

M/S. SUNDARAM CLAYTON LTD. ETC.

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v.

COMMISSIONER OF INCOME TAX

MAY 2, 1996

[G.N. RAY AND B.L. HANSARIA, JJ.]

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*Companies (Profits) Surtax Act 1964—Schedule II, Rule 3—Computation of capital—Whether bonus issue of shares resulted in proportionate increase in share capital—Held, no; issue of bonus shares only resulted in conversion of reserves and did not add to the capital base which was not there on the first day of the previous year.*

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*Companies (Profits) Surtax Act 1964, Schedule II, Rules 1 (iv), (v) and 3—Computation of capital—Held, for assessee to benefit from second part of Rule 3 capital base must have increased during previous year on account of increase of paid-up share capital or issue of debentures or borrowing of any moneys.*

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*Interpretation of Statutes—Super Profits Tax Act 1963—Schedule II, Rule 2—Held, being different, not germane for interpreting Rule 3 of Schedule II of Companies (Profits) Surtax Act 1964.*

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The reference before the High Court raised a short question about the computation of capital under Rule 3 of the Schedule II of the Companies (Profits) Surtax Act, 1964 ('Surtax Act'). In the assessment year 1971-72, corresponding to previous year beginning from August 1, 1969 and ending on July 31, 1970, the appellant-Company, SCL, issued 20400 bonus shares of the face value of Rs. 100 each. SCL claimed that Rs. 20,40,000 which represented the bonus issue as on February 23, 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. August 1, 1969. It was claimed that since the bonus shares were in addition to the paid up capital of the company, and since any "increase" in the paid up capital was to be properly reckoned for the purpose of computation of capital under Rule 3 of Schedule II of the surtax Act, the proportionate amount, worked out to Rs. 6,84,237, must be added to the capital as on August 1, 1969 for the purpose of capital computation.

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A Although the Income Tax officer rejected SCL's contention, the Income Tax Appellate Tribunal accepted its claim. A reference under s.256(1) of the Income Tax Act, 1961 was then made by the department before the Madras High Court for answering the question whether for the computation of capital under the Surtax Act the share capital of SCL should be proportionately increased on account of the issue of bonus shares.

B The Madras High Court, while answering the reference against the assessee SCL, relied on the decision of the Bombay High Court in *Commissioner of Income Tax v. Century Spinning and Manufacturing Company Ltd.*, 101 ITR 6 and noted the decision of the Delhi High Court in *Commissioner of Surtax v. Food Specialities Ltd.*, 129 ITR 731. The High Court did not agree with the decision of the Himachal Pradesh High Court in *Commissioner of Income Tax v. Mohan Meakin Breweries Ltd.*, 93 ITR 586 on the ground that the said decision proceeded on the application of Rule 2 of Schedule II of the Super Profits Tax Act, 1963 which was not *pari materia* with Rule 3 of Schedule II of the Surtax Act.

C Before this court the assessee reiterated its reliance upon the decision in *Mohan Meakins Breweries* and contended that Rule 2 of the Super Profits Act, 1963 being similar to Rule 3 of the Surtax Act, a plain reading of the rules would result in the bonus issue qualifying for proportionate inclusion in the capital base.

D Dismissing the appeal, this Court

E HELD : 1. By the issuance of 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. [263-D]

F *Commissioner of Income Tax v. Century Spinning and Manufacturing Company Ltd.*, (Bom) and *Commissioner of Surtax v. Food Specialities Ltd.*, (Del), approved.

G *Cape Brandy Syndicate v. Commissioners of Inland Revenue*, (1921) 1 KB 64, referred to.

H 2. In order that Rule 3 could apply, the capital base of the company, as computed in accordance with Rule 1 of Schedule II of the Surtax Act

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 the benefit contemplated by the second part of Rule 3 of Schedule II of the Surtax Act. [263-E-F]

*Commissioner of Surtax v. New India Industries Ltd.*, 202 ITR 619 (Guj.), approved.

3. The incidence of Rule 2 of the 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 the Surtax Act. [263-H]

*Commissioner of Income tax v. Mohan Meakin Breweries Ltd.*, 93 ITR 586, overruled.

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 4360-61 (NT) of 1981 Etc.

From the Judgment and Order dated 21.10.81 of the Madras High Court in T.C. Nos. 743-44/77 Reference Nos. 495-96 of 1977.

Ms. Janki Ramachandran Adv. for the Appellants.

G.C. Sharma and Dr. R.R. Mishra, B.S. Ahuja and S.N. Terdol for the Respondent.

The Judgment of the Court was delivered by

G.N. RAY, J. Civil Appeal Nos. 1360-61 of 1981 are directed against judgment dated October 21, 1981 passed by the Division Bench of Madras High Court in Tax Case 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 November 12, 1986 passed by the Division Bench of Madras High Court in Tax Case Petition No. 367 of 1986. It may be stated here that the 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 Case Nos. 743-744 of 1977. It will, therefore, be appropriate to refer to the relevant facts relating to Tax Case Nos. 743-744 of 1977 which were

A disposed of by the Madras High Court on October 21, 1981.

B Tax Case 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 the 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 moping 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.

D 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 August 1, 1966 and ending on July 31, 1970, the appellant-Company, M/s. Sundaram Clayton Ltd., issued 20400 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 issue as on February 23, 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. August 1, 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, worked out to Rs. 8,84,237, must be added to the capital as on August 1, 1969 for the purpose of capital computation.

H 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 :

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"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?"

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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, get 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 balance sheet. In other words, there must be a fresh influx of capital in order to attract Rule 3 of Schedule II of the Surtax Act, 1964.

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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 in 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 common-sense 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 *Commissioner of Income Tax v. Century Spinning and Manufacturing Company Ltd.*, 101 ITR 6. The High Court also noted the decision of the Delhi High Court in *Commissioner of Surtax v. Food Specialities Ltd.*, 129 ITR 731 which held the similar view. The Delhi High Court in the said decision also referred to the decision of the Bombay High

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A Court in *Century Spinning Mill's* case (supra).

B On behalf of the assessee, however, reliance was placed on a decision of the Himachal Pradesh High Court in *Commissioner of Income Tax v. Mohan Meakin Breweries Ltd.*, 95 ITR 586. In the said case, interpretation of Rule 2 of Schedule II of Super Profits 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 Spinning Mill's* case (supra) 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.

E It may be stated here that two other questions were also referred to before the High Court in Tax Case 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 v. Commissioner of Income Tax*, 130 ITR 545 and in *Additional Commissioner of Income Tax v. Bimetal Bearings Ltd.*, 110 ITR 131. 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.

G 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 revenue and against the assessee-Company by holding that the finding made by the Income Tax Appellate Tribunal that by issue of bonus shares in the assessment year in question had resulted in increase in capital asset 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.

Mrs. Janki 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 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 the Schedule II of the Surtax Act, 1964.

*Rule 2 of Second Schedule of Super Profits Tax Act, 1963.*

Where after the first day of the previous year relevant to the assessment year, the paid up capital of a company is increased or reduced by any amount during the 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 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)

A 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. Commissioners of Inland Revenue*, (1921) 1 King's Bench 64. She has submitted that this Court has also followed the view taken in *Cape Brandy's* case (supra) in the case reported in 60 ITR 392 by observing to the following effect :

G "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 the 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

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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." A

Mrs. Ramachandran has submitted that the Bombay High Court in *Century Spinning Mill's* case (supra) did not spell out as to why Rule 2 of Super Profits Tax Act 1963 and Rule 3 of Surtax Act, 1964 was different. B  
The Delhi High Court in *Food Specialities* case (supra) 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 taken by the Income Tax Appellate Tribunal in favour of the assessee. C D

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 *Commissioner of Surtax v. New India Industries Ltd.* 202 ITR 619 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 E F G H

A 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 concerned amounts 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.

D 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 increased in the paid up share capital, without reference to any increase in the 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 (supra) 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 debenture 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 been 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 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.

After giving our careful consideration of 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* case (supra) 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 1 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.

The Bombay, Madras and Delhi High Court 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

A 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 the principle of interpretation of taxing statute do not call for any change in the view we have taken on the language of the Rule.

B 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.

S.M.

Appeals dismissed.