

Mysore Electrical Industries Ltd. Vs Commissioner of Surtax

Court: Karnataka High Court

Date of Decision: Oct. 28, 1969

Acts Referred: Companies (Profits) Surtax Act, 1964 " Section 18
Income Tax Act, 1961 " Section 256 (1)

Citation: (1971) 80 ITR 571

Hon'ble Judges: G.K. Govinda Bhatt, J; B. Venkataswami, J

Bench: Division Bench

Judgement

Govinda Bhat, J.

This is a reference u/s 18 of the Companies (Profit) Surtax Act, 1964, hereinafter called "the Act" read with section 256(1) of the Income Tax Act, 1961.

2. The question referred for our opinion are :

1. On the facts and circumstances of the case, whether the Tribunal was justified in law in holding that the sum of Rs. 2,56,000 representing

modernisation and rehabilitation reserve was not to be considered in computing the assessee's capital for the purpose of the Companies (Profits)

Surtax Act, 1964 ?

2. On the facts and circumstances of the assessee's case, whether the Tribunal was justified in law in holding that the sum of Rs. 1,00,000

representing loan redemption reserve was not to be considered in computing the assessee's capital for the purpose of the Companies (Profits)

Surtax Act, 1964 ?

3. On the facts and circumstances of the assessee's case, whether the Tribunal was justified in law in holding that the sum of Rs. 89,557

representing development rebate reserve, was not to be considered in computing the assessee's capital for the purpose of the Companies (Profit)

Surtax Act, 1964 ?

4. On the facts and circumstances of the assessee's case, whether the Tribunal was justified in law in holding that the sum of Rs. 3,15,000

representing dividend reserve was not to be considered in computing the assessee's capital for the purpose of the Companies (Profits) Surtax Act,

1964 ?

5. On the fact and circumstances of the assessee's case, whether the Tribunal was justified in law in holding that the sum of Rs. 1,03,162

representing excess provision for depreciation was not to be considered in computing the assessee's capital for the purpose of the Companies

(Profits) Surtax Act, 1964 ?

6. On the fact and circumstance of the case, whether the Tribunal was justified in law in holding that the sum of Rs. 2,85,000 representing super

profits tax reserve was not to be considered in computing the assessee's capital for the purpose of the companies (Profits) Surtax Act, 1964 ?

3. The assessee is assessable to surtax under the Act for the assessment year 1964-65. The capital for surtax purpose is the aggregate of paid up

capital, development rebate and other reserves. The capital has to be computed for the assessment year 1964-65 as on the first day of the

previous year to the relevant assessment year and that day is the 1st of April, 1963. Section 2(5) defines the expression ""chargeable profits"" to

mean the total income of an assessee computed under the Income Tax Act, 1961, and adjusted in accordance with the provisions of the First

Schedule of the Act. Section 2(8) defines the expression ""statutory deduction"" to mean the amount equal to 10 per cent. of the capital of the

assessee as computed in accordance with the provisions of the Second Schedule or an amount of the rupees two hundred thousand, whichever is

greater. The excess of the chargeable profits over the statutory deduction is chargeable to tax u/s 4. The provisions of the Act are substantially in

accordance with the provisions of the Super Profits Tax Act, 1963, which remained operative only for the assessment year 1963-64. Rule 1 of the

Second Schedule provides for computation of the capital of a company for the purpose of Surtax. The Explanation to Rule 1, which is relevant for

the purpose of this case reads :

For the removal of doubts it is hereby declared that any amount standing to the credit of any account in the books of a company as on the first

day of the previous year relevant to the assessment year which is of the nature of item (5) or item (6) or item (7) under the heading "Reserves and

surplus" or of any item under the heading "Current liability and provisions" in the column relating to "Liabilities" in the "Form of balance sheet"

given in Part I of Schedule VI to the Companies Act, 1956 (1 of 1956), shall not be regarded as a reserve for the purposes of computation of the

capital of a company under the provisions of this Schedule.

4. The above Explanation is new; there was no corresponding provisions in the Super Profits Tax Act, 1963. The Explanation has resolved doubts

as to whether the items falling under the heading ""Current liabilities and provisions"" in the column relating to ""Liabilities"" and the items in the nature

of items (5), (6) or (7), under the heading ""Reserves and surplus"" in the balance-sheet of a company have to be computed as ""Other reserves"" for

the purpose of computation of the capital of a company.

5. The paid up capital of the assessee as on April 1, 1963, was Rs. 34,93,000. Some of the items of ""reserves"" of the assessee as on 1st of April,

1962, were as follows :

Rs.

Plant modernization and rehabilitation reserve 2,40,000

Loan redemption reserve 3,50,000

Development rebate reserve 99,510

6. On the 8th of August, 1963, the directors of the assessee in their report to the general body of shareholders proposed the following

appropriation out of the profits of the year ending on 31st March, 1963 :

Rs.

Plant modernization and rehabilitation reserve 2,56,000

Loan redemption reserve 1,00,000

Reserve for development rebate 89,557

Dividend reserve 3,15,000

Reserve for Super Profits Tax 2,85,000

7. The assessee claimed that the above items have to be computed as ""other reserves"" for the purpose of calculating the capital base. In addition to

the above items, the assessee claimed that a sum of Rs. 1,03,162 representing the excess provisions for depreciation has to be added to the

capital.

8. In our opinion rendered in T.R.C. No. 11 of 1967, we have held that provisions made for payment of tax and dividends are in the nature of

provisions"" and that they do not constitute ""reserve"" for the purpose of computation of the capital base. Whatever doubts there might have been

under the Super Profits Tax Act, there can be no doubt as to whether the said items constitute reserve or provision under the Act. The Explanation

to rule 1 makes it clear that any amount standing to the credit of any account in the books of a company as on the first day of the previous year

relevant to the assessment year which is of the nature of any item under the heading ""Current liabilities and provisions"" in the column relating to

Liabilities"" in the ""Form of balance-sheet"" shall not be regarded as a reserve for the purpose of computation of the capital of a company under the

provisions of the Second Schedule. In Part I of Schedule VI of the Companies Act, 1956, which prescribes the form of the balance-sheet,

provisions for taxation and proposed dividends come under the sub-heading of ""Provisions"". The amount standing to the credit of ""dividend

reserve"" and ""reserve for super-tax"" in the balance-sheet of the assessee are in the nature of the items ""provisions for taxation"" and ""proposed

dividends"" (items (8) and (9) in form of balance-sheet) and consequently they cannot be regarded as ""reserves"" for the purpose of computation of

the capital. Therefore, question Nos. 4 and 6 have to be answered against the assessee.

9. The amount of Rs. 1,03,162 referred to in question No. 5 is said to be the difference between the depreciation computed by the assessee on its

assets and the depreciation allowed by the Income Tax authorities. It was urged that to the extent of the difference, the value of the assets is

enhanced and therefore the said item should be regarded as ""reserve"". We are unable to accede to the said contention. The balance-sheet of the

company does not show any such item as ""reserve"". We are entirely in agreement with the view expressed by the Tribunal regarding the said item.

The Tribunal has not specifically dealt with the items referred to in questions Nos. 1 to 3. That the amounts appropriated for ""plant modernization

and rehabilitation reserve"", ""loan redemption reserve"" and ""development rebate reserve"" are amounts in the nature of ""reserves"" for the purpose of

computation of the capital of a company under the Second Schedule was not disputed before us by the learned counsel appearing for the revenue.

In fact, the amounts reserved under the same heads as on 1st April, 1962, have been allowed for the purpose of the computation of the capital of

the assessee. The amounts in question were disallowed by the Income Tax Officer and the Appellate Assistant Commissioner on the sole ground

that the board of director made the appropriations on August 8, 1963, and not on or before April 1, 1963. Sri k. Srinivasan, the learned counsel

for the assessee, relying on the decisions of the Bombay High Court in Commissioner of Income Tax v. Aryodaya Ginning and Manufacturing Co.

Ltd., urged that the appropriations when made by the board of directors and subsequently passed by the general body of the shareholders, take

effect from March 31, 1963. Sri Rajasekhara Murthy, the learned Counsel for the revenue, relied on the decision of the Madras High Court in

Commissioner of Income Tax v. Vasantha Mills Ltd., where the view of the Bombay High Court has been dissented from.

10. The appropriations were made by the board of directors out of the profits for the year ending March 31, 1963. The balance-sheet was passed

by the general body of the shareholders. The appropriations shown under the different heads in the balance-sheet of the assessee-company are as

on March 31, 1963, It is not possible for the board of the directors of any company to make the appropriations out of the profits of any year

before the close of the year of accounting. The Explanation to rule 1 states that any amount standing to the credit of any account in the books of a

company as on the first day of a previous year relevant to the assessment year which is of the nature referred to therein shall not be regarded as a

reserve. It follows from the language of the Explanation to the rule that the amounts in the nature of reserves standing to the credit of any account in

the books of the company as on the first day of the previous year relevant to the assessment year shall be regarded as reserve for the purpose of

computation of the capital of the company. In the account books of the assessee-company also in the balance-sheet as on the first day of the

previous year relevant to the assessment year, i.e. on April 1, 1963, the sums referred to in questions Nos. 1 to 3 have been credited to the

account of, (a) plant modernisation and rehabilitation reserve, (b) loan redemption reserve, and (c) development rebate reserve, Though the board

of directors in their report to the shareholders made the appropriations after April 1, 1963, the said appropriations, in our view, are effective from

April 1, 1963, We are in respectful agreement with the view of the law in the decision of the Bombay High Court in Commissioner of Income Tax

v. Aryodaya Ginning and Manufacturing Co. Ltd. Therefore, question Nos. 1 to 3 have to be answered in the negative and in favour of the

assessee. We accordingly answer question Nos. 1 to 3 in favour of the assessee and questions Nos. 4 to 6 in favour of the revenue. In the

circumstances, the parties are directed to bear their own costs.