

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX REFERENCE NO.164 OF 2000

M/s.Herdillia chemicals Limited,
18th Floor, Air India Building,
Nariman Point, Mumbai-400 021

Applicant

versus

The Commissioner of Income Tax,
City-III, Mumbai

Respondent

Mr.Niraj Seth i/by Mr.Rajesh Shah for applicant.
Mr.A.R.Malhotra with Mr.N.A.Kazi for respondent.

**CORAM : S.C.DHARMADHIKARI AND
PRAKASH D. NAIK, JJ.**

DATE : 29th September 2017

ORAL JUDGMENT - (Per : S.C.Dharmadhikari, J.) :-

1. The Income Tax Appellate Tribunal, Mumbai Bench 'C', Mumbai, at the instance of the assessee, has forwarded following questions for the opinion of this Court :

“1. Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in upholding the deduction of the amount of depreciation differential of Rs.2,43,11,321/- from the capital ?

2. Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in applying the devision of the Supreme Court in the case of Zenith Ltd. Vs. CIT (200 ITR 572-SC) without considering the assessee's claim relating to the deletion of the depreciation differential consequent upon distribution of dividends from year to year ?

3. *Whether in upholding the deduction of the amount of depreciation differential from the capital, the Tribunal has omitted to consider relevant material ?”*

2. Mr.Seth appearing on behalf of the assessee contended that the matter must really go back to the Tribunal. He would submit that the Tribunal has not decided the matter in accordance with the provisions of law and which were pressed into service in the backdrop of the facts. He would submit that the decision of this Court in the case of **Commissioner of Income Tax, Bombay City-III Vs. Zenith Steel Pipes Limited reported in (1978)-112-ITR-215 (Bombay)** was not concerned with that aspect of the matter, which was highlighted by the assessee. The Division Bench while deciding the Zenith Steel (supra) matter rested its conclusion on one aspect of the matter and that is with regard to the deduction for the purposes of charge of Surtax. Mr.Seth inviting our attention to the charging provision, would submit that Surtax Act states that subject to the provisions contained therein, there shall be charged on every company for every assessment year commencing on and from 1st April 1964 but before first day of April 1988, a tax referred to as Surtax, 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 deduction, at the rate specified in the third schedule. After inviting our attention to the definitions of the term 'Chargeable Profits' appearing in Section 2(5) and the definition of the term 'Statutory Deduction' as defined in Section 2(8) of the Surtax Act, it is submitted that the second schedule is referable to Section 2(8) of the Surtax Act. The second schedule of Surtax Act prescribes rules for computing the capital of a company for the purposes of Surtax.

3. Mr.Seth would submit that capital of the company shall be the aggregate of the amounts mentioned in Rule 1(i), (ii) and (iii) of the Second Schedule of Surtax Act. As far as we are concerned, Rule 1(iii) would be applicable. Thus, other reserves as reduced by the amounts credited to such reserves as have been allowed as deduction in computing the income of the company for the purposes of Indian Income Tax Act, 1922 or the Income Tax Act, 1961, would be the capital of the company. That is how the definition of the term 'Statutory Deduction' would have to be understood.

4. Mr.Seth submitted that the Tribunal erroneously held that the judgment of this Court in Zenith Steel Pipes (supra) concludes the issue. However, in the case of Zenith Steel Pipes (supra), applicability of later part of Rule 1(iii) was not in issue. Therefore, other reserves as reduced by the amounts credited to such reserves as have been allowed as deduction in computing the income of the company, would alone be the part of the aggregate and therefore, can be a capital of the company. In the instant case, there has been no satisfaction of this part namely crediting of the reserves of the amount which have been allowed as a deduction in computing the income of the company. Therefore, the Tribunal should have accepted the plea of rectification of the mistake and then re-heard the matter. Sine that has not been done, we must grant his request is the submission.

5. The precise argument is that in the present case there was a depreciation claim. The amount of depreciation is credited to the books of accounts. However, that amount should be credited to the

reserves. Crediting the amount of depreciation into books of account, does not mean that the differential amount is credited to the reserves of the company. Alternatively, if the amount, instead of crediting to reserves, is already spent on dividends, then, the same will not form part of the reserves within the meaning of clause (iii) of Rule 1. Mr.Seth, therefore, attempted to distinguish the judgment in the case of Zenith Steel Pipes (*supra*).

6. On the other hand, Mr.Malhotra, learned counsel appearing on behalf of the revenue, would submit that the matter stands concluded in favour of revenue and against the assessee. If Mr.Seth's argument and request is accepted, that would mean adding something to the provision or reading into it something which is expressly not there. If the second schedule and the rules therein and particularly Rule 1(iii) are read, there is no scope for accepting the alternate argument of Mr.Seth as well. There is nothing in this rule which would enable the assessee to argue that the reserves, as depleted by payment of dividend, should be reduced. These are the words read into by the assessee and the Legislature has not provided for anything other than the words specifically inserted therein. For all these reasons he would submit that the questions be answered against the assessee and in favour of revenue.

7. For properly appreciating the rival contentions, we must note the facts. The assessee before us is a public limited company. The accounting year for the surtax assessment is 1986-87. Under the Surtax Act, capital of the assessee as on the first day of the accounting year namely 1st July 1984 was to be computed. The capital was computed by taking into consideration the fact that the

assessee charges depreciation in its books of account under straight line method, which is permitted under the Companies Act, 1956. However, under the provisions of Income Tax Act, 1961, the assessee is required to claim deduction for depreciation only on the basis of written down value and in the income tax assessment, depreciation is allowed on a written down value basis. As a consequence of two different methods of computing the depreciation, there was a difference in the quantum of depreciation as per books of account and depreciation as per income tax assessment. This also resulted into diminished value under the straight line method exceeding the corresponding diminished value under the written down value basis, over the years. The position on 1st July 1984 was noted and the difference was worked out at Rs.2,43,11,321/-. In spite of the objection of the assessee, the assessing officer reduced this amount from the capital. This exercise of the assessing officer was confirmed in appeal by Commissioner (Appeals) by relying on the decision of this Court in Zenith Steel Pipes (supra).

8. Before the Tribunal the argument was that this decision is distinguishable on facts, particularly because in the instant case the entire differential which would have swelled the reserve, had been depleted by the amount of dividend declared over the years. The Tribunal did not agree. The assessee moved a miscellaneous application seeking to rectify the mistake and then relying upon an order passed by the Tribunal's coordinate Bench at Madras. The coordinate Bench of the Tribunal distinguished the view taken by this Court in Zenith Steel Pipes (supra). That is how Mr.Seth would submit that once the coordinate Bench of the Tribunal at Madras had taken a different view, then, interest of justice and fairness

demanded that the Tribunal should have re-heard the matter and re-considered the issue. When that request was even refused, then he would submit that we must remand the case.

9. We are unable to agree with Mr.Seth for more than one reason. The charge of tax appearing in Section 4 means as under :

“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 first day of April, 1964 (but before the first day of April, 1988), a tax (in this Act referred to as the surtax) 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 deduction, at the rate or rates specified in the third Schedule.”

Thus, there shall be charged on every company for every assessment year commencing on and from 1st April 1964 but before 1st April 1988 a tax which is referred to as the Surtax, 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 deduction, at the rate or rates specified in the third schedule.

The definitions are contained in Section 2 and we are concerned with terms 'chargeable profits' and 'statutory deductions'. The term 'chargeable profits' is defined in Section 2(5) to mean that total income of an assessee computed under the Income Tax Act, 1961 (43 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 term 'statutory deduction' is defined in Section 2(8) to mean :

“an amount equal to fifteen per cent of the capital of the company as computed in accordance with the provisions of the Second Schedule, or an amount of two hundred 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 fifteen per cent or, as the case may be, of two hundred 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; and (9) all other words and expressions used herein but not defined and defined in the Income-Tax Act shall have the meanings respectively assigned to them in that Act.”

10. A perusal of this definition would indicate that statutory deduction means an amount equal to 15% of the capital of the company as computed in accordance with the provisions of Second Schedule, or an amount of Rs.2,00,000/-, whichever is greater. Once the charging section says that this tax is 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 deduction, at the rate or rates specified in the Third Schedule, and chargeable profits means total income of an assessee computed under the Income Tax Act for any previous year and years, and adjusted in accordance with the provisions of First Schedule, we cannot rest our opinion only by reading these two provisions namely Section 4 and Section 2(5), because the tax is 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 deduction. Therefore, we reproduced Section 2(8) and which defines the term `statutory deduction'.

11. Now, the rules in Second Schedule for computing the capital of the company for the purpose of Surtax have to be referred. Rule 1 says that subject to other provisions contained in the schedule namely Second Schedule, the capital of a company shall be the aggregate of the amounts, as on the first day of the previous year relevant to the assessment year of and for that purpose we reproduce Rule 1 with clauses thereof :

“(i) its paid-up share capital;

(ii) its reserves, if any, created under the proviso (b) to clause (vib) of sub-section (2) of section 10 of the Indian Income-Tax Act, 1922 (11 of 1922) or under sub-section (4) of Section 32A, or sub-section (3) of Section 34 of the Income-tax Act, 1961 (43 of 1961);

(iii) its other reserves as reduced by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Indian Income-tax Act, 1922 or the Income-tax Act, 1961.

(1A) Where a company has not made any credit in any account in its books as on the first day of the previous year relevant to the assessment year which is of the nature of item (8) or item (9) under the heading 'Current Liabilities and Provisions' in the column relating to 'Liabilities' in the 'Form of Balance Sheet', given in Part I of Schedule VI to the Companies Act, 1956, or where the Income-tax Officer is of opinion that the amount credited in such account falls short of the amount which should have reasonably been credited by it the amount of its capital as computed under rule I shall be reduced by the amount which has not been so credited or, as the case may be, the amount of such shortfall.

Explanation - For the purposes of this rule, the amount of credit which should have reasonably been made by a

company in relation to any account of the nature of item (9) aforesaid, means the amount of dividend declared or paid by the company, on or after the first day of the previous year relevant to the assessment year, for the previous year immediately preceding the first mentioned previous year.”

12. The argument is that the aggregate of the paid up share capital, reserves, other reserves would mean capital of the company. However, the other reserves have to be reduced by the amounts credited to such reserves as have been allowed as deductions in computing the income of the company for the purpose of income tax.

13. In Zenith Steel Pipes (supra), this Court was required to answer three questions placed for its opinion. All the questions are relevant for our purposes and we reproduce them hereinbelow :

“1. Whether, on the facts and in the circumstances of the case, the sums of Rs.4,20,000/- and Rs.5,59,756/- being the dividend recommended by the board of directors of the assessee for the respective years ended 30th April, 1963, and 30th April, 1964, were to be treated as part of ‘other reserves’ for the purpose of computation of capital base for the year concerned ?

2. Whether, on the facts and in the circumstances of the case, the entire difference between the depreciation actually allowed to the assessee for the assessment year 1964-65/1965-66, and actually provided in the accounts of the year concerned should be deducted from the respective ‘general reserves’ amounts of Rs.7,50,000/- and Rs.37,00,000/- and the balance amount should be taken into account in the capital computation base for the year concerned ?

3. Whether, on the facts and in the circumstances of the case, for the purpose of computation of ‘other reserves’ under rule 1(iii) of the Second Schedule to the

Companies (Profits) Surtax Act, 1964, deduction for depreciation under the Income-tax Act for the assessment years 1964-65 and 1965-66 could be said to have been allowed to the assessee as on the respective first day of the previous year concerned, even though, factually, its income-tax assessments for the said assessment years were completed after the respective first day of the previous year ?”

14. The Hon'ble Division Bench noted the relevant facts. It held that two questions arise out of Surtax liability for the A.Y.1965-66 and 1966-67. The balance sheet and profit and loss account as prepared by the company in the manner noted by the Bench, were ultimately approved by the shareholders. The depreciation was worked out by same method namely straight line method. Income Tax Officer held that the company ought to have provided a sum of Rs.17,39,255/- by way of depreciation and what has been actually provided was lesser than that which ought to have been provided. He took the view that the whole of the sum which was transferred to the general reserve was not liable to be taken into account in the computation of capital as on 1st May 1963. This was the view also for the A.Y.1966-67. However, the appellate authority which was approached, had to decide two contentions, one of which was that the conditions in clause-(iii) of Rule 1 of Second Schedule have to be satisfied. Mr.Seth relies upon these conditions but would read something further in them. The Division Bench held as under :

“... .. The two questions which are for our consideration, one at the instance of the revenue and the other at the instance of the assessee, depend upon the interpretation of the provisions contained in clause (iii) of rule 1 of the Second Schedule to the Act. Under section 4, which is a charging section of the Act, surtax is leviable in respect of so much of the chargeable profits of the

company of the previous year or previous years, as the case may be, as exceed the statutory deduction, at the rate or rates specified in the Third Schedule. The expression "statutory deduction" is defined in section 2(8) as meaning an amount equal to ten per cent of the capital of the company as computed in accordance with the provisions of the Second Schedule or an amount of two hundred thousand rupees, whichever is greater. There are two provisions to this definition but they are not relevant for the present purpose. The Second Schedule lays down the rules for computation of capital of a company for the purpose of surtax. We are concerned in the present case with the provisions of clause (iii) of rule 1 and its provisions are as under :

1. Subject to the other provisions contained in this Schedule, the capital of a company shall be the aggregate of the amounts, as on the first day of the previous year relevant to the assessment year, of -

(i) its paid-up share capital;

(ii) its reserves, if any, created under the proviso (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;

(iii) its other reserves as reduced by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Indian Income-tax Act, 1922, or the Income-tax Act, 1961

The sum of Rs.7,50,000 which stands to the credit of the general reserve as on May 1, 1963, and the sum of Rs.37,00,000 which stands to the credit of the general reserve as on May 1, 1964, are "other reserves" within the meaning of clause (iii). The short question that we have to consider is whether in computation of capital the entire amount of "other reserves" is to be included or any deduction has to be made therefrom for the two respective years in view of the provisions contained in clause (iii). If regard be had to the very plain language used in clause

(iii), it is very clear that the entire amount of other reserves is not to be included in the computation of capital but it is the balance of the amount of "other reserves" as subjected to the deductions therein provided which is to be included. The reduction has to be made "by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Indian Income-tax Act, 1922, or the Income-tax Act, 1961. It is common ground and it cannot be disputed having regard to the facts determined by the taxing authorities and the Tribunal that the assessee, as it was following the straight-line method of depreciation, provided depreciation at an amount lesser than that was permitted to it in its assessment under the Indian Income-tax Act. For the year ending April 30, 1963, it merely provided a sum of Rs.4,86,298 as and by way of depreciation while the Appellate Assistant Commissioner found as a fact that the assessee-company was entitled to provide Rs.10,54,410 by way of depreciation in respect of its profits for the period ending April 30, 1963. Similarly, the aggregate depreciation provided as on April 30, 1964, in the books of the assessee-company was Rs.12,72,908 while the Appellate Assistant Commissioner allowed by way of depreciation up to that year the sum of Rs.27,59,923. Thus for the year ending April 30, 1963, a sum of Rs.5,68,112 was allowed as depreciation in addition to the sum provided in the books of the assessee-company, while for the year ending April 30, 1964, a sum of Rs.12,52,957 was allowed as depreciation in excess of what was provided by the assessee-company in its books. The questions which are raised are in relation to these amounts and whether any part thereof is liable to be deducted merely on the ground that they are credited to "other reserves", i.e. general reserves in the present case. As the assessee-company provided lesser amount by way of depreciation than what was allowed in the computation of the income of the assessee-company for purposes of the Income-tax Act, 1961, the difference between the amount of depreciation actually allowed to the assessee and the amount actually provided in its books, was forming part of the general reserve. It is,

therefore, quite apparent that the assessee-company when it asked for deduction of depreciation for the purposes of income-tax was conscious of the fact that the depreciation provided for was insufficient as per the provisions of the Income-tax Act and, in fact, the contention of the assessee-company was accepted because the depreciation in its books of account was provided on the footing of straight-line method while in fact the depreciation to be calculated in accordance with the provisions of the Income-tax Act was much larger. For computing its income for the purposes of the Income-tax Act such larger amount of depreciation was allowed and the excess amount, i.e. the amount of difference between the amount of depreciation actually allowed for the purposes of the Income-tax Act and the amount of depreciation actually provided in the books of the assessee-company, was diverted as forming part of the general reserve and actually the amounts that were credited to the general reserve included within its item such difference between the amount of depreciation allowed for the purposes of Income-tax Act and the amount of depreciation actually provided in the books. Thus, on a plain interpretation of the language used in clause (iii) of rule 1 of the Second Schedule to the Act, it is quite apparent that if the amount of depreciation provided in the books of the assessee-company for a particular year is less than the amount of depreciation actually allowed by the Income-tax Officer for computation of the income, then the difference between these two amounts has to be deducted from the amount standing to the credit of "other reserves", namely, general reserve, so far as the facts of this case are concerned. Thus, the Appellate Assistant Commissioner was right in taking the view that for the first year a sum of Rs.5,68,112 ought to be deducted from the amount of general reserve of Rs.7,50,000 and a sum of Rs.12,52,957 ought to have been deducted from the amount of general reserve of Rs.37,00,000 for the second year.

... .. What is required to be considered having regard to the language of clause (iii) of rule 1 of the Second Schedule to the Act as well as the circular referred to by Mr.Toprani is when for the

purposes of surtax the capital has to be computed as required by the Second Schedule to the Act whether depreciation has been allowed under the Income-tax Act for the relevant year; and if it is so allowed, then if the provisions of clause (iii) of rule 1 are attracted, they are to be given effect to.”

15. Mr.Malhotra is right in his contention that merely because a coordinate Bench has distinguished a judgment of this Court in Zenith Steel Pipes (supra), we must not remit the questions back to the Tribunal. Firstly he would submit that the coordinate Bench was sitting at Madras. The Tribunal's coordinate Bench at Madras was bound by the judgment and order of the jurisdictional High Court. The jurisdictional High Court for that Tribunal is not this Court, but High Court of Madras, at Madras. Secondly, in that case, the Tribunal found on facts that the issue of Companies (Profits) Surtax Act, 1964 levying additional tax on the total income of a company in the manner stipulated by the Act, was brought in issue by the assessee. The assessee argued that Surtax is charged over and above the statutory deductions. The First Schedule to the Act contains the rules for computing the chargeable profits and Second Schedule contains rules for computing the capital base of the company. The assessee raised for consideration the question whether investment allowance granted to assessee under Section 32(1) of the Act could be treated as income, profits and gains not includible in the total income. The Tribunal held that neither in law nor in logic is there any warrant for treating the said allowance as income not includible in the total income of the assessee. The Tribunal then considered in one set of appeals an issue with which we are not concerned. However, as per interpretation of Rule 1(iii) of the Second Schedule is concerned, it found that the case of the assessee there was that the

amount of depreciation allowed as deduction, was in excess of the amount of depreciation charged on the tax of amount of the assessee. The argument of the assessee was that Rule 1 of the Second Schedule does not contemplate any adjustments as regards paid up capital. Therefore, even on footing that the aggregate differential went to augment the general reserve, as long as the amount capitalised out of the general reserve is more than the amount represented by the aggregate differential, the department cannot insist on tracing the aggregate differential to general reserve alone. The alternate argument was that a part of the general reserve might well have been declared as dividend. In such case also the assessee could attribute such payments to the aggregate differential. The Tribunal then went on to refer to the law and equally to all other aspects but what it found that conditions and three in number as enumerated in Rule 1(iii) would have to be satisfied. Firstly there should be reserve; secondly amount should have been credited to such reserve, by conscious overt act on the part of Board of Directors. Thirdly, the amount credited to reserve must have been allowed as deduction in computing the income of the company for the purposes of income tax. The Tribunal found that in the case before it, these conditions have not been satisfied. In the case before the Tribunal in respect of differential, there is no reserve credited by the board of directors through a conscious overt act, nor is there any crediting of amount to any reserve by a conscious overt act on the part of board of directors. Of course, a large amount has been allowed in the income tax proceedings as and by way of depreciation. But the other two conditions were not satisfied. That is why the Tribunal found that there was no need to reduce the capital base by differential.

16. It is these facts of the matter which enabled the coordinate Bench of the Tribunal at Madras to observe that true it is that in the case of Zenith Steel Pipes (supra) this Court has taken a view which supports the revenue, but the contentions advanced before the Tribunal's coordinate Bench at Madras and considered by it, were not advanced before the Bombay High Court. It is in these circumstances that the coordinate Bench of the Tribunal distinguished it. We do not see how in the abstract and de-hors the factual backdrop Mr.Seth can rely upon the view of the coordinate Bench of the Tribunal.

17. As far as the Income Tax Appellate Tribunal, Mumbai Bench is concerned, it was bound by the judgment of this Court in Zenith Steel Pipes (supra) and when it applies with full force to the facts also.

18. In our view, therefore, none of the contentions of Mr.Seth can be accepted. The questions which have been forwarded for our opinion by the Tribunal are answered against the assessee and in favour of revenue. Moreso, when there is no scope for reading anything further in the provision namely Rule 1(iii) after the conditions set out therein are satisfied. The reference is thus disposed off.

(PRAKASH D. NAIK, J.)

(S.C.DHARMADHIKARI, J.)