

Srf Ltd. Vs. Assistant Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Aug-30-1993

Reported in : (1993)47ITD504(Delhi)

Judge : A Kalyanasundharam, M Bakshi

Appellant : Srf Ltd.

Respondent : Assistant Commissioner of

Judgement :

1. The assessee, a limited company, has filed this appeal aggrieved by the order of CIT (Appeals) and has raised as many as nine grounds of appeal, before us. This appeal has two distinct parts, issues raised as grounds 1 & 2 are related to the computation of the book profit under Section 115J of the Act and issues raised as grounds 3 to 9 relate to the computation of the profit and gains from business or profession within the meaning of Sections 28 to 43A of the Act. The counsel addressed us initially with reference to grounds numbering 3 to 9, followed by the grounds numbering 1 & 2 and we are dealing with the issues as raised, as argued before us, in that order.

2. The assessee, has raised a very strange claim as its grounds of appeal No. 3 and had contended that, the statutory deduction under Section 37(2A) of the Act, of Rs. 5,000 is to be allowed from the profit of each of the business units, treating them to be separate undertakings. The contention was that, the authorities below, were in error in allowing one consolidated statutory deduction of Rs. 5,000 on the

entertainment allowance, while Rs. 5,000 should have been allowed as a deduction from the profits of each of the business units. The plea was that, this claim has the recognition in *Garden Silk Wvg. Factory v. CIT* [1991] 189 ITR 512 (SC), *Dr. B.A. Rajakrishnan v. ITO* [1986] 15 ITD 33 (Coch.), *First ITO v. Yash Raj Chopra* [1984] 10 ITD 709 (Bom.) and by the Special Bench in *Ranbir Raj Kapoor v. ITO* [1988] 25 ITD 56 (Bom.)(SB). The departmental representative placed reliance on the orders.

3. The rival submissions in this regard have been given our very careful consideration. Section 37(2A) of the Act prescribes amount of allowance from the expenditure in the nature of entertainment incurred by an assessee, while computing the income from profits and gains from business or profession, of that assessee. It states that, the maximum allowance is limited to 1/2% or Rs. 5,000, whichever is higher on the first Rs. 10 lakhs of the profit and gains from business or profession, on the next Rs. 40 lakhs of the profits or gains from business or profession 1/4% shall be allowable and on the balance of the profits and gains from business or profession 1/4% shall be allowed. The assessee, may be having several business units, but, since, the emphasis of allowance is on the assessee, it clearly is suggestive of the consolidated amount expended on entertainment expenditure by an assessee. Therefore, the statutory deduction of Rs. 5,000 is allowable to the assessee, only once and not severally as pleaded by the assessee, unless each of the business units themselves are separate assesseees. The plea of the assessee of treatment of each of the business unit separately, has been raised with reference to the various decisions cited by it, in which cases, the issue revolved around deducibility of expenditure in the nature of advertisement, publicity or sales promotion under Section 37(3A) of the Act. In all those decisions, the issue was with reference to Sub-section (3D) of Section 37, which stated that, the provisions contained in Sub-section (3A), would not apply to an assessee who has set up an industrial unit in the previous year to manufacture or produce any article or thing, in the year in which the production commences and to the following two previous years. There being no such similar reference in Sub-section (3D) to Section 37, to the Sub-section (2A) of Section 37, the decisions are not applicable to the present issue before us. The ratio in *Garden Silk Weaving Factory* is only suggestive of the normal manner of computation of income from business, i.e., it

only suggests that, the income from business of each of the business unit is to be computed and then to be aggregated, for determination of the income from business of the assessee. It does not lay down the proposition that is desired by the assessee, because, in the computation of the allowance under Section 37(2A), it suggests for the consolidation of the entertainment expenditure as incurred by all of the business unit.

Hence, we do not see merit in the claim advanced by the assessee and thus reject it.

4. The claim on the aspect of working out of the disallowance from the travelling expenses under Section 37(3), read with Rule 6D of the IT Rules, 1962, is the issue that has been raised as ground No. 4. The appellant company, has incurred travelling expenses on four of its business units. The claim of the appellant is that, the disallowance should be worked out by consolidating all of the travel undertaken by each of the employees in a year and then applying the rate of admissible travel allowance, so that, excess in one trip would get adjusted against another, where the expenses would be very much below the allowable limit. This plea is based on the decisions of the Tribunal, in IT Appeal No. 6322 (Delhi) of 1985, assessment year 1982-83, of Bharat Commerce Industries Ltd. v. ITO and on S.V. Ghatalia v. Second ITO [1983] 4 ITD 583 (Bom.). The above cited decisions have been consistently followed by the Tribunal and hence, for the sake of consistency, we shall uphold the claim and direct the Assessing Officer to work out the disallowance by consolidating all of the travel undertaken by each of the employees in a year and then work out the disallowance by applying Rule 6D of the IT Rules, 1962.

5. The claim as advanced by the assessee in its fifth grounds of appeal, is that, the rent, repair and expenditure on the guest house expenses that are normally allowed under Sections 30, 31 & 32 of the Act, could not be reconsidered for working out the disallowance under Section 37(4) of the Act, in support of which, the decision of the Tribunal, in its own case for the assessment year 1983-84 has been furnished in the paper book at pages 92 to 104. Expenditure as has been incurred by the assessee, Rs. 2,13,929 on rent and Rs. 55,086 on repairs of guest

house, was stated to be normally allowable under Sections 30 & 31 of the Act, which expenditure, have been disallowed, by applying Section 37(4) of the Act. Reliance was also placed on the decision of the Gujarat High Court in CIT v. Kaira District Co-operative Milk Purchasers Union Ltd. [1991] 192 ITR 608. Since, in the assessment year 1983-84, the Delhi Benches of the Tribunal in the assessee's own case, had applied the decisions of the Bombay High Court in CIT v. Chase Bright Steel Ltd. [1989] 177 ITR 124 and on Kaira District Co-operative Milk Purchasers Union's case [supra] and had held that, the expenses as are normally allowed under Sections 30 & 31 of the Act, could not be disallowed under Section 37(4) of the Act, for the sake of consistency, respectfully following the earlier orders as above, we allow this claim of the assessee.

6. The counsel Sh. Syali did not seriously contested the grounds of appeals numbered as No. 6 relating to the disallowance under Section 40A(3), disallowance out of foreign travel, treating it to be on capital account, as No. 7 and non-allowing of professional expenses on new line of activity of Rs. 2,10,000 as No. 8 and hence, we reject these three grounds of appeal as without any merit.

7. The assessee, has raised the issue of allowing of investment allowance on that part of the cost of the assets comprising of the difference in the exchange fluctuation, to the tune of Rs. 45,85,769, as its ground No. 9. The identical issue was considered by the Tribunal, in the case of the assessee, for the assessment year 1983-84, where it was held that, Section 43A does not debar the claim of allowing of investment allowance on that portion of the cost, that has been enhanced due to the exchange fluctuation, unlike the specific bar on allowing of development rebate under Section 33, on the enhancement caused due to the exchange fluctuation, as was held by Supreme Court in CIT v. Arvind Mills Ltd. [1992] 193 ITR 255. Respectfully following the earlier decision of the Tribunal in the case of the appellant, we allow this claim in favour of the assessee.

8. The appellant-company, has raised the following ground as ground No.1 relating to its claim under Section 115J of the Act : 1. That on the facts and in the circumstances of the case and in law the CIT (Appeals) erred in restoring the addition made to the book profits under Section 115J of the Act to the file of the

Assessing Officer: (i) as the question involved was purely legal and no fresh investigation of facts was required, (ii) without giving a specific direction to dispose of the ground as contemplated in Clause (a) of Section 251(1) of the Act, and 9. The Assessing Officer, directed the appellant company to furnish a computation of its book profit as under Section 115J of the Act. The appellant, complied with this direction and according to the said computation, the book profit was shown at a loss of Rs. 10,50,98,557.

The computation as submitted by the appellant company, is reproduced below for the sake of convenience :

4. Leasing Division	9,33,344	-----	Book Profit
10,50,98,557	-----	10.	The Assessing Officer, had noted that, the depreciation as was charged to the profit & loss a/c, was Rs. 21,62,23,154 and the depreciation as was allowable as per the Income-tax Rules was Rs. 5,49,28,878 and that, the profit & loss appropriation a/c was credited with an amount that represented withdrawal from revaluation reserve account, equal to the figure of depreciation on the revaluation of the assets. He was of the opinion that, the purpose of crediting the profit & loss account by the amount from the revaluation reserve account, was to bring down the charge of depreciation on the historical cost of the assets, which is relevant for declaration of dividend. The Assessing Officer rejected the computation of the book profits, because, (a) it did not reflect the credit representing the amount transferred from revaluation reserve account, which should have either been credited to the profit & loss account or reduced from the depreciation charged to the profit & loss account; (b) depreciation as was charged to the profit & loss a/c was at historical cost plus a percentage of the revaluation of the assets, thus reducing and depicting a lower quantum of profit; and (c) Section 115J of the Act, does not permit the exclusion of the amount withdrawn from the revaluation reserve, from the term book profits. The Assessing Officer, while computing the book profits under Section 115J of the Act, had observed-
Net Profit as per P & L a/c:	ISD Rs. Rs. 9,46,41,956	Less:	Excess depreciation of earlier
7,19,73,684	years written back (LD)	5,170	-----
Taxable Book Profit under Section 115J-	2,15,90,514	@ 30% of Rs. 7,19,68,514	11.

The assessee objected to the above computation and had raised very detailed contentions before the CIT (Appeals). The submission was that, it was on the advice of the Financial Institutions in 1983 & 1986, that the assets were revalued

so as to reflect the replacement cost of the assets, in the balance sheet of the company. This was so advised keeping in view the inflationary trends, for retaining of sufficient funds for replacing of the assets in the future and to present a realistic picture of the operations of the company. This was based on guidelines and established accountancy principles, which required creation of an account styled 'Revaluation Reserve Account' and crediting it with an identical amount, by which cost of the assets have been increased. It required charging the profit & loss account with depreciation on the revalued cost each year and credit to the appropriation account with the amount of depreciation on that portion of the cost, that is equal to the difference of the revalued cost and the written down value, as a withdrawal from the Revaluation reserve account. The purpose of the revaluation of the assets is to indicate the operating profit, holding gain and to act as an indicator for the decisions taken. Referring to the Guidance Notes issued on 'Accounting for Changing Prices', the submission was that, the note suggested that, "out of various methods of accounting for changing prices discussed above, the current cost accounting method seems to be most appropriate in the context of the economic environment in India. The periodic revaluation of fixed assets and adoption of UFO formula for inventory valuation are partial responses to the problem of accounting for changing prices. Current purchasing power accounting though simple to apply, does not ensure maintenance of the operating of an enterprise.

Current cost accounting, on the other hand, is a rational and comprehensive system of accounting for changing prices as it considers the specific effects of the changing prices of individual enterprises and thus, ensures that profits are reported only after maintaining the operating capability". The charging of depreciation on the revalued cost of the assets, do not distort the book profits. Referring to book on Book-keeping & Accounts by Spicer & Peglar, it was submitted that, accounting practice has always permitted companies to incorporate fixed asset revaluation into their balance sheet.

12. Referring to Statements on Accounting Practices Nos. 12 & 37, as issued by the Institute of Chartered Accountants of India, it was contended that, from the time assets are revalued, depreciation is to be charged to the profit & loss account

on the revalued cost consistently thereafter and no part of such depreciation should be set off directly against the reserves. Reference was also made to the various statements on the current cost accounting practices issued by several Institutes of UK, USA etc., which all uniformly advocate similar accounting treatments. It was contended that, the statements also clarify that, no part of the revaluation reserve is available for distribution of dividends. The salient distinction between reserve and provision was also brought out, with reference to the decisions of the Calcutta High Court in CIT v. Sankey Electrical Stamping Ltd. [1982] 134 ITR 545, CIT v. Indian Leaf Tobacco Development Co. Ltd. [1981] 132 ITR 831, Madras High Court decision in CIT v. Gordon Woodroffe and Co.

(Madras) (P.) Ltd. [1990] 183 ITR 465 and to the Supreme Court decision in Vazir Sultan Tobacco Co. Ltd. v. CIT [1981] 132 ITR 559. The meaning of the term 'Capital Reserve' as brought out in the Treatise 'Accounting' by William Pickles was also referred to. It was contended that, the courts have been unanimous in their opinion that, whenever complex questions of accountancy principles arises, then the views of the Institute of Chartered Accountants of India, should be given their weightage. The CIT (Appeals), considered the arguments as advanced by the appellant company and the objections of the Assessing Officer. The CIT (Appeals) summarised the contentions of the appellant company and these are- (a) provisions which prescribe that depreciation should be granted only with reference to historical cost are not a bar to claim depreciation on revalued figures as 115J applies notwithstanding what is contained in other provisions; (b) when revaluation is done, depreciation has to be claimed on the revalued figures and the differential amount of depreciation has to be credited to the profit & loss account as the act of revaluation and consequential claim of depreciation are, in effect, healthy trend recognising the importance of retaining sufficient funds through additional depreciation in the event of replacement of fixed assets. This is more conducive to the true and fair view; (c) Section 115J does not differentiate between capital and revenue reserve except for reserves created after 1-4-1988. A reserve may be created as capital reserve and since 115J includes within its ambit both capital and revenue reserves, withdrawals from the reserve created before 1-4-1988 (although from capital reserves) will reduce profit; (d) intention behind Section 115J can be resorted to only where language of the section is not clear, resort to other aids to

interpretation including intention of the Legislature is of no consequence. Reliance is placed in this connection on the decision of Hon'ble Delhi High Court in Escorts Ltd. v . Union of India [1991] 189 ITR 81; (e) without prejudice, the intention of the Legislature is evident from the fact that it has taken capital reserve out of its purview of the Explanation only with reference to those reserves created after 1st day of April, 1988. Nothing prevented the Legislature to prescribe or legislate otherwise; and (f) the Institute's Guidelines holding this to be more conducive to true and fair views and providing for depreciation on revalued figures should be given due weightage specially where matters pertaining to Accountancy are involved.

13. The CIT (A) noted that, the computation of book profit under Section 115J was furnished by the appellant on 31-3-1992 and on the same date, the assessment order was passed. He observed that, though, the appellant had not raised any specific ground for lack of opportunity, he felt that, it was a case where proper opportunity was not provided to the appellant and the Assessing Officer also had no opportunity of considering the various arguments of the appellant. He therefore, expressed that, the Assessing Officer not having been addressed on the various arguments, for being properly dealt with by him, he need not adjudicate on the issue and set aside the order of Assessing Officer and directed the Assessing Officer to adjudicate upon the issue, after providing an opportunity to the appellant.

14. Shri Syali pleaded that, though the grounds of appeal as raised by the appellant company, is towards the remanding of the issue regarding the computation of book profit under Section 115J, still, he is entitled to raise the legal ground that, the withdrawal from revaluation reserve, which was credited to the profit & loss account, could not form part of the book profit. The learned counsel for the appellant company, vehemently argued that, the issue as to whether, withdrawal from revaluation reserve account that is credited to profit & loss account, could be treated as profit for arriving at the figure of book profit, involves pure question of law, without requiring investigation of any further facts and therefore, despite the question not having been answered by the CIT (A), the Tribunal, in its inherent power, should decide this question. He pleaded that, under Section 103 of the Civil Procedure Code, the High Court, in its capacity as the

second appellant authority has been given the power to decide on an issue, that is raised during the hearing in appeal, though the first appellate authority may not give any conclusion on that point. He submitted that, this power of the High Court to decide a question is subject to only one condition, that the evidence in connection therewith is available on the records and it does not require any investigation into any facts. He pleaded that, had the issue required investigation into any facts, then, the remand by the CIT (A), would not have caused any grievance to the company.

15. He submitted that, the CIT (A), had to merely answer the question, as to whether, the withdrawal from the capital reserve, equivalent to the amount of depreciation on the revaluation surplus, would form part of the book profits or not. He pleaded that, the undisputed fact was that, the assets of the company, were revalued in the two years 1983 and 1986, at the instance of the Financial Institutions, who had a large stake in the company. Consequent to revaluation of the assets, the assets, had to be shown at its revalued cost and in order to balance the Balance Sheet, a capital reserve was created, by an equal amount, by which the assets were increased. Drawing our attention to the Schedule of Fixed Assets, he pleaded that, the schedule contains columns for original cost, additions in the year, sales in the year, revaluation surplus, gross block, depreciation, written down value and the balance of the revaluation surplus. The amount by which the assets were revalued, was added to the cost of the asset and the depreciation on the original cost and the revalued amount, was charged to the profit and loss account. Since, for the purposes of declaration of dividends, depreciation is to be charged on the historical cost or the original cost, an amount equal to the amount of depreciation charged on the revalued cost, was withdrawn from the capital reserve and credited to the profit and loss account. The Assessing Officer, had treated this withdrawal from the capital reserve account, as part of the book profits, which is the only bone of contentious issue.

16. He submitted that, the task of the assessee has been made considerably simpler by the Special Bench decision, in *Sutlej Cotton Mills Ltd. v. ACIT* [1993] 45 ITD 22 (Cal.) (also reported in [1993] 199 ITR 164). He pleaded that, the Special Bench had in fact gone further by holding that, the profit on sale of shares, that are

held as investment, need not be considered for calculating the book profit. He pleaded that, the Special Bench (supra) had categorically held that, so long as the profit & loss account is in conformity with the requirement of the provisions of Parts II & III of Schedule VI to the Companies Act, 1956, the Assessing Officer, could not disturb it. He submitted that, the Special Bench had also observed categorically that, unless the reserve is created by debiting the profit & loss account which has reduced the profit in the year of creation, it would not be open to the Assessing Officer, to consider the withdrawal from the reserve, as part of the profit, in the year in which credit is given to the profit & loss account. He contended that, the Special Bench, had also observed that, there arises no profit by the revaluation of assets, but, only at the time of their sale. He pleaded that, the Explanation that was introduced effective from 1-4-1988, was also considered in the Special Bench and it was held that, since the reserve was created prior to 1-4-1988 and that too by not debiting to the profit & loss account, the Assessing Officer could not consider the withdrawal from the reserve, in the computation of the book profit. He accordingly pleaded that, in view of the fact that, the Special Bench having concluded the issue as had been raised by the assessee, the withdrawal from revaluation reserve created prior to 1-4-1988, by corresponding increase to the value of the assets and not by means of a debit to the profit & loss account, could not be considered in the computation of the book profit.

17. The DR, vehemently objected to the various claims put forth by the appellant's counsel. He pleaded that, the CIT (A) had remanded the issue of the claim of the manner of computation, especially with reference to the amount of withdrawal from the revaluation reserve credited to the profit & loss account and therefore, it would be most inappropriate for the Tribunal to decide on that claim. He pleaded that, the claim of the appellant is limited to remand to Assessing Officer by CIT (A), was proper or not and therefore, the Tribunal should limit its finding on that aspect alone and not to transgress into areas that do not arise out of the order of the CIT (A). He pleaded that, the jurisdiction of the Tribunal is limited to those aspects that arise from the order of CIT (A), which is very clear from the Section 253 of the Act. He contended that, a legal issue may be the main claim of the appellant, but, that legal aspect having been left undecided by remand to Assessing Officer, the Tribunal could not take upon itself to decide that issue, when neither of the

authorities had any occasion to deal with that aspect.

18. On merits, he contended that, the various backgrounds, that resulted in the enactment of the section, indicate that, the State intended to retain its share from that profit, which the company is stating its profit to its shareholders. He contended that, for the declaration of dividend, the depreciation needed to be provided on historical cost, which is why, the appellant had to credit the profit & loss account with the amount from revaluation reserve account. He pleaded that, revaluation of the assets by the company for its balance sheet, is of no relevance when it comes to the computation of income as per the provisions of the Act, because, it does not increase the real cost to the assessee. He contended that, the real cost could get increased only when additional amount is paid, but, in the instant case, the revaluation has been done by the assessee of its own accord, only to depict in the balance sheet, the current price of the asset. He pleaded that, the true profit of the company could be derived only with reference to the actual cost and not with reference to hypothetical cost. He contended that, the revaluation of assets, may be reasonably allowable for the purposes of the accounts, but, when it comes to arriving at the true profit of the company, depreciation needs to be charged with reference to the actual cost. Since, in the instant case, the profit & loss account is excess charged by that amount of depreciation representing the portion of revaluation, it needs to be discarded, which is the same thing as that, the withdrawal from the revaluation reserve to the extent of amount of depreciation charged on that portion of revaluation of assets, is to be added to the profit that has been reduced by that amount of depreciation represented by the revaluation portion.

19. We have considered the rival submissions on the issue. We have no doubt in our minds that, the issue as has been raised before us involves pure question of law, that requires no investigation of facts.

The action of the CIT (A) in remanding the issue back to the files of the Assessing Officer, for consideration of the various submissions put forth by the appellant company, knowing fully well that it does not require any investigation of facts, but pure interpretation of the provisions of Section 115J of the Act, together with the

accounting concepts in these circumstances, cannot but be held as inappropriate.

Since this is an issue raised before us, we have to hold that, the order of the CIT (A), in the circumstances of the case, is highly arbitrary and needs to be set aside.

20. The Tribunal gets jurisdiction to decide an issue in appeal, that arises from the order of CIT (A). The jurisdiction of the Tribunal in appeal, is always related to the scope of the appeal before it and is encompassed by the nature of the order appealed against and the issues as are raised by the appellant in the grounds of appeal, additional grounds as are permitted to be raised. The subject-matter of the appeal, would always depend upon the order appealed against, but, in certain circumstances such as an issue involving pure questions of law, that does not call for investigations of any facts, by virtue of the plenary powers conferred by the Act on the appellate authority, it would be the duty of the Tribunal to entertain such plea and render its decision on that issue, especially when both parties are entitled to file their appeals and are heard. Where a question that goes to the root of the case, refusal by the Tribunal to entertain it, Courts have regarded it as exercise of improper discretion and as erroneous in law.

The Tribunal has the inherent jurisdiction to consider a contention or point not raised earlier and it is expected of the Tribunal to pass an order on the basis of such a new point or contention. The power to admit a plea is restricted only where it involves investigation into the facts. Therefore, in the circumstances of the case before us, the plea to decide the legal issue, though the CIT (A), had not expressed his view point, especially when it is closely linked to the claim raised in the grounds of appeal, we are of the view that, the issue could be decided at this stage. More so, because, it does not involve any investigation into any fact, we have considered it proper to deal with the issue and are giving our conclusions on the legal issue, "whether the withdrawal of revaluation reserve, that has not been created by debit to the profit & loss account but by increasing the value of the assets on revaluation, that has been credited to the profit & loss appropriation account, could be added to the figure of profit for arriving at the book profit under Section 115J of the Act 21. It is an admitted position that, the assets of the company were revalued at the instance of the financial institutions in 1983 and

1986, Le., very much prior to 1-4-1988. It is also an admitted position that, consequent upon the revaluation of the assets, the difference between original cost and revalued cost was credited to an account opened specifically for the purpose of balancing both sides of the balance sheet, which has been styled as 'Revaluation Reserve Account', i.e., the reserve was not created by debiting the profit of any earlier year or years, thus reducing the profit of that year or those years. It is an admitted fact that, since the revaluation of the assets, the profit & loss account had been charged with depreciation on the revalued cost and the profit & loss appropriation account had been credited with an equivalent amount representing the difference in the amount of depreciation on the original/written down value of the assets and the revalued cost, as a withdrawal from revaluation reserve account. The controversy is limited to the aspect of the amount that is credited to the profit & loss account, representing the withdrawal from revaluation reserve account, is to be added to the profit for arriving at the book profit or should be disregarded.

22. In the Special Bench case (supra), the Assessing Officer had included the profit on sale of investments and allowed deduction of the amount withdrawn from the revaluation reserve, for arriving at the figure of book profit. In that case, the assessee, had credited the revaluation reserve account, with the profit on sale of investments and had debited the said account with loss on sale of investments as well.

In that case too, the assets were revalued prior to 1-4-1988 and profit & loss account was charged with depreciation on the revalued cost of the fixed assets and the profit & loss appropriation account was credited with the amount that was withdrawn from the revaluation reserve. The issue that was considered was whether the gain or profit on sale of investments could be considered for arriving at the book profit. Therefore, the Special Bench decision is not directly on the issue as has been raised in the present appeal. However, arguments had been raised with reference to the creation of reserves prior to 1-4-1988, with reference to the amendment that was introduced on 1-4-1989, as was considered by the Special Bench (supra). Since identical argument had been raised in the instant appeal, we proceed to examine the effect of the said amendment on the issue

before us, by referring to the decision of the Special Bench.

23. The Section 115J, as amended, with effect from 1-4-1989, Sub-section (1A) had the following features- Every assessee, being a company, shall, for the purposes of this section, prepare Us profit & loss account for the relevant previous year in accordance with the provisions of Part II & III of Schedule VI to the Companies Act, 1956: Explanation: For the purposes of this section, "book profit" means the net profit as shown in the profit & loss account for the relevant previous year prepared under Sub-section (1A), as increased by- (a) the amount of income-tax paid or payable and the provision therefor; (b) the amounts carried to any reserves other than the reserves specified in Section 80HHD, by whatever name called; (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; (d) the amount by way of provision for losses or subsidiary companies; (e) the amount or amounts of expenditure relatable to any income to which any of the provisions of Chapter III applies; (g) the amount withdrawn from the reserve account under Section 80HHD, to the extent it has been utilised for any purposes other than those referred to in Sub-section (4) of that section; (h) the amount credited to the reserve account under Section 80HHD, to the extent that amount has not been utilised within the period specified in Sub-section (4) of that section; if any amount referred to in Clauses (a) to (f) is debited or, as the case may be, the amount referred to in Clauses (g) and (h) is not credited to the profit & loss account and as reduced by,- (i) the amount withdrawn from reserves (other than reserves specified in Section 80HHD) or provisions, if any such amount is credited to the profit & loss account : Provided that, where this section is applicable to an assessee in any previous year (including the relevant previous year), the amount withdrawn/mm reserves created or provisions made in the previous year relevant to the assessment year commencing on or after the 1st day of April, 1988, shall not be reduced from the book profit unless the book profit of such year has not been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation; (ii) the amount of income to which the provisions of Chapter III applies, if any such amount is credited to the profit & loss account; (iii) the amount as arrived at after increasing the net profit by the amounts referred to in Clauses (a) to (f) and reducing the net profit by the amounts referred to Clauses (i) and (ii)

attributable to the business, the profits from which are eligible for deduction under Section 80HHC or Section 80HHD; so, however, that such amounts are computed in the manner specified in Sub-section (3) or Sub-section (3A) of Section 80HHC or Sub-section (3A) of Section 80HHC or Sub-section (3) of Section 80HHD, as the case may be; (iv) the amount of loss or the amount of depreciation which would be required to be set off against the profits of the relevant previous year as if the provisions of Clause (b) of the first proviso to Sub-section (1) of Section 205 of the Companies Act, 1956 are applicable.

(2) Nothing contained in Sub-section (1) shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of Sub-section (2) of Section 32 or Sub-section (3) of Section 32A or Clause (it) of Sub-section (1) of Section 72 or Section 73 or Section 74 or Sub-section (3) of Section 74A or Sub-section (3) of Section 80J.24. The memorandum explained the amendment to section as would be effective from 1-4-1989 [176 ITR (St.) 112 at 128] and we reproduce from the explanation giving the background and the intention behind it, the one that concerns the reserves created before 1-4-1988 and after 1-4-1988.

Under the existing provisions certain adjustments are made to the net profit as shown in the profit & loss account. One such adjustment stipulates that the net profit is to be reduced by the amount withdrawn from the reserves or provisions, if any, such amount is credited to the profits & loss account. Some companies have taken advantage of this provision by reducing their net profit by the amount withdrawn from the reserve created or provision made in the same year itself, though the reserve when created was not added to the book profit. Such adjustment led to undue lowering of profit and consequently the quantum of tax payable gets reduced. With a view to counteract such a tax avoidance device, it is proposed to reduce the 'book profit' by the amount withdrawn from reserves or provisions only in two situations, namely :- (i) if the reserves have been created or provisions have been made before 1st day of April, 1988; or (ii) if the reserves have been created or provisions have been made after 1st day of April, 1988 and have gone to increase the book profits in any year when the provisions of Section 115J of the Income-tax Act were applicable.

25. The Special Bench (supra), in para 15.1 considered the power of the Assessing Officer with reference to the adjustments to be made to the profit, in the calculation of the book profit. The observations have been made to the effect that, the profit of the year is to be computed only with reference to the figures of opening balance reflected in the accounts. Reference was made to the Supreme Court ruling in Chainrup Sampalram v. CIT [1953] 24 ITR 481, for the observation that, no profit arises on a mere revaluation of the assets and thus there was no escapement of any income in any earlier year. Reference was made to the amendment to the section with effect from 1-4-1989 and also to the memorandum explaining the amendment [175 ITR (St.) 112] and the following conclusion was arrived at, which is reproduced for the sake of facility.

At para 9.6 above, we have set down the amendment providing for the adjustments of the amounts transferred from book profit to any reserve in computing the book profit. Explaining this, it was stated that some companies sought to reduce the net profit by the amount withdrawn from the reserve created in the same year to lower the profit. It was stated that where an amount is transferred from the book profit to the reserve, an equal amount was to be added except in a situation where the reserve has been created before 1-4-1988 or where the reserve has been created after 1-4-1988 but had gone to increase the book profit in any year when the provisions of Section 115J were applicable. It will be seen that the revaluation reserve was created by the assessee before 1-4-1988 and is therefore saved by this amendment. Thus, we find that not only because the opening balance depends upon the assessments of earlier year but also because of the amended provisions of Section 115J, the Assessing Officer cannot disturb the value of the revaluation reserve in the Balance Sheet.

The above observation was made because the Assessing Officer, intended to disturb the reserve account created in the earlier years.

26. In the instance case, as observed earlier, the revaluation reserve that was created before 1-4-1988, was not by providing any debit to the profit and loss account, thus reducing the profit of that year, but to balance both sides of the balance sheet, consequent upon the revaluation of the assets. On revaluation of

the assets, the value of the assets was shown in the books at the revalued amount and a corresponding credit was given to the account styled 'Revaluation Reserve Account', that, was carried to the liability side of the balance sheet. The explanation on amendment to the adjustment of the reserves to arrive at the book profit, stipulates that, the reserve or provision if created before 1-4-1988, would be allowed to be deducted in arriving at the book profit.

27. Section 115J of the Act, is a specific code by itself, that required drawing up of the profit & loss account uniformly as on 31st March, 1989, by all companies irrespective of whether their accounting year ends on that date or not. It starts with the profit as per the profit & loss account drawn in accordance with Parts II & III of Schedule VI to the Companies Act, 1956 and describes various adjustments for arriving at the end result 'book profit'. The transfer to and from the reserves from the profit, are as a matter of accounting practice reflected or shown in the profit & loss appropriation account.

The amendment has been explained earlier, consists of two parts, namely, reserves created before 1-4-1988 and reserves created on or after 1-4-1988. In regard to reserves created before 1-4-1988, since, Section 115J of the Act was not applicable to those years, the words 'and have gone to increase the book profits in any year when the provisions of Section 115J of the Act were applicable', have not been made part of it. The reason is obvious because, for all the assessment years up to 1987-88, the income was to be computed with reference to the normal provisions of the Act and depreciation on the fixed assets were allowable at the rates prescribed in the IT Rules and the charging of depreciation to the profit & loss account, on the revalued cost had no effect in the computation of income.

There is no denial that, but for the charge of depreciation on the revalued cost of assets, to the profit & loss account in the previous year relevant to the assessment year under appeal, the profit of the year would have been higher because of depreciation on the historical cost would be lower, because historical cost is lower than the-revalued cost. But, the charge of depreciation on the revalued cost is not the same thing as creation of the reserve, because, creation of the reserve means debit to the profit & loss account by an amount and giving credit to the reserve by

an equivalent amount.

According to the amendment made effective from 1-4-1988, the credit to the profit & loss account by the amount withdrawn from the reserve account, created in the previous year relevant to the assessment year commencing on or after 1st day of April, 1988, by debit to the profit & loss account, shall not be allowed to be reduced from the book profit, unless the book profit of such year has been increased by those reserves. Since, the revaluation reserve was created before 1-4-1988 and by not debiting to the profit & loss account, in the light of the explanation rendered at the time of the amendment, giving the intent of the Legislature (reproduced above) and by virtue of the conclusion of the Special Bench (supra), the credit that has been given to the profit & loss account by the amount that is withdrawn from the revaluation reserve account, could not have been considered at all for arriving at the figure of book profit.

If, it is proceeded as if the reference to the net profit as per profit & loss account, is that figure after all adjustments on account of transfers to and from the reserves, then, since the revaluation reserve was not created by any debit to the profit & loss account, in the previous year relevant to the assessment year under appeal, then, by virtue of the explanation rendered at the time of amendment, as reproduced earlier, then, the amount withdrawn from the revaluation reserve account, is to be reduced to give the figure of book profit.

This is obvious because, all adjustments as are provided in Section 115J, has to be necessarily to be given effect to.

If, it is proceeded on the basis that, the figure of net profit is that, before any adjustments from it for transfer to and from the reserves, by whatever name called, then, in view of the Special Bench decision [supra] which has been given after considering the explanation to the amendment, the amount withdrawn from revaluation reserve could not be added, but given a reduction, for the reason that, that reserve was not created in the previous year, relevant to the assessment year under appeal.

In either case, from the figure of net profit, adjustments as envisaged by the section for adding to the profit and reducing from the figure of profit, have to be given, after which adjustments only, the amount of book profit would be the result.

The Assessing Officer had taken the figure of profit below the line, i.e., after all adjustments for transfers to and from reserves, including the amount withdrawn from the revaluation reserve, but had not allowed reduction of the amount withdrawn from the revaluation reserve account that was credited to the profit & loss appropriation account. Since the Assessing Officer has to apply the provisions of Section 115J in the like manner as was intended to by the Legislature, he could have only reduced the amount withdrawn from the reserve from the profit amount taken by him.

The Special Bench (*supra*) in para 17 of the order has given this salient finding : However, the Explanation to Section 115J provides for the book profit to be increased by the amounts carried to any reserves, by whatever name called in item (b), that is to say, if the Reserve is created out of current year's book profits. If out of current year's profit, any amount is transferred to Reserve Account it would diminish the Book Profits. Therefore, the Explanation provided that the book profits be shown at their original level, by bringing back to the profit & loss account the amount transferred to Reserve account. The revenue, when it insisted on bringing back to the profit & loss account, the amount transferred to Reserve account, it postulates that the reserve was a transfer out of current profits, which was not a fact.

The above is suggestive of the position that, notwithstanding that, the profit & loss account has been credited with the amount that has been withdrawn from revaluation reserve account, it could not be added to the book profit, because, the prerequisite for such an addition postulates that, the reserve was created out of current year's profits, which is not a fact in the instant case too. Therefore, the Special Bench decision, squarely provides answer on the issue, that, the addition to the book profit, by the amount withdrawn from the revaluation reserve is not tenable, because the credit to the reserve account, was not by means of any debit to the profit & loss account in the current year, but, by the enhancement of the

value of the assets, that too, in the earlier years, viz., 1983 & 1986. Respectfully following the Special Bench (supra) decision, we hold that, the Assessing Officer, having introduced his own criteria of adjustments, not intended by the Legislature, of taking the profit figure after credit of withdrawal from the revaluation reserve, without deducting that amount of withdrawal of revaluation reserve, for calculating the book profit, is clearly contrary to both the provisions and the intent of the Legislature and hence, is erroneous and without any sanction. We therefore hold that, the credit given to the profit & loss account by the amount withdrawn from revaluation reserve account is to be reduced for arriving at the figure of book profit.

28. In ground No. 2, the claim of the appellant company is that, the CIT (A), had not allowed carried forward of the amount on which book profit tax has been paid. Sub-section (2) of Section 115J of the Act reads as under: (2) Nothing contained in Sub-section (1) shall affect the determination of the amount s in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of Sub-section (2) of Section 32 or Sub-section (3) of Section 32A or Clause (iii) of Sub-section (1) of Section 72 or Section 73 or Section 74 or Sub-section (3) of Section 74A or Sub-section (3) of Section 80J. The reading of the above provision is indicative that, it relates to the carried forward of depreciation & investment allowance that has remained unabsorbed, to the losses and the deduction, allowable under Section 80J of the Act only. Therefore, the claim of allowing of the carried forward of the amount on which book profit tax has been paid, is clearly outside the ambit of the section, hence rejected.

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