

(1949) 03 BOM CK 0054

Bombay High Court

Case No: Income-tax Reference No. 18 of 1948

DEVKARAN NANJEE BANKING
CO., LTD.

APPELLANT

Vs

COMMISSIONER OF EXCESS
PROFITS TAX, BOMBAY CITY.

RESPONDENT

Date of Decision: March 24, 1949

Acts Referred:

- Excess Profits Tax Act, 1940 - Section 6

Citation: (1950) 18 ITR 47

Hon'ble Judges: Chagla, C.J; Tendolkar, J

Bench: Full Bench

Judgement

CHAGLA, C.J. - The assessee is the Devkaran Nanjee Banking Co., Ltd., and the questions that arise for our consideration deal with the construction of certain provision of the Excess Profits Tax Act (XY of 1940), and the first question that we have to consider is whether the assessee bank is entitled to the benefit conferred upon assesseees under Rule 5 of Schedule I to the Act. Schedule I contains rules for the and under Rule 2 of that Schedule, any borrowed money and debts shall be deducted for the purposes of computing the average amount of capital. Therefore, if the bank borrowed any moneys, those moneys could not go to the increase of the average amount of capital used by the bank. But there is an exception contained in rule 5 of schedule I, and that exception is that notwithstanding the provisions of rule 2 of Schedule II the amount of loan or debentures from a bank carrying on a bona fide banking business or effected by means of a public issue of debentures secured on the property of the company, shall not be deducted in arriving at the amount of the capital employed in the business. But this rule 5 starts by the opening words, "if at any time after the close of the standard period," and obviously this rule can only apply to those companies which have a standard period. When we turn to the Act itself, Section 6 deals with standard profits and lays down various standard periods

for which profits have got to be assessed in order to arrive at a conclusion as to what the standard profits are. But to section 6 there is proviso which lays down that in the case of a business which was commenced on or after the 31st day of March, 1936, the standard profits shall, at the option of the person carrying on the business, be an amount calculated by applying the statutory percentage of the average amount of capital employed in the business during such chargeable accounting period. Now, the assessee bank commenced business after the 31st March, 1936, and it availed itself of the option given by this proviso, and it is not disputed before us that this particular assessee did not have any standard period as indicated in sub-clause (2) of section 6. The sub-clause contains four different periods which may be adopted by an assessee as the standard period at its option. But the assessee bank having exercised its option under the proviso to which I have referred, did not and in fact could not, adopt any of the four periods as the standard period. Therefore, for the purposes of the Excess Profits Tax Act it had no standard period whatsoever. If that be so, in my opinion,, it is clear that in the computation of the average amount of capital it would be governed by Rule 2 only and it could not avail itself of the exception contained in Rule 5 of schedule I. If it had no standard period, if its standard period never commenced, there could be no question of the close of the standard period, and as that rule is only applicable to those assessees who have a standard period and the rule comes into operation after the close of such standard period, in my opinion Rule 5 cannot apply to the case of the assessee and the Tribunal was right in coming to the conclusion that the assessee was not entitled to the benefit set out in that rule.

The second question that we have to consider is with regard to the method of completing the average amount of capital as set out in schedule II to the Act. Rule 5 in that Schedule provides that for purpose of ascertaining the average amount of capital employed in a business during any period, the profits or losses made in that period shall, except so far as the contrary is shown, be deemed (a) to have accrued, at an even rate throughout the period; and (b) to have resulted, as they accrued, in a corresponding increase or decrease, as the case may be, in the capital employed in the business. Therefore, the effect of this rule is that an artificial or notional method is adopted for computing profits or losses and the increase or decrease of the capital employed in the business by the computation of those profits or losses and the artificial method adopted is this that the profits or losses made during the period should be considered to have accrued evenly throughout the standard period. The second provision which is also notional and artificial is that as the profits or losses accrued evenly they should be considered to have increased or decreased the capital employed in the business. Sir Jamshedji is right in the two contentions that he has put forward. His first contention is that the expression "profits or losses" used in this rule must be construed to mean "statutory profits" as defined in the Act itself, and the definition of "profits" in the Act is: "profits means profits as determined in accordance with the first Schedule." Profits in this rule cannot mean book profits

or actual profits. Sir Jamshedji is also right in his contention that the legislature has laid down an artificial method of determining the profits or losses and also determining the increase or decrease in the capital employed in the business. But the legislature has provided one safeguard and that is that it leaves it open to the Income Tax Department to prove the contrary which would demolish the presumption raised by rule 5. I do not accept Sir Jamshedji's contention that the expression "be deemed" applies only to sub-clause (a) of rule 5 and not to sub-clause (b). The presumption raised by the rule is (1) that there is an accrual of profits or losses at an even rate throughout the period, and (2) that these profits or losses as they accrued have increased or decreased the capital employed in the business. Either of these two presumptions can be rebutted by the contrary being shown. It may be shown that in fact the profits or losses did not accrue at an even rate throughout the period, or it may be shown that although the profits or losses accrued evenly throughout the period, fact they did not result in an increase or decrease in the capital employed in the business.

Now, in this case the figures are that during the chargeable accounting period the statutory profits were Rs. 4,56,585 whereas the profits according to the books of the company were Rs. 2,49,544 and the Excess Profits Tax Officer took the view that only Rs. 2,70,727 went to add to the capital of the company. Mr. Muzumdar, the Accountant Member of Tribunal, gave directions to the Excess Profits Tax Officer that he should take Rs. 4,56,585 as the profits contemplated by rule 5, and then it would be for him to show that in fact the whole of that amount had not gone to increase the capital but that there had been various disbursements which prevented the capital being increased and that the capital was increased by a much lesser amount than Rs. 4,56,585. In our opinion, these directions given by Mr. Muzumdar are proper. The President of the Tribunal, Mr. Shah, agreed with the directions given by Mr. Muzumdar, but rather surprisingly he took the view that the expression "profits" used in Rule 5 should not be given the same meaning as given by the definition contained in Section 2(19) of the Act. According to him the word "profits" should carry the meaning of actual profits. As I have pointed out earlier, that view is in my opinion erroneous and if that was the view of Mr. Shah, the President, then it is difficult to understand how he agreed with the directions given by Mr. Muzumdar, because the directions given by Mr. Muzumdar, are only reconcilable with the profits being construed as statutory profits defined in the Act. In this case it is not disputed that the profits have accrued at an even rate throughout the accounting period. The only question is whether, having so accrued, they have resulted in a corresponding increase in the capital employed in the business. Unless the contrary is shown there is a presumption in favour of the assessee that the capital was increased by the accrual of profits, but it would be open to the Department to rebut that presumption by showing that there have been actual disbursements by the assessee out of the profits which accrued to the assessee, and in fact although the profits accrued the capital has not been increased as a result of actual

disbursements.

I would therefore answer question No. 1 in the negative and question No. 2 in the affirmative. We will reformulate the last question by deleting the words "notwithstanding that the entire profits so computed do not go to increase the capital employed in the business", and answer the question so reformulate in the affirmative. Assessee to pay the costs.

TENDOLKAR, J. - I agree.

Reference answered accordingly.