

(1972) 07 AHC CK 0010

Allahabad High Court

Case No: Income-tax Reference No"s. 171 and 172 of 1971

Commissioner of Income Tax

APPELLANT

Vs

British India Corporation (P.) Ltd.

RESPONDENT

Date of Decision: July 21, 1972

Acts Referred:

- Super Profits Tax Act, 1963 - Section 2(9)

Citation: (1973) 92 ITR 38

Hon'ble Judges: R.L. Gulati, J; H.N. Seth, J

Bench: Division Bench

Advocate: R.R. Misra, for the Appellant; S.D. Agarwal and K.L. Misra, for the Respondent

Judgement

R.L. Gulati, J.

This is a reference u/s 256(1) of the Income Tax Act 1961, read with Section 10 of the Super Profits Tax Act, 1963, at the instance of the Commissioner of Income Tax, Kanpur.

2. The assessee is a public limited company with its registered office at Kanpur. For purposes of the assessment of super profits tax there arose a dispute between the assessee and the Income Tax department with regard to the computation of "standard deduction". The assessee claimed that as many as fifteen accounts represented reserves which should be taken into account while determining the "standard deduction ". The Income Tax Officer disallowed the entire claim on the ground that the so-called reserves were not free reserves, but were meant to discharge existing liabilities or to safeguard against the diminution in the value of assets. On appeal the Appellate Assistant Commissioner of Income Tax allowed the claim of the assessee in part and held that the following accounts do not represent allowable reserve:

(a) Out of capital reserve,

- (b) Investment reserve.
- (c) Future taxation reserve.
- (d) Forfeited monies.
- (e) Profit & loss account, account balance.
- (f) Provision for taxation,
- (g) Provision for contingency.
- (h) Provision for others.
- (i) Proposed dividends.

Being dissatisfied with the decision of the Appellate Assistant Commissioner of Income Tax both the assessee and the Income Tax Officer went up in appeal before the Income Tax Appellate Tribunal. The Tribunal dismissed the department's appeal and allowed that of the assessee holding that all the items of reserves claimed by the assessee before the Income Tax Officer were permissible. At the instance of the Commissioner of Income Tax, the Tribunal has submitted a statement of the case with the following question of law for the opinion of this court:

" Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that: (a) capital reserve, (b) stocks and stores reserves, (c) bad and doubtful debts reserves, (d) obsolescence reserve, (e) loans and insurance reserves, (f) investment reserve, and (g) forfeited monies reserves, were to be included in the computation of capital according to the provisions in the Second Schedule to the Super Profits Tax Act, 1963?"

Under Section 4 of the Super Profits Tax Act, 1963, hereinafter referred to as "the Act", every company shall be charged for every assessment year commencing from 1st of April, 1963, a tax as super profits tax in respect of so much of its chargeable profits of the previous year as exceed the standard deductions at the rate or rates specified in the Third Schedule. "Standard deduction" has been defined in Clause (9) of Section 2 to mean: "An amount equal to six per cent. of the capital of the company as computed in accordance with the provisions of the Second Schedule, or an amount of Rs. 50,000, whichever is greater."

3. The Second Schedule contains rules for computing the capital of a company for purposes of super profits tax. Rule 1 of the Schedule in effect, so far as is material for our purposes, provides that the capital of a company shall be the sum of amounts as on the first day of the previous year relevant to the assessment year of its paid up share capital and of its reserves except those which are allowed as deductions in computing the profits of the company for purposes of the Indian Income Tax Act, 1922, or the Income Tax Act, 1961.

4. None of the reserves claimed by the assessee-company has been allowed as a deduction in the computation of its profits under the Income Tax Act. Thus, the only question is as to whether the amounts in dispute represent reserves. The term "reserve" has not been defined in the Act, so that its meaning has to be gathered from other sources. This term is used frequently in the accounts of a limited company. Companies generally set apart certain amounts out of their profits or other surpluses to meet future liabilities or to meet the existing liabilities. When an amount is set apart to meet a future liability, it is called a reserve; when it is set apart to meet an existing liability, it is called a provision. In Advance Accounting by R. Keith Yorston, the terms "reserve" and "provision" have been defined as under :

"It is recommended that the item to be described as reserve should include amounts set aside out of profits and other surpluses which are not intended or necessary to meet any liability, contingency or diminution in value of assets, known to exist at the date of the balance sheet. On the other hand, the term "provision" should be used to describe any amount charged against current revenue or set aside out of the profits or other surpluses of a prior period to provide for a specific commitment or contingency of a revenue nature or diminution in value in assets on the date of the balance sheet, the amount of which cannot be determined with substantial accuracy."

These definitions have been accepted by the chartered accountants in India and the terms "reserves" and "provisions" are known in that sense in the commercial world. This is evident from the Commentaries on the Indian Companies Act by A. Ramaiya (6th edition, at page 371). The learned author, after observing that the term "reserve" has not been defined in the Companies Act, sets out its meaning as given in various dictionaries. At the end it is observed :

"The Institute of Chartered Accountants, England, has defined a "reserve" as an amount set aside out of profits and other surpluses which are not designed to meet any liability, contingency, commitment or diminution in value of assets known to exist as at the date of the balance sheet (Recommendations on Accounting Principles, No. VI para. 43).

The reserve may be a general reserve or a special reserve; but there must be a clear indication to show whether it was a reserve either of the one or the other kind. The fact that it constituted a mass of undistributed profits cannot automatically make it a reserve. [Commissioner of Income Tax, Bombay City Vs. The Century Spinning and Manufacturing Co. Ltd.,](#)

5. The Supreme Court in [The Commissioner of Income Tax \(Central\), Calcutta Vs. Standard Vacuum Oil Company,](#) has observed on page 698 :

"In its ordinary meaning the expression " reserve" means something specifically kept apart for future use or for specific occasion."

Thus, the meaning of the term is reasonably clear :

We shall now proceed to determine as to whether the accounts in dispute represent reserves.

Capital reserve.--There is no dispute that the balance of this account represents reserve. It is not earmarked for any existing liability and the amount is being utilised as capital of the company for earning profits. Thus, this amount is clearly a reserve and there is no difficulty in holding it as such. Likewise, the amounts in stocks and stores reserves, bad and doubtful debts reserves, obsolescence reserve, loans and insurance reserves, and investment reserves also do not present any difficulty and can safely be held to constitute reserves according to the meaning of this term as set out above. The last item, namely, the forfeited monies reserve, presents some difficulty. The Tribunal in paragraph 17 of its appellate order has dealt with this account in the following words :

" The forfeited monies amounting to Rs. 3,10,570 represents reserve in the sense that certain unclaimed dividends and other amounts have been transferred to the forfeited monies reserve account. The said amount has, therefore, to be considered for purposes of computation of capital base of the assessee-company."

The Tribunal has not set out detailed information with regard to the nature of this account. In paragraph 17 of his appellate order, the Appellate Assistant Commissioner of Income Tax has given the following facts with regard to this account:

" Forfeited monies: Rs. 3,10,570.

17. The appellant had been transferring to this account dividends which had not been collected by the various shareholders after they had been declared. The appellant-company after waiting for some period transferred such amounts to the forfeited monies account. However, as and when some shareholders make a claim, the company, though not bound under the rules to make these payments, makes payments and debits the same to the forfeited moneys account. From these it would appear that this amount cannot be treated as a reserve, but represents only a liability, though contingent, which is payable as and when a shareholder comes forward with a claim."

Now, unclaimed dividends represent existing liability of the company to the shareholders in whose favour the dividend has been declared. It is payable by the company as and when a shareholder puts forward a claim, and that is what the company has been doing. It was suggested by the learned counsel for the assessee that only such unclaimed dividend is transferred to that account which is not claimed within a period of six years and becomes time-barred. In the first instance, there is no such finding given by any of the Income Tax authorities or by the Income Tax Appellate Tribunal. We cannot accept the statement of the learned counsel at

the Bar. There should have been a specific finding in that regard by the Income Tax Appellate Tribunal. The fact that the company pays the dividend as and when claimed by the shareholder shows that the claim is not time-barred. Even if it was time-barred, the liability of the company would not cease ; only the remedy is barred. It is open to the company to waive the bar of limitation and to make payment of a belated claim. When such a payment is made, it would still be a payment made against an existing liability. In any view of the matter, this account, so far as it represents the unclaimed dividend, represents a provision in respect of an existing liability of a company and, as such, it cannot be called a reserve. We, accordingly, answer the question as under;

" Our answer to items Nos. (a), (b), (c), (d), (e) and (f) is in the affirmative and in respect of item No. (g) " forfeited monies reserve account" is in the negative."

In the circumstances of the case, there will be no order as to costs."