

# CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs.

Lothian Jute Mills Co., Ltd

I.T. Ref. No. 33 of 1961, I.T. Ref. No. 177 of 1961

(G.K. Mitter and S.A. Masud, JJ.)

06.04.1965

## JUDGMENT

**G.K. Mitter, J.**

1. Two questions have been referred to this court, one under section 66(1) and the other under section 66(2) of the Act, in two separate references which are hereby consolidated.

2. The questions are as follows:

"(1) Whether, on the facts and in the circumstances of the case, the assessee-company is entitled to rebate of one anna per rupee on the undistributed balance of the profits as provided in clause (i) of the proviso to Item B Part I of the Schedule to the Finance Act, 1955 ?

(2) Whether, on the facts and circumstances of the case, the Tribunal was correct in holding that the provisions of proviso (b) to section 23A(1) of the Income-tax Act were not applicable to the assessee-company for 1955-56 ?"

3. The facts are as follows: The assessee is a limited company in which the public are not substantially interested. For the assessment year 1955-56, the relevant accounting year ending on November 30, 1954, the assessee was assessed on a total income of Rs. 10,53,739. The gross income-tax and corporation tax computed on the above was Rs. 4,57,711. There was thus a sum of Rs. 5,96,021 available for distribution to the shareholders. The company declared a dividend to the extent of 62 per cent. of the distributable profit. In computing the taxes payable no rebate was allowed, under the Finance Act of 1955, on the undistributed profits of the company on the footing that although no order under section 23A(1) had actually been passed the provisions of that section were applicable to the company. In denying this rebate, the Income-tax Officer noted that the assessee was a company to which the provisions of section 23A appeared to be

applicable and the application of the section was under consideration. The said officer further noted that if section 23A was not eventually applied, the assessee would be entitled to the rebate and he stayed the collection of so much of the amount of tax as would be equal to the rebate in question. The assessee preferred an appeal to the Appellate Assistant Commissioner. There it was contended that as the company had already declared more than 60 per cent. of the profits available for distribution, section 23A(1) was not applicable and the rebate ought to be allowed. The Appellate Assistant Commissioner felt that the contention ought to be accepted. He further held that if and when an order under section 23A(1) was passed the rebate allowed could be recovered. The revenue then went in second appeal to the Tribunal. There it was argued that the granting of the rebate on undistributed profits in terms of the Finance Act of 1955 was independent of the pendency or otherwise of the proceedings under section 23A of the Act and the assessee was not entitled to the rebate on the undistributed profits of the company if the circumstances were such that the said section could be made applicable. Being of the view that there was no definite finding as to whether the assessee's affairs attracted the operation of section 23A, the Tribunal remanded back the case to the Income-tax Officer for reporting the relevant facts and giving his finding on this point. On remanded, the Income-tax Officer found that the accumulation of past profits amounted to Rs. 36,97,985 and it had exceeded the paid up capital of the assessee-company, Rs. 20,00,000. Further, the paid-up capital of the assessee, i.e., Rs. 20,00,000, exceeded the actual cost of the fixed assets as on November 30, 1954, namely, Rs. 14,92,881 being the difference between the original cost, i.e., Rs. 50,99,335, and the depreciation written off, i.e., Rs. 36,06,454. At the final hearing before the Tribunal it was urged on behalf of the revenue that the assessee was a company to which the provisions of proviso (b) to section 23A(1) were applicable inasmuch as, the reserves representing accumulated profits of past years which had not been the subject of an order under section 23A exceeded the aggregate of the paid up capital of the company.

4. Section 23-A(1) as it stood at the relevant time contained a proviso which ran as follows :

"Provided that -

(a) in the case of a company whose business consists wholly or mainly in the dealing in or holding of investments; and

(b) in the case of any other company where the accumulated profits and reserves (including the amounts capitalized from the earlier reserves) representing accumulations of past profits which have not been the subject of an order under this sub-section, exceed either the aggregate of -

(i) the paid up capital of the company exclusive of the capital, if any, created out of its profits and gains which have not been the subject of an order under this sub-section, and

(ii) any loan capital which is the property of the shareholders or the actual cost of the fixed assets of the company, whichever of these is greater.

This section shall apply as if for the words, sixty per cent. of the total income, wherever they occur, the words the whole of the total income had been substituted."

5. The question in this case is whether the accumulated profits and reserves of the company exceed the actual cost of the fixed assets of the company.

6. The Tribunal noted from the report of the Income-tax Officer that

"The paid up capital of the assessee-company is Rs. 20,00,000. The total reserves out of the accumulated profits as worked out by the Income-tax Officer are Rs. 37,97,985. The original cost of fixed assets was Rs. 50,99,335 and the amount of depreciation written off was Rs. 36,06,454."

7. According to the Tribunal, it is necessary to find out whether the reserves representing the accumulations of past profits which have not been the subjected of an order under section 23A exceed either the aggregate of (1) the paid-up capital of the company exclusive of the capital, if any, created out of its profits and gains which have not been the subject of an order under this sub-section and (ii) any loan capital which is the property of the shareholders, or the actual cost of the fixed assets of the company, whichever is greater. It is apparent from the figures reported by the Income-tax Officer and confirmed by the assessee, that the total reserves out of the accumulated profits exceed the share capital. It is, therefore, to be further seen whether the actual cost of the fixed assets exceeds the reserves. Although the original cost of the assets is reported by the Income-tax Officer to be Rs. 50,99,335, he has computed the actual cost of the assets at Rs. 14,92,881 after deducting the depreciation of Rs. 36,06,454 written off in computing the assessee's profits in the past. It is on the basis of this figure of actual cost of the fixed assets which certainly is lower than the reserves that the Income-tax Officer has reported that the assessee is a company to which the provisions of section 23A can be made applicable. Before the Tribunal it was contended on behalf of the assessee that the actual cost of the fixed assets corresponded to the original cost and could not be the figure arrived at by the deduction of depreciation written off in the accounts from the said original cost. The contention to the contrary by the revenue was turned down by the Tribunal holding that

"if depreciation is deducted from the original cost to the assessee, what we get is the written down value. It is evident from the definition of written down value in section 10(5) of the Income-tax Act where the expression actual cost has been used, that save in certain circumstances, which do not apply in the assessee's case, the term actual cost means what the assessee pays for and is synonymous with the original cost to the assessee as mentioned in section 10(2) (vi) of the Act. Secondly, depreciation written off cannot be considered as a reserve much less a reserve created out of the accumulated past profits."

8. Referring to the provisions to Schedule VI of Part III of the Indian Companies Act, 1956, the Tribunal concluded that reserves did not include provisions for depreciation.

9. The Tribunal went on to consider the question whether for the purpose of denying the rebate it

is was sufficient if the provisions of section 23A were merely attracted but not applied. It followed the ruling of the Bombay High Court in *Commission of Income-tax v. Afco Private Ltd<sup>1</sup>*, which was affirmed by the Supreme Court of India in *Commissioner of Income-tax v. Afco (Private) Ltd<sup>2</sup>*. There it was held that expression "cannot be made applicable" meant that the applicability of section 23A depended upon an order to be made by the Income-tax Officer and not upon any exclusion by the provisions of the Act. It was observed

"satisfaction of the Income-tax Officer as to the existence of several conditions prescribed thereby even if the company is one which does not fall within sub-

<sup>1</sup>(1959) 35 ITR 177

<sup>2</sup>(1963) 1 ITJ 175 : (1963) 1 SCJ 271 : (1963) 48 ITR 76

section (9) of section 23A is a condition of making of the order. The language used by the legislature clearly indicates that it is only when an order under section 23A will not, having regard to the circumstances, justified that the right to obtain rebate under the Finance Act (15 of 1955) is claimable."

10. The whole question revolves upon the meaning of the expression "actual cost". Does it mean the "original cost" or the "original cost less depreciation" ? Again if actual cost is to be computed as original cost less depreciation should the accumulated profits and reserves include the depreciation suffered ? Here the profits and reserves were said to be Rs. 37,97,985 as comprising of (a) general reserve Rs. 31,00,000, (b) dividend equalization reserve Rs. 5,00,000, (c) marine insurance fund Rs. 1,51,301, and (d) profit and loss account Rs. 46,684 as shown at page 18 of the paper-book. These certainly exceed the original cost of the assets (Rs. 50,90,335) less depreciation written off (Rs. 36,06,454) which amounts to Rs. 14,92,881. The contention on behalf of the revenue was that the actual cost was the last mentioned figure and if the actual cost is taken to be the original cost one has to add the depreciation written off (Rs. 36,06,454) to the total of items (a) to (d) above to find out the sum of accumulated profits and reserves.

11. Our attention was drawn to the use of the expression "actual cost" in three places in the Act, namely section 10(5), section 12B and section 23A. Section 10(2) enumerates the allowances which are to be taken into account in computing profits and gains of business, profession vocation etc. Section 10(5) provides a key to the meaning of certain expressions used in sub-section (2) of the section. It lays down that "written down value" means –

"(a) in the case of assets acquired in the previous year, the actual cost to the assessee : Provided that where, before the date of acquisition by the assessee, the assets were any time used by any other person for the purpose of his business and the Income-tax Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly, to the assessee was the reduction of a liability to income-tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as

the Income-tax Officer may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case :

Provided further that where before the date of acquisition by the assessee, the assets, which belonged to the assessee and had been used by him for the purposes of his business, profession or vocation, had ceased to be his property by reason of transfer or otherwise, the actual cost to the assessee shall be the actual cost to him when he first acquired the assets less all depreciation actually allowed to him under this Act or under any Act....

(b) in the case of assets acquired before the previous year the actual cost to the assessee less all depreciation actually allowed to him under this Act or any Act repealed thereby."

12. Broadly speaking the expression "actual cost to the assessee" means the amount in fact paid by the assessee subject to certain exceptions.

13. Ignoring the proviso to section 12B(2) the expression "actual cost to the assessee" would seem to indicate the amount actually paid by the assessee. The second proviso however reads :

"Provided further that where the capital asset is an respect of which the assessee has obtained depreciation allowance in any year, the actual cost of the asset to the assessee shall be its written down value, as defined in section 10, increased or diminished, as the case may be, by any adjustment made under clause (vii) of sub-section (2) of that section."

14. It would therefore appear that in using the expression "actual cost to the assessee" the legislature wanted to indicate the sum of money or moneys worth which it cost the assessee to acquire the asset. In special cases however the legislature indicated that the "actual cost to the assessee" might be determined at some other figure. The word "actual" means according to the Oxford Dictionary "existing in act or fact, really acted or acting, carried out, real as opposed to potential, possible, virtual, theoretical, ideal, etc." Again it may mean "in action or existence at the time, present, current." In my view, "actual cost" means "real cost" - the cost which the assessee incurred in act or fact. This can only mean the cost at which the assessee acquired the asset, namely, the original cost. This was the view taken in the Bombay High Court in *Habib Hussein v. Commissioner of Income-tax*<sup>3</sup>, and *Miss Dhun Dadabhoy Kapadia v. Commissioner of Income-tax*<sup>4</sup>,

15. I find myself unable to accept the contention raised on behalf of the revenue that if actual cost to the assessee means the cost originally incurred by it the reserves ought to include the amount of depreciation. Our attention was drawn to the "definition of depreciation and the consideration necessary to determine its rate" according to Spicer and Peglers well-known book on Book-keeping and Accounts, fourteenth edition, page 47. There the learned authors say that

"Depreciation is the measure of the effective life of an asset owing to use or obsolescence during given period. The object of providing for depreciation is to spread the expenditure incurred on the asset over its effective lifetime, and the amount written off during an accounting period is intended to represent the proportion of such expenditure which has expired during the period."

16. It was argued on the strength of the above that depreciation was really a reserve created out of profits. We do not think that is the correct view Under section 211 of the Indian Companies Act, the balance-sheet of the company has to prepared in the form prescribed in Schedule VI. The heads of reserve there shown are :

"(1) capital reserves, (2) capital redemption reserve, (3) share premium account, (4) other reserves specifying the nature of each reserve and the amount in respect thereof, (5) surplus, i.e., balance in profit and loss account after providing for

<sup>3</sup>(1963) 48 ITR 859

<sup>4</sup>(1963) 48 ITR 882

proposed allocations, namely, dividend, bonus or reserves, (6) proposed additions to reserves, and (7) sinking funds."

17. Depreciation does not find a place there but in Part III clause 7(1) (b) the expression "reserve" shall not, subjected as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability. It would therefore appear that a provision for depreciation was not to be included in any reserves. We find a similar provision in Schedule VIII, Part IV, of the English Companies Act of 1948. Clause 27(1) (b) gives the same interpretation of "reserve" as is to be found in our Companies Act. Mr. Pal drew our attention to the case of *Commissioner of Income-tax v. Bibhuti Bhusan Dutt*<sup>5</sup>, where a portion of the profits of a company was set apart for meeting depreciation of the fixed assets and this depreciation fund was added to year after and was shown as a reserve in the balance-sheet. There it was held that it formed part of the accumulated profits for the purpose of section 2(6A) of the Income-tax Act. It was said in that case that the assessee might not have created a reserve fund in respect of the depreciation but having done so, it was bound by its own act. If the company is not obliged to show depreciation in its balance-sheet by way of reserves and indeed ought not to do so under the form prescribed by section 211, depreciation cannot be considered in the context of reserves.

18. In this view of the matter, the proviso (b) to section 23A(1) of the Income-tax Act was not applicable to the assessee for the year 1955-56 on the facts of this case and the company was entitled to the rebate of one anna per rupee on the undistributed balance of the profits as provided in clause (i) of the proviso to item (b) of Part I of the Schedule to the Finance Act of 1955. The objection to the rebate was based only on the ground of applicability of section 23A. That being out of the way, the assessee was rightly held entitled to the rebate. The answers to both the questions, therefore, are in the affirmative and in favor of the assessee who will have the costs of

this reference.

Answered accordingly.

<sup>5</sup>(1963) 48 ITR 233