

(1976) 03 BOM CK 0005

Bombay High Court

Case No: Income-tax Reference No. 315 of 1976

Commissioner of
Income Tax, Bombay
City-VI

APPELLANT

Vs

Golden Tobacco Co.
Ltd.

RESPONDENT

Date of Decision: March 29, 1976

Citation: (1977) 108 ITR 453

Hon'ble Judges: V.D. Tulzapurkar, J; R.M. Kantawala, J

Bench: Division Bench

Advocate: R.J. Joshi, for the Appellant; I.M. Munium, for the Respondent

Judgement

Tulzapurkar, J.

Two questions have been referred to us for our opinion in this reference at the instance of the Commissioner of Income Tax, Bombay City-VI, Bombay, which run thus :

"(1) Whether, on the facts and in the circumstances of the case, the amounts in the doubtful debt reserve account were includible in the computation of the capital of the company for the purposes of the Act ?

(2) Whether, on the facts and in the circumstances of the case, the amounts in the dividend reserve account were includible in the computation of the capital of the company for the purposes of the Act ?

2. So far as the first question is concerned, the admitted facts are that the assessee-company followed a systematic method of transferring an ad hoc amount to the doubtful debt reserve account each year. The amount transferred to the said account was not computed on the basis of the debts which were expected to become bad during the year or even in the future. It did not consider the soundness of every debt individually and did not ascertain which of the debts were likely to

become bad in the near future; in other words, it transferred to the doubtful debt reserve account ad hoc amounts year after year which had no connection with the possibility of the debts becoming bad in the near future. Admittedly, the assessee-company did not claim the deduction of the amounts so transferred to the said account in the computation of its total income nor the Income Tax Officer allowed it as a deduction. The debts which became bad during any year were debited directly to the profit and loss account and not to the doubtful debt reserve account. After a number of years, a large amount, which stood accumulated to the doubtful debt reserve, was transferred by it to the general reserve. Before the Income Tax Officer the assessee-company claimed that the balance in the doubtful debt reserve account should be included in the capital computation for surtax purposes. The Income Tax Officer rejected the claim on the ground that the amounts transferred to the "reserve account" were not free reserves but were held for a specific purpose and as such the same were not includible in the capital computation for surtax purposes. The Appellate Assistant Commissioner, when the matter was carried in appeal, disagreed with the view of the Income Tax Officer and included the amount in the capital computation. When the matter was carried in further appeal by the revenue it was contended that the said amount could not be regarded as a reserve but will have to be regarded as a provision for doubtful debts in view of the tests which have been laid down by the Supreme Court in [Commissioner of Income Tax, Bombay City Vs. The Century Spinning and Manufacturing Co. Ltd.,](#). Reliance was also placed upon the Supreme Court decision in [Metal Box Company of India Ltd. Vs. Their Workmen,](#), where a distinction between provision and reserve had been clearly pointed out by the Supreme Court. The Tribunal took the view that the amounts transferred to the doubtful debt reserve account had no relation to the debts which had become bad or which were likely to become bad, that when the debts actually became bad they were directly debited to the profit and loss account, that the amount accumulated in this account was ultimately transferred to the general reserve and that the amounts were transferred to this account in order to create a secret reserve. It took the view that the said reserve was not created to meet any known or existing liability and it was a reserve and required to be included in the computation of the capital of the company. At the instance of the Commissioner of Income Tax, Bombay City-VI, Bombay, the first question has been referred to us for our opinion.

3. It is not necessary to refer to the two decisions of the Supreme Court, one in the [Commissioner of Income Tax, Bombay City Vs. The Century Spinning and Manufacturing Co. Ltd.,](#) and the other in [Metal Box Company of India Ltd. Vs. Their Workmen,](#), as the distinction between provision and reserve has now been well-established and even the two concepts have been defined in clause 7 of part III of Schedule VI to the Companies Act, 1956. The expression "provision" has been defined in clause 7(1)(a) to mean "any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by

way of providing for any known liability of which the amount cannot be determined with substantial accuracy" and, admittedly, in the instant case ad hoc amounts were transferred by the assessee-company to the doubtful debt reserve account irrespective of the question whether individual debts had become doubtful or not. Admittedly, whenever any particular debt became bad the profit and loss account was debited and this particular account was not even touched. It cannot, therefore, be said that these various amounts which had been transferred to the doubtful debt reserve account were by way of providing for "diminution in value of assets" nor could it be said that these various amounts were retained by way of providing for any known liability or existing liability. In the circumstance, we are clearly of the view that the Tribunal was right in taking the view that the amounts in the doubtful debt reserve account were includible in the computation of the capital of the company for the purpose of the Companies (Profits) Surtax Act, 1964. The first question is, therefore, answered in the affirmative and in favour of the assessee.

4. So far as the second question is concerned, in view of the judgment which has been delivered by us to-day in I. T. Reference No. 316 of 1975 [Commissioner of Income Tax, Bombay City-II Vs. Marrior \(India\) Ltd.](#), it was fairly conceded by counsel for the assessee, so far as this court was concerned, that the question will have to be answered against the assessee. The question is, therefore, answered thus : The amounts in the dividend reserve account were not includible in the computation of the capital of the company for the purpose of the Companies (Profits) Surtax Act, 1964.

5. There will be no order as to costs.