

SUPREME COURT OF INDIA

Dynamic Orthopedics P.Ltd.

Vs.

Commissioner of Income Tax, Kerala

C.A.No.8419 of 2003

(S.H. Kapadia and Aftab Alam JJ.)

16.02.2010

ORDER

S.H. Kapadia, J.

1. A short question which arises for determination in this civil appeal is - whether the Income Tax Appellate Tribunal was, on the facts and circumstances of this case, justified in upholding the order of the Commissioner of Income Tax (Appeals) directing the Assessing Officer to allow the claim of depreciation as per the Income Tax Rules, 1962, for the purposes of computing the book profit under Section 115J of the Income Tax Act, 1961? In this civil appeal, we are concerned with Assessment Year 1990-1991.

2. The appellant-assessee is a private limited company engaged in the manufacture and sale of Orthopaedic appliances. In the Return of Income filed, the assessee returned an income of Rs.1,50,730/-. In the Profit and Loss Account, depreciation was provided at the rates specified in Rule 5 of the Income Tax Rules, 1962 ['Rules', for short]. While completing the assessment of income, the Assessing Officer re-computed the book profit for the purpose of Section 115J of the Income Tax Act, 1961, ['Act', for short], after allowing depreciation as per Schedule XIV to the Companies Act. The rates of depreciation specified in Schedule XIV to the Companies Act, 1956 ['1956 Act', for short] were lower than the rates specified under Rule 5 of the Rules. Being aggrieved by the assessment order, the assessee took up the matter before the Commissioner of Income Tax [Appeals] ['C.I.T.(A)', for short], who came to the conclusion that the assessee was a private limited company. It was not a subsidiary of a public company. Therefore, placing reliance on Section 355 of 1956 Act, the C.I.T. (A) held that Section 350 of 1956 Act was not applicable to the assessee and, in the circumstances, the Income Tax Officer had erred in providing depreciation at the rates specified under Schedule XIV to 1956 Act. Consequently, the C.I.T.(A) held that the assessee was right in providing depreciation in its accounts as per Rule 5 of the Rules.

3. Aggrieved by the decision of the C.I.T.(A), I.T.A. No.115 of 1993 was preferred by the Department to the Income Tax Appellate Tribunal ['Tribunal', for short]. By judgement and

order dated 13th January, 1999, the Tribunal held that, since the assessee was a private limited company, Section 349 and Section 350 were not applicable to the facts of the case and, in the circumstances, the Income Tax Officer had erred in directing the assessee, which was a private limited company, to provide for depreciation as per Schedule XIV to 1956 Act, which was not applicable to the private limited companies [See Section 355 of 1956 Act]. Consequently, the appeal filed by the Department before the Tribunal stood dismissed.

4. Aggrieved by the said decision of the Tribunal, the Department preferred I.T.A. No.66 of 1999 before the High Court of Kerala which held that Section 115J of the Act was introduced in Assessment Year 1988-1989 to take care of the phenomenon of prosperous 'zero tax' Companies which had continued despite the enactment of Section 80VVA of the Act. These Companies were paying no income tax though they had profits and though they were declaring dividends.

5. Consequently, Section 115J of the Act was inserted to levy a minimum tax on book profits of certain Companies.

6. According to the High Court, Section 115J of the Act read with Explanation clause (iv), as it stood at the material time, was a piece of legislation by incorporation and, consequently, the provisions of Section 205 of 1956 Act stood incorporated into Section 115J of the Act, hence, the Income Tax Officer was right in directing the assessee to provide for depreciation at the rate specified in Schedule XIV to 1956 Act and not in terms of Rule 5 of the Rules. Hence, this civil appeal is filed by the assessee.

7. To answer the controversy, we quote hereinbelow the relevant provision(s) of the Companies Act, 1956, Income Tax Act, 1961, as it stood at the material time, as also Income Tax Rules, 1962:

“Provisions of the Companies Act, 1956:

205.(1) No dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with those provisions and remaining undistributed or out of both or out of moneys provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government.

349.(1) In computing for the purpose of section 348, the net profits of a company in any financial year-- [a] xxxx xxxx xxxx [b] the sums specified in sub-section (4) shall be deducted, and those specified in sub-section (5) shall not be deducted.

xxxx xxxx xxxx [4] In making the computation aforesaid, the following sums shall be deducted:-- [a] to [j] xxxx xxxx [k] depreciation to the extent specified in section 350. Ascertainment of depreciation.

350. The amount of depreciation to be deducted in pursuance of clause (k) of sub-section (4) of section 349 shall be the amount calculated with reference to the written down value of the assets as shown by the books of the company at the end of the financial year expiring at the commencement of this Act or immediately thereafter and at the end of each subsequent financial year at the rate specified in Schedule XIV."

Provisions of Income Tax Act, 1961:

"115J.(1A).-- Every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (1 of 1956).

[a] to [d] xxxx xxxx xxxx [e] the amount or amounts of dividends paid or proposed."

Provisions of Income Tax Rules, 1962:

"Depreciation.

5.(1) Subject to the provisions of sub-rule (2), the allowance under clause (ii) of sub-section (1) of section 32 in respect of depreciation of any block of assets shall be calculated at the percentages specified in the second column of the Table in Appendix I to these rules on the written down value of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year."

8. In this case, the question which arose for determination before the High Court was - whether the C.I.T.(A) was right in directing the Assessing Officer to allow the claim of depreciation made by the assessee as per the Income Tax Rules, 1962, for the purposes of computing the book profit under Section 115J of the Act, as it stood at the material time? The High Court allowed the appeal filed by the Department holding that the Assessing Officer was right in re-computing the book profit for the purpose of Section 115J of the Act after allowing depreciation as per Schedule XIV to the 1956 Act and not as per the rates specified in Rule 5 of the Income Tax Rules, 1962, as claimed by the assessee. This view of the High Court, in the present case, was similar to the view taken by it in the case of *Commissioner of Income Tax vs. Malayala Manorama Company Limited*¹, which High Court's judgement stood reversed by the judgement of this Court in the case of *Malayala Manorama Company Limited vs. Commissioner of Income Tax*².

9. In our view, with respect, the judgement of this Court in *Malayala Manorama Company Limited vs. Commissioner of Income Tax*³, needs re-consideration for the following reasons: Chapter XII-B of the Act containing "Special provisions relating to certain Companies" was introduced in the Income Tax Act, 1961, by the Finance Act, 1987, with effect from 1st April, 1988. In fact, Section 115J replaced Section 80VVA of the Act. Section 115J [as it stood at the relevant time], inter alia, provided that where the total income of a company, as computed under the Act in respect of any accounting year, was less than thirty per cent of its book profit, as defined in the Explanation, the total income of the company, chargeable to tax, shall be deemed to be an amount equal to thirty per cent of such book profit. The whole purpose of Section 115J of the Act, therefore, was to take care of the phenomenon of prosperous `zero tax' Companies not paying taxes though they continued to earn profits and declare dividends. Therefore, a Minimum Alternate Tax was sought to be imposed on `zero tax' Companies. Section 115J of the Act imposes tax on a deemed income. Section 115J of the Act is a special provision relating only to certain Companies. The said section does not make any distinction between public and private limited companies.

10. In our view, Section 115J of the Act legislatively only incorporates provisions of Parts II and III of Schedule VI to 1956 Act. Such incorporation is by a deeming fiction.

11. Hence, we need to read Section 115J(1A) of the Act in the strict sense. If we so read, it is clear that, by legislative incorporation, only Parts II and III of Schedule VI to 1956 Act have been incorporated legislatively into Section 115J of the Act. Therefore, the question of applicability of Parts II and III of Schedule VI to 1956 Act does not arise. If a Company is a MAT Company, then be it a private limited company or a public limited company, for the purposes of Section 115J of the Act, the assessee-Company has to prepare its profit and loss account in accordance with Parts II and III of Schedule VI to 1956 Act alone. If, with respect, the judgement of this Court in *Malayala Manorama Company Limited* [supra] is to be accepted, then the very purpose of enacting Section 115J of the Act would stand defeated, particularly when the said section does not make any distinction between public and private limited companies.

12. It needs to be reiterated that, once a Company falls within the ambit of it being a MAT Company, Section 115J of the Act applies and, under that section, such an assessee-Company was required to prepare its profit and loss account only in terms of Parts II and III of Schedule VI to 1956 Act. The reason being that rates of depreciation in Rule 5 of the Income Tax Rules, 1962, are different from the rates specified in Schedule XIV of 1956 Act. In fact, by the Companies (Amendment) Act, 1988, the linkage between the two has been expressly de-linked.

13. Hence, what is incorporated in Section 115J is only Schedule VI and not Section 205 or Section 350 or Section 355. This was the view of the Kerala High Court in the case of *Commissioner of Income Tax vs. Malayala Manorama Company Limited*¹ (Supra), which has been wrongly reversed by this Court in the case of *Malayala Manorama Company Limited vs. Commissioner of Income Tax*²(Supra).

14. For the afore-stated reasons, the Registry is directed to place this civil appeal before the learned Chief Justice for appropriate directions as we are of the view that the matter needs re-consideration by a larger Bench of this Court.

¹[2002] 253 I.T.R. 378 (Kerala)

²[2008] 300 I.T.R.251