such redemption.*"

Further, that – "*So, the preference shareholders cannot ask for payment unless there are sufficient profits and a dividend has been declared in accordance with the framework of the statutory provisions and those in the company's articles.*"

In so far as last submission is concerned it can be straightaway pointed out that the payment in this case, was made on the basis of "specific stipulation in this regard" contained in the contract which provides as follows:-

5.1 The Company agrees to pay dividend on these preference shares at the rate of 12.00% per annum. However, in case, the Company issues Preference Shares with similar terms either in this issue or through any other issue, to any person at a rate higher than 12.00% p.a. out of the total issue or any other issue of Preference Shares which may be made within a period of six months after the date of this Agreement, then the Company agrees to revise the rate of dividend on the Preference Shares subscribed by the Investor to such higher rate from the date of allotment of Preference Shares to the Investor. In case, the Company issues Preference Shares with any terms different from the terms of the present issue, anytime within six months after the date of this agreement, the Company agrees to give an option to the Investor to revise the present terms of these new terms and in the event the Bank opts for the new terms, the Company agrees to change *the terms from the first date of allotment of Preference Shares under such later issue.*

6.1 *The Company agrees that interim dividend shall be declared and paid pro-rata on or before 31st March of each financial year. However, the last dividend shall be paid immediately on the date of redemption/early redemption. The Company agrees to organise the payment of dividend such that the credit of the dividend proceeds is received by the investor on the dividend payment date as mentioned above or earlier to such date.*

6.2 *The Company agrees that in the event of lack of profits or losses for the purpose of declaration of dividend on preference share in any year, the company shall declare dividends out of the undistributed profits of the Company for any previous financial year being held as surplus balance in Profit and Loss Account. In the event of lack of surplus in the Profit and Loss Account for the purposes of declaration/payment of dividend, the Company agrees that it shall declare/pay dividend from undistributed profits of the previous years transferred to reserves, in accordance with the Companies (Declaration of Dividend out of Reserves) Rules, 1975. In case, for any year, the dividend cannot be declared and paid even from the profits of the previous years and balance in reserves, the amount of dividend which could not be paid for that year shall accumulate and shall be paid in the immediate next year in which it is possible to declare and pay dividends according to the provisions of the Companies Act, 1956.* ***Further, in case of any delay in declaration of dividend or where due to inadequacy of profits or due to whatsoever reason the Company has not been able to declare the dividend, the Company agrees to compensate the investor, such that the post-tax (and surcharge) return to the investor remains at 12.00% (compounded annually) or such higher rate as determined in clause 5.1.***

6.3 *Notwithstanding anything contained to the contrary in this Agreement, both the parties hereby agree that, in case, the Company does not or is unable to declare and pay dividend on or before March 31 of any financial year or on redemption, for any reason whatsoever, the Company shall within 30 days from such date, redeem the Preference Shares held by the investor at such premium that the post-tax (and surcharge) return to the investor remains at 12.00% (compounded annually) or such higher rate as determined in clause 5.1. For this purpose, the Company shall make all possible efforts, including issue of further equity or preference shares at premium."*

The fact that the payment took the character of liquidated damages, does not obliterate the fact that the liability to pay was on account of dividend. Failure on the part of the assessee to pay dividend was a breach of the contract which entitled the UTI Bank to recover damages. The measure of damages was lucidly answered in the case of Robinson –Vs- Harman reported in 1843-1860 AER 383 as follows:-

"The next question is: What damages is the plaintiff entitled to recover? The rule of the common law is that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."

Therefore when the assessee paid the damages the assessee was really discharging its liability to pay dividend under the contract.

We are, as such, convinced that the payment was, in fact, a payment of the agreed dividend and therefore, the Tribunal, CIT(A) and the assessing officer took a correct view in the matter.

For the aforesaid reasons, the question as formulated is answered in the negative and in favour of the revenue.

The appeal is dismissed.

(GIRISH CHANDRA GUPTA,J.)

(ASHA ARORA,J.)

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