CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs

Schrader Scovill Duncan Ltd

(Sabyasachi Mukharji and S M Guha, JJ.)

30.07.1980

JUDGMENT

Sabyasachi Mukharji, J.

1. The question posed for our consideration in this reference under Section 256(1) of the I.T. Act, 1961, are as follows :

> "1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the income, profits and gains of a company not includible in its total income referred to in Rule 4 of the Second Schedule of the Companies (Profits) Surtax Act, 1964, applied only to those amounts, which are not includible in the total income by the provisions of Chapter III of the Income-tax Act, and not to any of the deductions claimable under Chapter VIA of the Income-tax Act, 1961 ?
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> 2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that there was no error in the order of the Income-tax Officer in not reducing the capital computed proportionately having regard to the deductions allowed under Sections 80-I and 80J of the Income-tax Act, 1961, and in that view cancelling the order of the Commissioner of Income-tax under Section 18 of the Companies (Profits) Surtax Act?"

2. This reference relates to the assessment years 1968-69, 1969-70 and 1970-71. For these assessment years, the surtax assessments made by the ITO were considered by the Commissioner of Income-tax to be erroneous and prejudicial to the interests of the revenue, since the capital computed was not proportionately reduced, having regard to the deductions allowed under Section 80-I and Section 80J of the I.T. Act, 1961, overlooking the provisions of Rule 4 of the Second Schedule to the C. (P.) S.T. Act, 1964. The Commissioner, therefore, after giving to the assessee-company a show-cause notice and considering the submissions made on behalf of the assessee-company in response thereto, had held that the capital computed should have been proportionately reduced, having regard to the deductions allowed under Sections 80-I and 80J, in

view of the provisions of Rule 4 of the Second Schedule to the C.(P.) S.T. Act, 1964. The Commissioner, accordingly, set aside the assessments made by the ITO and directed the ITO to compute the capital and make fresh assessments in accordance with law.

3. Being aggrieved by the order of the Commissioner, the assessee went up in appeal before the Income-tax Appellate Tribunal, The Appellate Tribunal considered the arguments advanced on behalf of the assessee as well as on behalf of the revenue and held that Rule 4 of the Second Schedule to the C.(P.) S.T. Act, 1964, applied only to those amounts which were not includible in the total income under the provisions of Chap. III of the I.T. Act and not to any of the deductions claimable or allowable under Chap. VI-A of the I.T. Act, 1961, and, therefore, there was no error in the order of the ITO in not reducing the capital computed proportionately, having regard to the deductions allowed under Sections 80-I and 80J and the order of the Commissioner on the basis of a contrary view taken by him was not correct. The appeal of the assessee was, therefore, allowed.

4. In the circumstances mentioned above, the two questions, as we have indicated before, have been referred to this court. The consideration of these two questions will naturally involve the construction, primarily, of the relevant provisions of the C. (P.) S.T. Act, 1964.

5. Section 2(5) of the said Act states that "chargeable profits "means the total income of an assessee computed under the I.T. Act, 1961, for any previous year or years, as the case may be, and adjusted in accordance with the provisions of the First Schedule.

6. Section 4 of the said C. (P.) S. T. Act is "charge of tax" and stipulates that subject to the provisions contained in that Act, there shall be charged on every company for every assessment year commencing on and from the 1st day of April, 1964, a 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 statutory deductions, at the rate or rates specified in the Third Schedule.

7. The computation of rate of tax is contemplated by the schedule and the First Schedule lays down rules for computing the chargeable profits as defined under Section 2(5) of the said Act. It stipulates that "in computing the chargeable profits of a previous year, the total income computed for that year under the Income-tax Act shall be adjusted" in the manner mentioned thereinafter. Thereafter, certain exclusions are stipulated, and it is also instructive to bear in mind Rule 4 of the Second Schedule which deals with the computation of the capital of a company for the purposes of surtax. Rule 4 stipulates that "where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, its capital shall be the sum ascertained in accordance with Rules 1, 2 and 3, diminished by an amount which bears to that sum the same proportion as the amount of the aforesaid income, profits and

gains bears to the total amount of its income, profits and gains". Therefore, in order to answer the questions posed before us, it is material to consider as to what is the meaning of the expression "total income of an assessee computed under the Income-tax Act". The meaning of "total income not includible in Rule 1 of the Second Schedule of the Super Profits Tax Act, 1963" was construed by a decision of this court in the case of Nava Bharat Vanijya Ltd. v. CIT [1980] 123 ITR 865, where the Division Bench of this court held that the word "includible" in Rule 1 of the Second Schedule to the S.P.T. Act, 1963, was indicative of the quality or description of the assets, the cost of which was to be excluded from the capital base. The word "includible", the Division Bench was of the view, meant capable of being included. The words "is not includible", therefore, meant "is not capable of being included". These could not mean "has not been included". This expression, which the Division Bench construed, as we have mentioned before, was in the context of the S.P.T. Act, 1963. Rule 3 of the Second Schedule to the S.P.T. Act, 1963, contained more or less similar expression as Rule 4 of the present Second Schedule to the C. (P.) S.T. Act, 1964. The said Rule 3 read as follows:

> "Where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, its capital shall be the sum ascertained in accordance with Rules 1 and 2, diminished by an amount which bears to that sum the same proportion as the amount of the aforesaid income, profits and gains bears to the total amount of its income, profits and gains."

8. If a certain income, therefore, is not capable of being included, it is only in respect of the capital in respect of that income which can be diminished under Rule 4 of the C. (P.) S. T. Act, 1964 of the Second Schedule. Therefore, we have to consider whether the deductions allowable under Sections 80-I and 80J of the I.T. Act, 1961, are incomes not capable of being included in the total income of the assessee. On a plain construction of the relevant provisions of the relevant statute, which we shall presently note, we are unable to accept the contentions urged on behalf of the revenue that these incomes were not capable of being included in the total income. It would, therefore, be appropriate to refer to some of the provisions of the I.T. Act which throw light on this aspect. Chapter III of the I.T. Act, 1961, deals with incomes which do not form part of the total income. Therefore, they do not enter into the total income at all. In Chap. III, Section 10 included the agricultural income. There are other items which would not be necessary for our present purpose to enumerate. Then there is Section 11 which deals with income from property held for charitable or religious purposes. There are similar other incomes which do not enter into the computation or form part of the total income, which can properly or briefly be said to be not capable of being included in the total income of an assessee. In this connection, it will also be appropriate to refer to the definition of total income in the I.T. Act, 1961. Section 2(45) stipulates "total income", which is referred to in Section 5 (as income) computed in the manner laid down

in the Act. Section 5 of the Act defines the scope of the total income and stipulates that the total income of any previous year, which is received, includes "all income from whatever source derived" and it is not necessary to enumerate the different items. Therefore, it is apparent that it should be income which is includible in the total income of the assessee, on the basis of the actual receipt or accrual as contemplated under Section 5 of the I.T. Act. Learned advocate for the revenue, in this connection, drew our attention to Section 66 of the I.T. Act, which is in Chap. VI which stipulates that in computing the total income of an assessee, there shall be included all income given under Chap. VII. Chapter VII provides for certain income which forms part of the total income but on which no income-tax is payable. It contemplates the income, for example, of a partner of an unregistered firm in certain contingencies or a member of an association of persons or body of individuals and all deductions under certain Govt. securities. Other provisions, which were there previously in Chap. VII, were excluded and now form part of Chap. VI-A. Chapter VI-A deals with "all deductions".

9. It stipulates that deductions be made in computing the total income. The expression "deduction" stipulates subtracting something which is already there. If something does not come into the computation then no question of deduction therefrom arises. Therefore, something which formed part of the total income was contemplated to be deducted from the total income. On the plain construction of the provision as it stands today, it does not mean that those incomes are not capable of being included in the total income of the assessee. Learned advocate for the revenue, however, placed some reliance on the definition of "gross total income" as contemplated under Section 80B appearing in Chap. VI-A which stipulates that "gross total income" means the total income computed in accordance with the provisions of this Act before making any deduction under this chapter or under Section 280-0. This expression "gross total income", in our opinion, in that chapter, in contradistinction to total income of the I.T. Act, as denned in Section 2(45), was introduced for making the calculations as contemplated under Chap. VI-A. This expression "gross total income" in Section 80B appearing in Chap. VI-A of the Act cannot mean the total income before making deductions in accordance with the provisions of that chapter. The relevant provisions with which we are concerned are Sections 80-I and 80J which are in Chap. VI-A. Section 80-I, of course, has been omitted with effect from 1st April, 1973, by amendment and the provision, as it stood at the relevant time, stipulated deductions in respect of profits and gains from persons engaged in certain industries and companies. It is not, however, necessary to set out the actual provisions of the said section. Section 80J, which is still retained, contemplates the deductions in respect of profits and gains from newly established hotel establishments and hotel business in certain cases.

10. Our attention was drawn to the Notes on Clauses of the Finance (No. 2) Bill of 1967, item No. 13 which sought to explain why Chap. VI-A was substituted. It stated that the new Chap. VI-

A sought, inter alia, to replace the existing provisions for grant of full or partial rebate of tax at the average rate of tax or charging of tax at a concessional rate on certain items of the income or payments contained in Chap. VII., Chap. VIII, and Chap. XII of the I.T. Act, by provisions for allowing a straight deduction of the whole or a specified percentage of the amount qualifying for the rebate or at a concessional rate of tax, in computing the total income (See [1967] 64 ITR (St.) 177).

11. Learned advocate for the revenue also drew our attention to the Notes on Clauses on the introduction of the C. (P.) S. T. Act, 1964, which stated that the Second Schedule contained the rules for the computation of the capital of the company for the purpose of determining the amount of "statutory deduction" admissible to a company. Under those rules, the capital of the company consists of the amounts, as on the first day of the relevant previous year, of its paid up capital, reserves (including the reserves required to be created under the Indian I.T. Act, 1922, and the I.T. Act, 1961, for entitlement to development rebate) debentures and specified loans. If a company possessed assets, the income from which was not taken into account in computing the chargeable profits under certain provisions of the First Schedule such as investments in shares of companies, the cost thereof, (subject to certain adjustments for borrowed moneys not included in the capital of the company) is required to be deducted from the capital aforesaid (See [1964] 51 ITR (St) 85).

12. As the provisions of the Act stand today, which we have mentioned hereinbefore, in our opinion, Chap. Ill read with Chap. VI-A, side by side, that is to say, the expression " income " which did not form part of the total income and " deductions " to be made in computing the total income, the deductions contemplated under Section 80-I and 80J cannot be described as income " not includible in the total income ". As contemplated by the provisions of the I.T. Act, the expressions mean in the sense of not capable of being included in the total income. If that is the position, then, in our opinion, the Tribunal was right in coming to its conclusion as it did. The scheme of Chap. VI-A was explained by the Supreme Court in the decision in the case of Cloth Traders (P.) Ltd. v. Addl. CIT , where at p. 258, inter alia, it was observed as follows :

> " The whole of such income, that is, income by way of dividends from a domestic company or 60 per cent. of such income, as the case may be, would be deductible from the gross total income for arriving at the total income of the assessee. The words 'where the gross total income of an assessee.....includes any income by way of dividends from a domestic company ' are intended only to provide that a particular category of income, namely, income by way of dividends from a domestic company, should form a component part of the gross total income. These words merely prescribe a condition for the applicability of the section, namely, that the gross total income must include the

category of income described by the words ' income by way of dividends from a domestic company'. If the gross total income includes this particular category of income, whatever by the quantum of such income included, the condition would be satisfied and the assessee would be eligible for deduction of the whole or 60 per cent. of 'such income'. Now, if the words 'where the gross total income of an assessee.....includes any income by way of dividends from a domestic company', in the opening part of the section, refer only to the inclusion of category of the income denoted by the words 'income by way of dividends from a domestic company' and not to the quantum of the income so included, the words such income' cannot have reference to the quantum of the income included, but they must be held referable only to the category of the income included, that is, income by way of dividends from a domestic company. The words 'such income' as a matter of plain grammar must be substituted by the words 'income by way of dividends from a domestic company' in order to arrive at a proper construction of the section and if that is done, it would be obvious that the deduction is to be in respect of the whole or 60 per cent. of the 'income by way of dividends from a domestic company' which can only mean the full amount of dividends received from a domestic company. The deduction permissible under the section is, therefore, to be calculated with reference to the full amount of dividends received from a domestic company, and not with reference to the dividend income as computed in accordance with the provisions of the Act, that is, after making deductions provided under the Act."

13. The view that we are taking on the construction of the section is in consonance with the views of several other High Courts and it would be appropriate to refer to some of these views.

14. In this connection, it would be proper first to refer to the decision of the Karnataka High Court in the case of *Stumpp Schuele & Somappa P. Ltd. v. Second*[1] There the court had to construe Rule 4 of the Second Schedule to the C. (P.) S. T. Act, 1964, in relation to the assessment year 1970-71. The learned judge held that the expression " income, profits and gains of a company not includible in its total income as computed under the Income-tax Act" refers only to those sums which are not includible in the total income by the provisions of Chap. III of the I.T. Act and does not refer to any of the deductions claimable under Chap. VI-A of the I.T. Act. Therefore, the claim of the authorities that there had been under-assessment could not be accepted in that case. The reasoning of the said decision was noted by the learned judges at pp. 324 to 326. We are in respectful agreement with the ratio of the said decision on the construction of the provisions of the statute at the relevant time.

15. The Division Bench decision of the Karnataka High Court on appeal from the aforesaid decision which confirmed the said decision is Second *ITO v. Stumpp, Schuele and Somappa P.*

Ltd.[2] There the Division Bench dealt with the contention more or less which is advanced before us by the learned advocate for the revenue on the construction of the expression "gross total income" in Section 80B of the I.T. Act, 1961, which occurs in Chap. VI-A. The Division Bench observed that it was difficult to discern any connection between the definition of gross total income in Section 80B and Rule 4 of the Second Schedule to the Act. The Division Bench noted that the definition was only for the purposes of Chap. VI-A and we are in respectful agreement with the said observation of the said Division Bench.

16. The Madras High Court in the case of Addl. CIT v. Bimetal Bearings Ltd. more or less the identical view. The Bombay High Court in the case of *CIT v. Century Spg. and Mfg. Co. Ltd*[3]. also was in agreement with that view.

17. The Division Bench of the Bombay High Court in the case of *Commr. of Surtax v. Ballarpur Industries Ltd*[4]. was of the view that the expression "not includible" in Rule 4 of the Second Schedule to the C. (P.) S.T. Act, 1964, meant "not capable of being included" which could not refer to an amount which already formed part of the gross total income and which would be later on deducted for the purpose of determining the tax liability under Chap VI-A. The Division Bench observed, in this connection, that the expression "shall not be included" which is found in Sections 10 and II in Chap. III was not used in any of the provisions of Chap. VI-A. Similarly, the said expression was not used in Chap. IV of the I T. Act which provided for the method of computing the income under which the assessee was allowed deduction by way of expenses, rebates and allowances, etc. Both in Chap. IV and Chap. VI-A, Parliament had consistently used the words "deduction shall be allowed" and not the expression " shall not be included". It was very clear, according to the Division Bench, that the expression "income, profits and gains of a company not includible in its total income as computed under the Income-tax Act" in Rule 4 referred to those sums which were not includible in the total income by the provisions of Chap. III of the I.T. Act and did not refer to any of the deductions claimable under Chap. VI-A of the Act. Hence, it was held that the amount of relief permissible by reason of the provisions contained in Section 80-I should not be deducted in determining the amount of capital of the company for the purpose of assessment to surtax.

18. The Madhya Pradesh High Court in the case of Gwalior Rayon Silk Mfg. (Wvg.) Co. Ltd. v. Jhawar, ITO , also expressed the same view.

19. Learned Advocate for the revenue sought to build up an argument by the fact that when the C. (P.) S.T. Act, 1964, was introduced, the prevalent law under the I.T. Act was Chap. VII, which included Section 84, which excluded income from certain undertakings with which Sections 80-I and 80J are concerned. Learned advocate sought to urge that the said Chap. VII stipulates that "incomes forming part of the total income on which no income-tax is payable". It was sought to

be urged that it was in this background, when the C. (P.) S.T. Act, 1964, was introduced, that the expression "not includible" in Rule 4 of the Second Schedule to the said Act should be construed. We are, however, unable to accept this contention. Knowing the background of the Act, the Legislature deliberately amended the Act, subsequently, and included the relevant provisions of Section 84 in Chap. VI-A and deleted it from Chap. VII. It may be for the purpose of giving special incentive to certain undertakings, but we are not entitled to, and do not intend to, speculate as to what was the intention of the Legislature. This provision should be construed strictly. On the construction of the section, we are of the view that incomes which are mentioned in Chap. VI-A are not includible and not capable of being included in the total income of the assessee as contemplated under Rule 4 of the Second Schedule to the C. (P.) S.T. Act, 1964.

20. Therefore, in consonance with the views taken by the other High Courts, we are of the view that the Tribunal was right in its conclusion and both the questions must, therefore, be answered in the affirmative and in favour of the assessee.

21. In the facts and circumstances, however, each party will pay and bear its own costs.

Sudhindra Mohan Guha, J.

I agree.

Cases Referred.

1ITO [1976] 102 ITR 320
2[1977] 106 ITR 399
3[1978] 111 ITR 6
4[1979] 116 ITR 528