Commissioner of Income-Tax, Ernakulam

Vs

Official Liquidator, Palai Central Bank Ltd., (In Liquidation)

Civil Appeal No. 2090 of 1980

(V. B. Eradi, V. D. Tulzapurkar, D. P. Madon JJ)

16.10.1984

JUDGMENT

ERADI J. -

1. Whether a company in liquidation is chargeable to super profits tax under the Super Profits Tax Act, 1963 (Act XIV of 1963) (hereinafter called "the Act"), is the short question arising for determination in this appeal. The answer thereto will depend upon whether, during the period subsequent to the date of winding up, any part of the funds in the hands of the official liquidator can be distinctly classified as representing paid-up share capital of the company as on the first day of the year of account relevant to the assessment year and whether any portion of the fund can be similarly identified as forming a "reserve".

The assessee is banking company, namely, the Palai Central Bank Ltd., which went into liquidation on August 8, 1960. On that date, the official liquidator took charge of the assets and liabilities of the company and a balance-sheet has been prepared as on the same date. Thereafter for every year, the liquidator used to prepare only an income and expenditure statement for submission to the Reserve Bank of India. The assessment year, with which we are concerned is 1963-64, i.e., the year ended March 31, 1963. For the said assessment year, the taxable income of the assessee was determined by the ITO at Rs. 5,79,678. The officer was of the opinion that this amount would attract liability to super profits tax also and, since the assessee had not submitted any return under the Act, a notice under s. 9(a) of the Act calling for the return was issued. The assessee thereupon submitted a return showing the chargeable profits as "nil". In support of the said return, the assessee contended, inter alia, before the officer that there could be no liability to super profits tax in respect of a company in liquidation since the formula laid down in the Second Schedule to the Act for calculation of the "standard deduction" was inapplicable on account of the fact that a company in liquidation could not be said to have paid-up share capital as on the first day of the previous year relevant to the assessment year which was long subsequent to the winding up. Certain other contentions were put forward by the assessee, but since they are not of any material relevance at this stage, it is unnecessary to refer to them.

The ITO overruled the contentions raised by the assessee, and worked out the chargeable profits at Rs. 2,04,740, after adopting minimum amount of Rs. 50,000 mentioned in s. 2(9) of the Act as a "standard deduction" applicable to the case. The AAC, before whom the assessee filed an appeal, confirmed the order of the ITO. The assessee carried the matter in further appeal before the Income-tax Appellate Tribunal, Cochin Bench. The Tribunal held that in the hands of the liquidator, there is only one integral fund which could not be split up into share capital, reserve and profits. In the opinion of the Tribunal, the exemption provision contained in s. 27 of the Act which states that

nothing contained in the Act shall apply to any company which has no share capital was clearly attracted to the case. It was further held by the Tribunal that even if the exemption under s. 27 of the Act did not get attracted, s. 4 of the Act, which is the charging section, would not apply to the assessee-company in liquidation as the "standard deduction" was incapable of ascertainment. The Tribunal, accordingly, allowed the appeal of the assessee and held that no assessment to super profits tax could be made on a company in liquidation.

Thereafter, at the instance of the Revenue, the Tribunal referred the following question of law to the High Court of Kerala for its opinion :

> "Whether, on the facts and in the circumstances of the case, was the Tribunal justified in holding that no assessment under the Super Profits Tax Act, 1963, can be made on the assessee-company (in liquidation) ?"

The High Court agreed with the view taken by the Tribunal that after a company has gone into liquidation, there cannot be said to be in the hands of the liquidator any amount that can be distinctly designated as paid-up share capital of the company or as "reserve" with respect to which the capital of the company is to be worked out as provided in the Second Schedule to the Act in order to arrive at the amount of standard deduction. The question referred was, accordingly, answered by the High Court in the affirmative, that is, in favour of the assessee and against the Revenue. Aggrieved by the said decision, the Revenue has preferred this appeal to this court by special leave.

After hearing the counsel appearing on both sides, we have unhesitatingly come to the conclusion that the view taken by the High Court is perfectly correct and that this appeal is devoid of merit.

Section 4 of the Act, which is the charging section, reads :

> "4. Charge of tax. - Subject to the provisions contained in this Act, there shall be charged on every company for every assessment year commencing on and from the day of April 1, 1963, a tax (in this Act referred to as the super profits tax) in respect of so much of its chargeable profits of the previous year or previous years, as the case may be, as exceed the standard deduction, at the rate or rates specified in the Third Schedule."

The expression "chargeable profits" has been defined in clause (5) of section 2 thus :

> "2(5) 'chargeable profits' means the total income of an assessee computed under the Income-tax Act, 1961 (XLIII of 1961), for any previous year or years, as the case may be, and adjusted in accordance with the provisions of the First Schedule."

The next definition that is relevant is contained in clause (9) of the same section which deals with the expression "standard deduction". That clause reads as follows :

> "2(9) 'standard deduction' means an amount equal to six per cent. of the capital of the company as computed in accordance with the provisions of the Second Schedule, or an amount of fifty thousand rupees, whichever is greater :
>
> Provided that where the previous year is longer or shorter than a period of twelve months, the aforesaid amount of six per cent. or, as the case may be, of fifty thousand

rupees shall be increased or decreased proportionately :

Provided further that where a company has different previous years in respect of its income, profits and gains, the aforesaid increase or decrease, as the case may be, shall be calculated with reference to the length of the previous year of the longest duration."

It is seen from the above definition that for the calculation of "standard deduction, one has to ascertain the capital of the company as computed in the manner specified in the Second Schedule. That makes it necessary for us to examine the provisions of the Second Schedule of the Act which contains the rules for computing the capital of a company for the purpose of levy of super profits tax. The relevant provision is contained in rule 1 of the said Schedule which is in the following terms :

"1. Subject to the other provisions contained in this Schedule, the Capital of a company shall be the sum of the amounts, as on the first day of the previous year relevant to the assessment year, of its paid- up share capital and of its reserve, if any, created under the proviso (b) to clause (vib) 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), and of its other reserves in so far as the amounts credited to such other reserves have not been allowed computing it profits for the purposes of the India Income-tax Act, 1922 (XI of 1922), or the Income-tax Act, 1961 (XLIII of 1961), diminished by the amount by which the cost to it of the assets the income from which in accordance with clause (iii) or clause (vi) or clause (vii) of rule 1 of the First Schedule is not includible in its chargeable profits, exceeds the aggregate of -

(i) any money borrowed by it which remains outstanding;

(ii) the amount of any fund, any surplus and such reserve as is not to be taken into account in computing the capital under this rule.

Explanation 1. - A paid-up share capital or reserve brought into existence by creating or increasing (by revaluation or otherwise) any book asset is not capital for computing the capital of a company for the purposes of this Act.

Explanation 2. - Any premium received in cash by the company on the issue of its shares standing of its shares standing to the credit of the share premium account shall be regarded as forming part of its paid-up share capital.

Explanation 3. - Where a company has different previous years in respect of its income, profits and gains, the computation of capital under rule 1 and rule 2 of this Schedule shall be made with reference to the previous year which commenced first."

It is manifest from the terms of the rule that the essential components which will together go to make up the capital of a company are :

(i) Its paid-up share capital on the first day of the previous year relevant to the assessment year.

(ii) Its reserves, if any, created under the provision (b) to clause (vib) of sub-section (2) of section 10 of the Indian Income-tax Act, 1922, or under sub-section (3) of section 34 of the Income-tax Act, 1961; and

(iii) Other reserve in so far as the amounts credited thereto have not been allowed in computing the profits of the company for the purpose of assessment to income-tax.

From the aggregate of the aforesaid amounts, certain deductions as specified in the section have to be made but the details of such deductions are not relevant for the purpose of the present case. What is important to notice is that unless the company can be said to have a paid-up share capital as on the first day of the previous year relevant to the assessment year, the formula laid down in the rule for computation of capital of the company cannot have any application and the calculation of "standard deduction" being based wholly on the capital of the company becomes wholly incapable of ascertainment. After accompany has gone into liquidation, can it be said that as on the first day in any subsequent year forming the previous year relevant to the assessment year, there exists in hands of the liquidator any amount distinctly forming the paid up share capital of the company any sum that can be characterised as "reserve" ? In our opinion, the answer must clearly be in the negative.

In IRC v. George Burrell [1924] 2 KB 52 (CA), at p. 63, Pollock M. R. observed :

> "It is a misapprehension, after the liquidator has assumed his duties, to continue the distinction between surplus profits and capital. Lord Macnaghten in Birch v. Cropper, [1889] 14 AC 525, the case which finally determined the rights inter se of the preference and ordinary shareholders in the Bridgewater Canal, said : 'I think it rather leads to confusion to speak to the assets which are the subject of this application as 'surplus assets' as if they were an accretion or addition to the capital of the company capable of being distinguished form it and open to different considerations. They are part and parcel of the property of the company-part and parcel of the joint stock or common fund-which at the winding up represented the capital of the company'"

The above statement of the law was cite with approval and adopted by this court in CIT v. Girdhardas and Co. Private Ltd. [1967] 63 ITR 300(SC) and it was held that in respect of a company in liquidation after the date of its winding up, the distinction between capital, reserve and the accumulated profits disappear and there is only one integrated or consolidated fund in the hands of the liquidator. The concept of a fluctuating share capital or reserve which is the basic premise necessary to attract the applicability of rule 1 of the Second Schedule is wholly foreign in respect of a company in liquidation.

IN CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294, this court pointed out that under the scheme of the I.T. Act, 1961, charge of tax will not get attracted unless the case or transaction falls under the governance of the relevant computation provisions. 'The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code. When there is a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section, there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. 'Exactly similar being the scheme of the super profits Tax Act, 1963, the above observations fully apply to the case before us. Hence, it has to be held that inasmuch as the provisions contained in the Act for computing the capital of a company and its reserves cannot have any application in respect of a

company in liquidation and, consequently, the "standard deduction" is incapable of ascertainment, the charge of charge of super profits tax under s. 4 of the Act is not attracted to such a case. The judgment of the High Court dose not, therefore, call for any interference.

This appeal is, accordingly, dismissed with costs.

Appeal dismissed.

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