
India Foils Ltd. Vs Commissioner of Income Tax

IT Reference No. 36 of 1985

Court: Calcutta High Court

Date of Decision: Jan. 12, 1990

Acts Referred:

Capital Issues (Control) Act, 1947 " Section 3#Companies (Profits) Surtax Act, 1964 " Section 18#Companies Act, 1956 " Section 2(32), 81, 93#Foreign Exchange Regulation Act, 1973 " Section 19, 19(1), 29, 29(1)(a), 76#Income Tax Act, 1961 " Section 256(1), 80J

Citation: (1995) 79 TAXMAN 255

Hon'ble Judges: Suhas Chandra Sen, J; Bhagabati Prasad Banerjee, J

Bench: Division Bench

Advocate: D. Pal and Miss M. Seal, for the Appellant;A.C. Moitra and S.K. Mukherjee, for the Respondent

Judgement

Suhas Chandra Sen, J.

The Tribunal has referred the following question of law to this Court u/s 256(1) of the income tax Act, 1961 ("the Act") read with section 18 of the Companies (Profits) Surtax Act, 1964 :

Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding that increase in the paid up share capital of the

company took place on 15-11-1977 and not on 1-9-1977 ?

The assessment year involved is 1978-79 and the previous year commenced on 1-1-1977 and ended on 31-12-1977.

2. The facts found by the Tribunal as stated in the statement of case is as under:

As on 1-1-1977 its paid up capital consisted of Rs. 200 only. Some time prior to 30-8-1977 it made an offer to India Foils Ltd., a company

incorporated in U.K. to take over its Indian business as a going-concern on certain terms and conditions. There were negotiations between the

parties wherein the terms of the offer were discussed. The terms of offer, which were accepted by the U.K. company, included, inter alia, the

following:

(1) The purchaser would discharge all the liabilities of the vendor relating to the Indian business subsisting as at 31st day of August, 1977 including

the liability for the remittance of past profit and head office charges of the Indian business accruing from the first day of January, 1977 to 31st

August, 1977. So long as the said profit was not remitted with the permission of the Reserve Bank of India, it was provided that the unremitted

part will be held by the purchaser as interest-free loan from the vendor to the purchaser in connection with the Indian business of the vendor;

(2) The purchaser-company agreed to discharge the liability to the extent of Rs. 6,47,000 in connection with the demand for surtax assessment

being raised on the vendor for the assessment year 1964-65. It was further agreed that in case the said sum of Rs. 6,47,000 or any part thereof

was not required for the payment and discharge of the said surtax liability it would be treated as an interest-free loan due to the vendor by the

purchaser;

(3) The purchaser agreed to continue the Indian business and to continue in employment all employees in India of the Vendor and accord to them

the same service terms in all respects as they enjoyed with the Vendor.

(4) All income or loss on account of the Indian business from the first day of September, 1977 was to accrue to or be borne by the purchaser. It

was specifically made clear that "any agreement resulting from acceptance by the Vendor of the offer of the purchaser to purchase the Indian

business will be conditional upon all necessary, or appropriate consents, permissions and authorities being obtained from amongst others

Government of India or any other relevant authorities.

(5) In addition to the above, it was provided that the Indian company would issue and allot to the Vendor, i.e., the U.K. company or its nominee

or nominees 14,00,000 equity shares of Rs. 10 each at par in the capital of the purchaser, credited as fully paid up.

3. In accordance with the aforesaid agreement, a letter was written by the assessee-company to the Controller of capital issues on 29-8-1977

seeking his permission to issue 19 lakhs equity shares of Rs. 10 each. The Controller of Capital Issues conveyed his sanction to issue the shares

vide his letter dated 15-9-1977 in the following terms :

19 lakhs equity shares of Rs. 10 each out of which shares worth Rs. 140 lakhs will be issued and allotted for consideration other than cash to the

U.K. company for the acquisition of the assets and liabilities of their Indian branch and the balance of Rs. 50 lakhs for cash at par to the general

public by a prospectus. Out of the public issue, 25,000 shares will be reserved for firm allotment to the employees and 50,000 shares to the

director of the company, their relatives, friends (all individuals) and individuals or bodies corporate having or likely to have business connection

with the company in such a manner that no individual gets more than 200 shares. In the event of the under-subscription in any of these two groups,

there can be a transfer of the excess to the other group. Shares not taken up by these persons will be added to the public quota. Shares allotted to

these persons will not be transferable for a period of at least two years from the date they are made fully paid-up.

4. The following conditions, inter alia, were further attached to the aforesaid permission :

(j) The company shall ensure that the prospectus for issue of capital consented to herein shall print the following condition:

An application should submit only one application (and not more than one) for the total number of shares required. Applications may be made in single

or joint names (not more than three) Two or more applications in single and/or joint names will be deemed to be multiple applications if the sole

and/or the first applicant is one and the same. The Board of Directors reserves the right to reject in its absolute discretion all or any multiple

applications.

(k) The prospectus should clearly mention the name(s) of the Stock Exchange where the shares are proposed to be listed. The entire public issues

shall be got under written by the Financial Institutions/Stock Brokers of repute. The company shall list its shares with the regional stock exchange

nearest to its Registered Office.

(l) The share capital consented to herein shall be made fully paid-up within the validity of this order as in (b)(i) above.

(m) The shares in settlement of purchase consideration will be so issued to the U.K. company that at no stage the non-resident interest in the

enlarged share capital of the Indian company exceeds 74 per cent.

(n) So long as the non-resident interest remains at a level higher than 74 per cent the company should not declare any dividend".

Steps were also taken to obtain the permission of the RBI for the issue of shares to the non-resident and for carrying on the business in terms of

the aforesaid section 29 of the Foreign Exchange Regulation Act, 1973. The assessee has placed on record copy of letter, dated 18-11-1977

granting permission to the assessee-company in terms of section 29(1)(a) of the Act. The letter granting permission for allotment of shares to the

non-resident has not been placed on record, but, in the context of course of events indicated above., it would be fair to presume that such

permission was obtained sometime after 1-9-1977. Once the aforesaid formalities were over, the company entered into an agreement with the

non-resident on 15-11-1977 and one of the clause of the said agreement, being clause 5, read as follows :

The purchaser will issue and allot to the Vendor and/or its nominee or nominees immediately after the transfer and sale by the Vendor to the

purchaser of the Indian business in one or more lots as may be mutually agreed between the parties hereto 14,00,000. Equity Shares of Rs. 10

each at par of the nominal value of Rs. 140 lakhs (Rupees one crore forty lakhs) in the capital of the purchaser, credited as fully paid-up. The said

shares shall rank for dividend as from the transfer date." ("Transfer date" has been defined in the agreement to mean 1-9-1977).

7. It is common ground that in pursuance of the aforesaid agreement 14 lakhs shares were allotted by the assessee-company to the non-resident

on 15-11-1977. The ITO accordingly treated the date of increase of the capital of the company on account of increase in paid up share capital as

15-11-1977 and worked out the proportionate increase in capital of the company in terms of rule 3 of taking the period 15-11-1977 to 31-12-

1977 as the one during which the increase in capital continued.

8. The assessee went up on appeal before the Commissioner (Appeals) against the order of assessment. The Commissioner (Appeals), however,

rejected the appeal on the point in dispute. A further appeal was preferred to the Tribunal. The Tribunal held as follows :

The analysis of rule 3 of Second Schedule clearly indicates that it is not any increase in capital of the company, which has to be taken note of for

purposes of rule 3. The increase in capital has to be on account of increase of paid-up share capital and, as such, the period during which the

increase remained effective would have to be the period during which the increase on account of paid-up share capital remained effective. In the

present case, it was not possible to issue any additional share capital by the assessee-company without obtaining prior consent of the Controller of

Capital Issues. Such consent, as has been noted above, was given on 15-9-1977. As we have been above, the Controller of Capital Issues could

have refused permission in terms of sub-section (5) of section 3 of the Capital Issues (Control) Act, 1947. Obtaining of the aforesaid permission

was, thus, not a mere idle formality, for the issue of share capital. It was an essential pre-requisite. It would take some time for making

arrangements for offering share capital to the various persons in terms of the order of the Controller of Capital Issues as noted above, and it is only

after such offer has been made and subscription in cash has been received from them with regard to 5 lakhs shares, which were to be issued in

cash, that the stage for allotment of shares would reach. Amounts received up to this stage may be on account of contribution to share capital of

the company, but the said amount could not be classified as paid-up share capital unless specific allotment of shares was done and appropriation

out of previously unappropriated capital was made in the form of certain number of shares to the persons concerned. Such appropriation took

place only on 15-11-1977. On this date alone, therefore, it could be said that the shares had been allotted and increase in paid-up" capital took

place. This being so, we are unable to find any fault in the order of the learned Commissioner (Appeals). Their Lordships of the Supreme Court

had pointed out in Commissioner of Income Tax, Madras Vs. Indian Bank Ltd., that-

"In construing a several clauses of the section we must adhere closely to the language of the Act". This principle of interpretation of the statute is

universally recognised and so long as the language of rule is unambiguous it would not be proper for us to make a departure from the said law on

the ground that the equity of the case demanded a different interpretation. May be it is possible to invoke the principle of equity in a case where the

language of the rule was not clear and explicit. So long as the language is plain, the intendment of the Parliament has to be inferred from the

language itself and any other meaning than the intendment would not be proper".

9. Dr. Pal appearing on behalf of the assessee has contended that this is not a case of a public issue of shares by a limited company. The shares

that have been issued were in consideration of certain assets of the vendor company being transferred to the purchaser company. It is the

purchaser company who is the assessee. The purchaser company received the assets even before the actual allotment of the shares. These assets

which are the consideration for the shares must be treated as a part of issued capital of the company on and from the date the assets were handed

over to the purchaser company. Dr. Pal has argued that both the companies had agreed that the shares that were to be allotted would be entitled

to dividend pari passu with the other already allotted shares. There is no reason why these shares should not be treated as effectively issued from

1-9-1977, or at the very latest, with effect from 15-9-1977, the date on which the Controller of Capital Issues gave permission to issue these

shares. It has further been argued on the strength of Life Insurance Corporation of India Vs. Escorts Ltd. and Others, that the permission of the

RBI was not a condition precedent to the allotment of shares. The permission could be given even after the shares were actually allotted. Lastly,

we were referred to a judgment of the Karnataka High Court in the case of Addl. Commissioner Of Income Tax, Karnataka Vs. Bangalore Soft

Drinks (P.) Ltd., where it was held that the amounts paid for specified purposes of allotment of shares could not be treated as loan. The sum could

not be treated as borrowed money or debt due by the assessee-company within the meaning of rule 19A(3) of the income tax Rules, 1962 and

could not be excluded from the computation of capital for the purpose of relief u/s 80J of the Act. It was argued on the strength of this decision

that if any money or asset is taken in advance for allotment of shares such money must be treated as a part of the capital of the company. In this

connection reference was made to section 2(32) of the Companies Act, 1956 whereby it is defined that "paid up capital" or "Capital paid up" to

include the capital credited as paid up.

10. Therefore, Dr. Pal has argued that in this case the capital that was acquired by the assessee-company was by virtue of an agreement to allot

share the assets were in effective possession of the company, but the allottee of the share did not pay for the shares in money. The payment was

made in kind by handing over the assets. The assessee-company was entitled to credit the value of its assets as part of issued share capital of the

company as from the date of handing over of the assets by the vendors to the assessee-company.

11. I am unable to uphold this contention for a number of reasons. The Surtax Act imposes, a tax on so much of the chargeable profits of the

previous years of a company as exceeds the statutory deduction. There are three schedules attached to the said Act. The First Schedule deals with

computation of the chargeable profits. The Second Schedule lays down the rule for computing the capital of company for the purpose of Surtax.

The Third Schedule provides the rates of surtax.

12. The Second Schedule lays down the rules for computation of capital of the company "as on the first day of the previous year relevant to the

assessment year". In this computation under rule 1 various categories of assets of a company has to be included. Paid up capital, certain specified

reserves and debentures and also certain specified types of borrowed money are to be included in the capital. It has been specifically stated that

amounts standing to the credit of item Nos. 5, 6 and 7 under the heading "Capital reserves and surplus of the balance sheet of a company" are not

to be included as reserve in computation of capital. In other words, in specifying what are to be included in capital and what are not to be included

in capital the Legislature was mindful of the provisions of the Companies Act and the form of the balance sheet set out in the Companies Act.

13. The paid up share capital of a company as on the first day of the relevant previous year is to be included in the capital under rule 1(0) of the

Second Schedule of the Companies (Profits) Surtax Act. Rule 3 provides as under:

3. Where after the first day of the previous year relevant to the assessment year the capital of a company as computed in accordance with the

foregoing rules of this Schedule is increased by any amount during that previous year on account of increase of paid up share capital or issue of

debentures or borrowing of any moneys referred to in clause (v) of rule 1 or is reduced by any amount on account of reduction of paid up share

capital or redemption of any debentures or repayment of any such moneys, such capital shall be increased or reduced, as the case may be, by a

sum which bears to that amount the same proportion as the number of days of the previous year during which the increase or the reduction

remained effective bears to the total number of days in that previous year.

14. In order to get advantage of rule 3, the assessee will have to establish that during the previous year there has been an increase in the paid up

share capital; the assessee will also have to establish the number of days of the previous year during which such increase in paid up share capital

remained effective.

15. Therefore, the enquiry must be as to the day on which the paid up share capital was increased. There cannot be a question of any increase of

share capital before the shares have been actually issued or allotted. Every company limited by shares and having a share capital is required to

have a nominal capital with which it is registered. This is one of the essential features of the company's constitution and must be stated in the

Memorandum of Association. The nature of issued capital has been stated in Palmer's Company Law, Vol. I, 22nd Edn., page 300 as under :

The nominal capital in its original or altered form sets the limit of capital available for issue, and accordingly the issued capital is, strictly speaking,

not ""Capital"" at all since, as we have seen, it is only an authority by the shareholders to the directors to create new capital by the issue of shares.

The issued capital, on the other hand, represents the shares which have actually been taken up by the shareholders who have agreed to give

consideration in cash or kind for the shares issued to them unless those shares are fully paid bonus shares; the issued capital is thus a reality and not

merely an authority.

16. The question therefore is, has the share capital been actually increased. Issuance of shares cannot be equated with the paid up share capital. In

fact, in this case shares could not be issued because the permission of the Controller of Capital Issue had not been obtained. That permission was

given on 15-9-1977. There was a further requirement of the permission of the RBI which was not given earlier than 18-11-1977. Section 19 of

the Foreign Exchange Regulation Act imposes a bar on any person to take or send any security to a place outside India. There is a bar of

transferring any security or issue of security, whether in India or elsewhere, which is registered or to be registered in India to a person resident

outside India. The language of section 19(1) of the Foreign Exchange Regulation Act is that

Notwithstanding anything contained in section 81 of the Companies Act, 1956 (1 of 1956), no person shall, except with the general or special

permission of the Reserve Bank,-

(d) issue, whether in India or elsewhere, any security which is registered or to be registered in India, to a person resident outside India,

17. Therefore, there is a complete bar to issue shares to a person resident outside India without the permission of the RBI. The assessee-company

could not issue shares without the permission of the RBI. The decision of the Supreme Court in the case of Escorts Ltd. (supra) does not lay down

that an Indian company can issue shares to a foreign person or resident outside India without the permission of the RBI or such permission could

be obtained even after allotment of the shares. The case of the Life Insurance Corpn. of India related to transfer of shares from a shareholder to a

purchaser. It was not allotment of shares to a purchaser by a company at all.

What came up for consideration in that case were sections 29 and 76 of the Foreign Exchange Regulation Act. In that case section 19 did not

come for interpretation by the Supreme Court at all.

18. The other case cited was of Bangalore Soft Drinks (P.) Ltd. (supra) where the Court dealt with the provisions of section 80J of the Income-

tax Act. There also the question of computation of capital in the manner laid down in the Second Schedule of the Surtax Act, 1964 did not arise.

19. In our view, the Tribunal has taken a correct decision on the controversy. Paid up share capital of a company has been defined in section 93 of

the Companies Act to mean ""the amount paid-up on each share"". There cannot be any paid up share capital without issue of shares. In fact, in the

column relating to issue or paid up capital of the shareholders of a going-company represent the shares which have been issued and in respect of

which money has been received. Full details have to be given therein. If any money is received on account of shares which have not been issued by

a company, then such amount has to be separately shown in some accounts as advance. The money can be kept till the allotment of shares in

suspense account.

20. Moreover, in the agreement itself was for allotment of shares to vendor or its nominee. Therefore, the issuance of shares is an automatic

process after the decision has been taken and permission has been obtained for allotment. The vendors will have to examine whether the shares

will have to be issued in the name of the vendor or its nominee. Particulars of the nominees will have also to be furnished for this purpose.

21. The Tribunal has noted specifically that it is common ground that the shares were allotted by the assessee-company to the non-residents on

15-11-1977. If that be the position then it cannot be said that the issued share capital had increased even before the shares were actually issued.

There is no scope for making any equitable construction in the language of the section. In that view of the matter, the question is answered in the

affirmative and in favour of the revenue.

Bhagabati Prasad Banerjee, J.

I agree.