

Commissioner of Income-Tax, Mysore, Bangalore

Vs

The Mysore Electrical Industries Ltd.

Civil Appeal No. 1794 of 1970

(G. K. Mitter, C. A. Vaidialingam, P. Jagmohan Reddy JJ)

27.04.1971

JUDGMENT

MITTER, J. -

The question involved in this appeal is, whether three several sums appropriated by the Direction of the respondent towards reserves on August 8, 1963, out of the profits of the year ending March 31, 1963, should be added to other items for computation of the capital of the respondent as on the 1st day of April 1963, in terms of Rule 1 of the Second Schedule of the Companies (Profits) Surtax Act, 1964, hereinafter referred to as the 'Act'.

2. The Act which received the assent of the President on May 2 1964, is an Act to impose a special tax on the profits of certain companies Under Section 4 of the Act a tax known as surtax became chargeable on every company for every assessment year commencing on and from the 1st day of April, 1964, in respect of so much of its chargeable profits of the previous year as exceeded the statutory deduction, at the rates specified in the Third Schedule. Under Section 2(3) "assessment year" means the period of twelve months commencing on the 1st day of April of every year. "Chargeable profits" is defined in Section 2(5) as the total income of an assessee computed under the Income-tax Act, 1961, for any previous year or years, as the case may be, and adjusted in accordance with the provisions of the First Schedule. "Statutory deductions", ignoring the provisos, means in terms of section 2(8) an amount equal to 10 per cent. of the capital of the company as computed in accordance with the provisions of the Second Schedule or an amount of Rs. 2,00,000/- whichever is greater. The second Schedule to the Act contains the rules for computing the capital of a company for the purposes of surtax. Rule 1 of the Second Schedule with which alone we are concerned in this section reads :

"Subject to the other provisions contained in the schedule, the capital of a company shall be the aggregate of the amounts as on the first day of the previous year relevant to the assessment year, of -

(i) its paid-up share capital;

(ii) its reserves, if any created under the proviso (b) to clause (vi-b) of sub-section (2) of Section 10 of the Indian Income-tax Act, 1922 (XI of 1922), or under sub-section (3) of Section 34 of the Income-tax Act, 1961 (XLIII of 1961);

(iii) its other reserves as reduced by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the

purposes of the Indian Income-tax Act, 1922 (XI of 1922), or the Income-tax Act, 1961 (XLIII of 1961);

(iv) its debentures, if any; and

(v) any moneys borrowed by it from Government or the Industrial Finance Corporation of India or the Industrial Credit and Finance Corporation of India or any other financial institution which the Central Government may notify in this behalf in the Official Gazette or any banking institution (not being a financial institution notified as aforesaid) or any person in a country outside India :

Provided that such moneys are borrowed for the creation of a capital asset in India and the agreement under which such moneys are borrowed provides for the repayment thereof during a period of not less than seven years.

Explanation. - For the removal of doubt 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 LIABILITIES 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 (I 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."

In terms of Section 4 of the act the first assessment year for the purpose of the Act in respect of the company was that commencing on and from the first day of April, 1964. The previous year in respect of which the chargeable profits had to be ascertained on the first of April, 1963, and ended on March 31, 1964. The capital of the company in terms of Rule of the Second Schedule would be its paid up share capital and inter alia reserves as would come under clauses (ii) and (iii) of Rule 1 to the Second Schedule. The reserves in this case in which exception is being taken by the appellant as components of the capital of the company are the following three sum : (1) Rs. 2,56,000 as plant modernisation and rehabilitation reserve; (2) Rs. 1,00,000 as loan redemption reserve, and (3) Rs. 89,557/- as development rebate reserve. These are three of the items of reserve which the directors of the respondent in their report to the general body of the shareholders proposed as appropriations out of the profits of the year ending on March 31, 1963.

3. This sole contention on behalf of the appellant is that these appropriations having been made on August 8, 1963, could not be treated as components of capital "as on the first day of the previous year." i.e. April 1, 1963, in terms of Rule 1 to the Second Schedule. The learned Solicitor-General submitted that these could only be taken into in the subsequent year commencing on the 1st of April, 1964, on the ground that on the 1st of April, 1963, they only formed a part of the mass of undistributed profits, no portion of which had been earmarked or set apart for any particular purpose. In our view, this is not the correct way of appreciation of the action of the directors.

4. It is well-known that the accounts of the company have to be made up for a year up to a particular day. In this case that day was March 31, 1963. If it was reasonably practicable to make up the account up to March 31, 1963, and present the same to the directors of the respondent on April 1, 1963, they could have made up their minds on that day and declared their intention of appropriating the said and other sums to reserve of different kinds. But the fact that they could not do so for the simple reason that the calculation and collection of figures of all the items of income expenditure of

the company for the year ending March 31, 1963, was bound to take some time cannot make any difference to the nature or qualify of the appropriation of the profits to reserves as determined by the direction after the first of April 1963. Their determination to appropriate the sums mentioned to the three separate classes of reserves on August 8, 1962, must be related to the 1st of April, 1963, i.e., the beginning of the accounts for the new year and must be treated as effective from that day.

5. A case very similar to the one before us came up for before the Bombay High Court in commissioner of Income-tax, Delhi v. Aryodya Ginning and Manufacturing Co. Ltd. (31 ITR 145) In that case the profits of the company for the year ended December 31, 1948, were shown as Rs. 28,56,997-14-2. The directors made certain appropriations which included Rs. 11,08,000 to reserve fund and Rs. 1,50,000 to dividend reserve fund. The report of the directors was made on April 27, 1949, and a general meeting of the shareholder held on June 27, 1949, adopted the report and recommendation of the directors. The company was assessed to business profit tax chargeable under the Business Profits Tax Act for the accounting period January 1 to March 31, 1949, and the question which arose was : what was the capital of the company for the accounting period. The company contended that its paid up capital should be increased by the amount of reserves constituted by the recommendation made by the directors and accepted by the shareholders. The Commissioner of Income-tax went up to the High Court on a reference contending that as the reserve was not sanctioned till June 27, 1949, it could not be looked at or considered as reserves on a day prior thereto. The learned Judges of the Bombay High Court were of the view that the resolution of June 27, 1949, had a retrospective effect inasmuch as it referred to the profits of the year ending on December 31, 1948, the appropriation to be made in the balance-sheet as of that date and the reserves which should be constituted and shown in the balance-sheet as of that date and the reserves which should be constituted and shown in the balance-sheet as on December 31, 1948. The High Court observed that when one looked at the balance-sheet of the year ended December 31, 1948, the amounts mentioned were shown respectively in the reserve fund and the dividend reserve fund and the share-holders by passing a resolution on June 27, 1949, did not decide that these amounts should constitute reserve as from that date but they accepted the recommendation of the directors that that these amounts should constitute reserve as of December 31, 1948.

6. The learned Solicitor-General referred to a judgment of the Madras High Court in Commissioner of Income-tax v. Vasantha Mills Ltd. (32 ITR 237) where the Madras High Court dissented from the view expressed by the Bombay High Court on the ground that there could be no reserve until there was allocation in fact by a person having the requisite authority to order that allocation. In our view, although such allocation was factually not possible on the very first day of a year but allocation on a late day should be treated as effective from that day in view of the fact that the division of undistributed profits became effective from that day.

7. In this view of the matter, we are of opinion that the High Court had come to the correct conclusion and the appeal should be dismissed. The appellant will pay the costs of the respondent.

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