

Sundaram Clayton Ltd.

Vs

Commissioner of Income Tax

Civil Appeals Nos. 4360-61 (NT) of 1981

(B. L. Hansaria, G. N. Ray JJ)

02.05.1996

JUDGMENT

G. N. RAY, J.--

1. Civil Appeals Nos. 1360-61 of 1981 are directed against judgment dated 21-10-1981 passed by the Division Bench of the Madras High Court in Tax Cases Nos. 743-744 of 1977 arising out of Reference Nos. 495-496 of 1977. Civil Appeal No. 1705 of 1980 is directed against judgment dated 12-11-1986 passed by the Division Bench of the Madras High Court in Tax Case Petition No. 367 of 1986. It may be stated here that Tax Case Petition No. 367 of 1986 was disposed of by the High Court following its judgment passed by the Madras High Court in the said Tax Cases Nos. 743-744 of 1977. It will, therefore, be appropriate to refer to the relevant facts relating to Tax Cases Nos. 743-744 of 1977 which were disposed of by the Madras High Court on 21-10-1981.

2. Tax Cases Nos. 743-744 of 1977 arose out of the reference made under Section 256(1) of the Income Tax Act, 1961. The reference before the High Court raised a short question about the computation of capital under Rule 3 of Schedule II of the Companies (Profits) Surtax Act, 1964. The origin of the Companies (Profits) Surtax Act, 1964 may be traced back to the Surtax Act, 1940, which was enacted for the purpose of mopping up unreasonable and extra profits earned in the business during the Second World War. Later on, Super Profits Tax Act, 1963, and the Companies (Profits) Surtax Act, 1964, were enacted for similar purpose. The rationale behind these Acts is that any profit over and above the reasonable profit expected in the commercial and productive activities would be taxed at a special rate.

3. It will be appropriate to note the relevant facts for the purpose of appreciating the rival contention made before the Madras High Court and also at the hearing of these appeals. In the Assessment Year 1971-72, corresponding to previous year beginning from 1-8-1969 and ending on 31-7-1970, the appellant Company, M/s Sundaram Clayton Ltd., issued 20,400 bonus shares of the face value of Rs 100 each. This bonus issue was brought about by capitalising part of the Company's general reserves. Accordingly, a sum of Rs. 20,40,000 was converted into bonus shares. The assessee Company claimed that the said amount of Rs 20,40,000 which represented the bonus issues on 23-2-1970 became the basis for increase in the capital determined at Rs 1,43,39,462 as on the first day of the previous year i. e. 1-8-1969. It was claimed by the Company that the bonus shares were in addition to the paid-up capital of the Company. Since any 'increase' in the paid-up capital of the Company was to be properly reckoned for the purpose of computation of capital under Rule 3 of Schedule II of the Companies (Profits) Surtax Act, 1964 (hereinafter referred to as Surtax Act, 1964), it was claimed that the Proportionate amount which worked out to Rs 8,84,237, must be added to the capital as on 1-8-1969 for the purpose of capital computation.

4. The Income Tax Officer rejected the said contention of the assessee Company, but the Income Tax Appellate Tribunal accepted the assessee's case. A reference was made by the taxing department under Section 256(1) of the Income Tax Act, 1961 before the Madras High Court for answering, inter alia, the following question:

"Whether on the facts and in the circumstances of the case and having regard to Rule 3 of Schedule II of the Companies (Profits) Surtax Act, 1964 the share capital of the Company should be increased proportionately on account of the issue of bonus shares for the purpose of computation of capital under the Companies (Profits) Surtax Act, 1964?"

5. The Madras High Court held that when bonus shares were issued, the paid-up capital of the Company increased, but so far as the column of liabilities in the balance-sheet of the Company was concerned, a sum equivalent to the value of the bonus shares was carved out from the amount of reserves and placed in the column of paid-up capital of the Company on the side of liabilities in the balance-sheet. The High Court held that the process of conversion of reserves into bonus shares did neither reduce the overall capital of the Company nor increase it. The overall capital of the Company remained the same as in the beginning of the financial year. It was held by the High Court that what Rule 3 of Schedule II of the Surtax Act, 1964 contemplated was that the capital, as on the first day of the previous year, gets increased by way of an addition to any part of the capital so computed, whether the increase be to the paid-up capital or to the reserves or to any other items figuring on the liabilities side of the balancesheet. In other words, there must be a fresh influx of capital in order to attract Rule 3 of Schedule n of the Surtax Act, 1964.

6. The High Court indicated that the mere act of capitalising a part of the reserve and issuing bonus shares did not mean that there was any influx of additional capital into the Company over and above what figured as the opening capital on the liabilities side of the balance-sheet, consisting of the paid-up capital and the reserves, among other things. The High Court, therefore, held that on a commonsense understanding of the said rule and on a proper reading of the various entries in the Company's balance sheet, the contention put forward by the assessee must be rejected as untenable. The High Court placed reliance on a decision of the Bombay High Court in *CIT v. Century Spg. and Mfg. Co. Ltd.* [(1978) 111 ITR 6 : 1977 CTR 132 (Bom)] The High Court also noted the decision of the Delhi High Court in *Addl. Commr. of Surtax v. Food Specialities Ltd.* [(1981) 129 ITR 731 (Del)] which held the similar view. The Delhi High Court in the said decision also referred to the decision of the Bombay High Court in *Century Spg. Mill case.* [(1978) 111 ITR 6 : 1977 CTR 132 (Bom)]

7. On behalf of the assessee, however, reliance was placed on a decision of the Himachal Pradesh High Court in *CIT v. Mohan Meakin Breweries Ltd.* [(1974) 95 ITR 586 : 1974 Tax LR 82 (HP)] In the said case, interpretation of Rule 2 of Schedule II of Super Profits Tax Act, 1963 came up for consideration. It was held in the said decision that an increase in the paid-up capital by the simple process of capitalising a part of the existing reserves, would entitle the assessee to claim for an increase in the computation of the capital under Rule 2 of Schedule II of the Super Profits Tax Act, 1963. The Madras High Court in the impugned decision did not agree with the view taken by the Himachal Pradesh High Court. the Madras High Court also indicated that the decision of the Himachal Pradesh High Court was rendered on a construction and application of Rule 2 of Schedule II of a different statute, namely, the Super Profits Tax Act, 1963. The Madras High Court indicated that the language of Rule 2 of Super Profits Tax Act, 1963 and Rule 3 of the Surtax Act, 1964 was not *pari materia*. The High Court also indicated that the Bombay High Court in *Century Spg. Mill*

case[(1978) 111 ITR 6 : 1977 CTR 132 (Bom)] noted that there was a distinction between Rule 2 and Rule 3 of the said Acts, and such difference had a bearing on the computation of capital.

8. It may be stated here that two other questions were also referred to before the High Court in Tax Cases Nos. 743-744 of 1977, and the same were answered by indicating that these stood answered by the decisions of that Court in *Southern Roadways Ltd. v. CIT*[(1981) 130 ITR 545 : (1981) 51 Comp Cas 513 (Mad)] and in *CIT v. Bimetal Bearings Ltd.* [(1977) 110 ITR 131 (Mad)] For the purpose of disposal of the appeals these questions answered by the High Court are not required to be considered and hence we are not doing so.

9. The question as to the computation of the income on account of the issue of bonus shares was answered by the High Court in favour of the Revenue and against the assessee Company by holding that the finding made by the Income Tax Appellate Tribunal that issue of bonus shares in the assessment year in question had resulted in increase in capital assets of the Company within the meaning of Rule 3 of Schedule II of Surtax Act, 1964 was erroneous and could not be sustained on a correct interpretation of the said rule. In these appeals such decision of the Madras High Court is under challenge.

10. Mrs Janaki Ramachandran, the learned counsel appearing for the appellant Company, has referred to Rule 2 of Schedule II of the Super Profits Tax Act, 1963 and Rule 3 of the Surtax Act, 1964 and contended that both the rules being essentially similar have same legal incidence and the High Court erred in proceeding on the footing that the incidence of Rule 2 of Super Profits Tax Act, 1963 and Rule 3 of Schedule II of Surtax Act, 1964 was different by placing reliance on the said decisions of the Bombay and Delhi High Courts. It will be appropriate at this stage to refer to Rule 2 of Schedule II of Super Profits Tax Act, 1963 and Rule 3 of Schedule II of the Surtax Act, 1964.

Rule 2 of Second Schedule of the Super Profits Tax Act, 1963

Where after the first day of the previous year relevant to the assessment year, the paid-up share capital of a company is increased or reduced by any amount during that previous year, the capital computed in accordance with Rule 1 shall be increased or decreased, as the case may be, by a portion of that amount which is proportional to the portion of the previous year during which the increase or the reduction of the paid-up share capital remained effective.

Rule 3 of the Second Schedule of the Companies (Profits) Surtax Act, 1964

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 the 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. (emphasis supplied)

11. The learned counsel for the appellant has contended that in the Schedules under Super Profits Tax Act, 1963 and Surtax Act, 1964 provisions have been made for calculating capital invested and the profits. The capital gains, though subject to normal income tax, was not taken into consideration

for arriving at chargeable income for the purpose of Super Profits Tax Act, 1963 and the Surtax Act, 1964. Mrs Ramachandran has submitted that from the chargeable profits as arrived in accordance with the provisions of the First Schedule, a specified percentage (six per cent in the case of the Super Profits Tax Act and ten per cent in the case of the Surtax Act) of the capital as computed in accordance with the provisions in the Second Schedule was to be deducted. This is known as the standard deduction or statutory deduction. This deduction is considered to be a fair or reasonable return on the capital invested in the business. Any balance remaining was to be subjected to surtax. She has contended that any method by which (1) the chargeable profits could be reduced and/or (2) the capital base could be increased will work out to the advantage of the taxpayer. She has urged that on a plain reading of the rules of the Second Schedule, the amount represented by the bonus shares issued by the appellant Company will straightaway qualify for proportionate inclusion in the capital base. There is nothing said anywhere either in the Schedules or in the main body of the Act that the increase in the share capital must be accompanied by a corresponding inflow of cash. She has submitted that in a taxing statute, clear words are necessary to tax the subject. In interpreting a taxing statute, one is to look simply at what is clearly said. There is no room for intendment; there is no equity about a tax. There is no presumption as to a tax; nothing should be read into the Act; nothing should be implied; one should fairly look at what is said and what is clearly said. In support of this contention, Mrs Ramachandran has referred to a decision of the English Court in *Cape Brandy Syndicate v. IRC*. [(1921) 1 KB 64] She has submitted that this Court has also followed the view taken in *Cape Brandy case* [(1921) 1 KB 64] in the case reported in *CIT v. Shahzada Nand and Sons* [(1966) 60 ITR 392 : AIR 1966 SC 1342] by observing to the following effect:

"In a taxing Act one has to look merely at what is clearly stated, and in a case of reasonable doubt the construction most beneficial to the subject is to be adopted. But even so, the fundamental rule of construction is the same for all statutes, whether fiscal or otherwise. The underlying principle is that the meaning and intention of a statute must be collected from the plain and unambiguous expression used therein rather than from any notions which may be entertained by the court as to what is just or expedient. The expressed intention must guide the court."

12. Mrs Ramachandran has submitted that the Bombay High Court in *Century Spg. Mill case* [(1978) 111 ITR 6 : 1977 CTR 132 (Bom)] did not spell out as to why Rule 2 of Super Profits Tax Act, 1963 and Rule 3 of Surtax Act, 1964 was different. The Delhi High Court in *Food Specialities case* [(1981) 129 ITR 731 (Del)] also did not state how the said rules were different. The learned counsel has submitted that it was only by a process of reasoning that the decision was arrived at by the Delhi High Court by attributing motives to the legislature which are not borne out by the plain words of the statute. Hence, the Madras High Court should not have placed reliance on the decisions of the Bombay and Delhi High Courts. The interpretation of Rule 3 of Schedule II of the Surtax Act, 1964 as made by the Madras High Court is erroneous and against plain reading of the provisions of Rule 3. She has, therefore, submitted that the appeal should be allowed by accepting the view by the Income Tax Appellate Tribunal in favour of the assessee.

13. Mr G. C. Sharma, the learned Senior Advocate appearing for the respondent, disputed the contentions of Mrs Ramachandran. He has submitted that Rule 2 of Schedule II of Super Profits Tax Act, 1963 and Rule 3 of Surtax Act, 1964 are not similarly worded. In this connection, he has referred to the decision of the Gujarat High Court in *Commr. of Surtax v. New India Industries Ltd*, [(1993) 202 ITR 619 (Guj)] which has explained the legal incidence of both the said Rules clearly by indicating cogent reasons. It has been held by the Gujarat High Court in that case that the expression 'reserves' has not been defined in the Super Profits Tax Act, 1963 or the Companies

(Profits) Surtax Act, 1964. The dictionaries do not make any distinction between the two concepts 'reserve' and 'provision' while giving their primary meanings, whereas in the context of those Acts, a clear distinction between the two is implied. Though the expression 'reserve' is not defined, since it occurs in a taxing statute applicable to companies only and to no other assessable entities, the expression has to be understood in its popular sense, namely, the sense or meaning that is attributed to it by men of business, trade and commerce and by persons interested in or dealing with companies. Therefore, the meaning attached to the words 'reserve' and 'provision' in the Companies Act, 1956, dealing with the preparation of the balance sheet and the profit and loss account would govern their construction for the purposes of the two enactments. The broad distinction between the two is that whereas a 'provision' is a charge against the profits to be taken into account against gross receipts in the profit and loss account, a 'reserve' is an appropriation of profits, the asset or assets by which it is represented being retained to form part of the capital employed in the business. If any retention or appropriation of a sum is not a 'provision', i. e. it is not designed to meet depreciation, renewals or diminution in the value of assets or any known liability, the same is not necessarily a 'reserve'. The question whether the amounts concerned constitute 'reserve' or not will have to be decided by having regard to the true nature and character of the sums to be appropriated depending on the surrounding circumstances, particularly the intention with which, and the purpose for which, such appropriations had been made. The true nature and character of the appropriation must be determined with reference to the substance of the matter.

14. Mr Sharma has further submitted that a mere look at Rule 2 of Schedule II of the Super Profits Tax Act, 1963 as contrasted with Rule 3 of Schedule II of the Surtax Act, 1964 will show that Rule 2 of Super Profits Tax Act, 1963 visualised mere increase in the paid-up share capital, without reference to any increase in capital base, enough for computation of capital; but before Rule 3 of Schedule II of Surtax Act, 1964 may apply, an increase in the capital base as computed under Rule 1 has to be shown to have taken place. Counsel has submitted that the Gujarat High Court in New India Industries case[(1993) 202 ITR 619 (Guj)] has very correctly indicated that Rule 3 will apply if (1) capital of the company as computed in accordance with Rule 1 of Schedule II of the Surtax Act, 1964 has increased by any amount during that previous year; and (2) such increase should be on account of increase of paid-up share capital or issue of debentures referred to in clause (iv) or borrowing of any moneys referred to in clause (v) of Rule 1. If these conditions are satisfied, then and then only, there will be an occasion for the company to get the benefit as contemplated by the second part of Rule 3 to the effect that such capital, computed as per Rule 1, will be permitted to be increased by a sum which bears to the amount of such increase of paid-up share capital, or issue of debentures or borrowings, the same proportion as the number of days of the previous year during which the increase in the paid-up share capital, or issue of debentures or borrowings of any money, as the case may be, bears to the total number of days in that previous year. It has also submitted that under Rule 3 of Schedule II of Surtax Act, 1964 before benefit under the rule can be pressed into service by the assessee Company, it must be shown that the capital base for the said company, as on the first day of the previous year relevant to the assessment year as per Rule 1, has in fact undergone a hike. If the said basic condition is not satisfied, Rule 3 is not attracted at all. Such interpretation of Rule 3 being clearly discernible, no other interpretation should be accepted and the Madras, Bombay and Gujarat High Courts had no difficulty in taking the same view in interpreting Rule 3 of Schedule II of Surtax Act, 1964. He has submitted that in the aforesaid facts no interference by this Court is called for and the appeals should be dismissed with cost.

15. After giving our careful consideration to the facts and circumstances of the case and the contentions made by the respective counsel for the parties, it appears to us that by issuing the bonus shares in the assessment year in question there had only, been a conversion of the reserves into fully

paid bonus shares, which conversion did not add up to the capital or reserve base which was not there on the first day of the previous year. The Gujarat High Court in New India Industries cases has very succinctly explained the difference in incidence of Rule 2 of Schedule II of Super Profits Tax Act, 1963 and Rule 3 of Surtax Act, 1964. We feel no hesitation in approving the view taken therein that before Rule 3 of Surtax Act, 1964 can be made applicable, an increase in the capital base as computed under Rule 1 has to be shown to have taken place. In order that Rule 3 could apply the capital base of the company, as computed in accordance with Rule i of Schedule II of Surtax Act, 1964, must have increased during the previous year and such increase should be on account of increase of paid-up share capital or issue of debentures referred to in clause (iv) or borrowing of any moneys referred to in clause (v) of Rule 1. Unless these conditions are satisfied, there would be no occasion for the assessee Company to get benefit contemplated by the second part of Rule 3 of Schedule II of Surtax Act, 1964.

16. The Bombay, Madras and Delhi High Courts have also taken the same view without, however, elaborating the implication of Rule 3 of Schedule II of Surtax Act, 1964 as has been done by the Gujarat High Court. The incidence of Rule 2 of Schedule II of Super Profits Tax Act, 1963 being different, the interpretation of the said rule by the Himachal Pradesh High Court is not germane for interpreting Rule 3 of Schedule II of Surtax Act, 1964. The aforesaid interpretation is quite reasonable and is clearly discernible in Rule 3. The decisions cited by Mrs Ramachandran relating to one principle of interpretation of taxing statute do not call for any change in the view we have taken on the language of the rule.

17. We, therefore, find no reason to interfere with the impugned decisions of the Madras High Court and all the appeals are dismissed, without any order as to costs.