

KARAMCHAND PREMCHAND PVT. LTD.
v.
COMMISSIONER OF INCOME TAX, GUJARAT

FEBRUARY 25, 1993

[B.P. JEEVAN REDDY AND N. VENKATACHALA, JJ.]

Super Profits Tax Act, 1963 :

Second Schedule—Rule 1—Amount set apart for contingent liability (Income-tax)—Whether a reserve or a provision—Whether to be included in the Computation of Capital of the assessee.

The appellant-assessee was issued a notice under Section 23A of the Income-tax Act, 1922. The assessee contested the same. At the same time, it set apart a sum of Rs. 6,52,000 in its books for the year ending 31st March 1956, to meet the contingency that may arise if his plea failed. During the year 1958-59 an amount of Rs. 2,02,000 out of the said amount was transferred to the profit & loss account. The balance amount of Rs. 4,50,000 continued to remain and was shown as a provision set apart to meet the aforesaid contingent liability. The assessee has been contesting the said proceedings. Ultimately it succeeded before the High Court which held that no action could be taken against the assessee under Section 23A.

For the assessment year 1963-64 in proceedings under the Super Profits Tax Act, the assessee claimed that the said sum of Rs. 4,50,000 was a reserve and should be included in its capital. The Income tax Officer did not agree. Ultimately the matter reached the Tribunal which agreed with the assessee. At the instance of Revenue the question as to whether the sum of Rs. 4,50,000 set apart for contingent liability (taxation) was to be included in the computation of capital of the assessee-company under Rule 1 of the Second Schedule of the Super Profits Tax Act, 1963 was referred to the High Court.

The High Court having answered the question against the assessee, the assessee has preferred the present appeal contending that inasmuch as no order levying additional tax under Sec. 23A was made the amount could not be treated as a provision.

A Dismissing the appeals, this Court,

HELD : 1.1. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the P.&L. accounts and the balance-sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital employed in the business. [112G]

1.2. In the instant case, the provision made by the assessee in its Books for meeting the anticipated liability of tax (under Section 23A of the Income Tax Act, 1922) was indeed a provision and not a reserve. The assessee itself called it a provision. It did not call it a reserve nor was the amount set apart or appropriated as a reserve. It is not to suggest that the description given or the Book entries made by the assessee are conclusive, but to emphasise how the assessee understood the said item itself. In the circumstances of the case the High Court was right in holding it to be a provision and not a reserve, and so the amount of Rs. 4,50,000 was not to be included in the computation of Capital of the assessee Company. [113E]

Metal Box Company of India Limited v. Their Workmen, 73 I.T.R. 53 and *Vazir Sultan Tobacco Co. Ltd. etc. etc. v. Commissioner of Income Tax, Andhra Pradesh etc. etc.*, 132 I.T.R. 559, relied on.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 2230 (NT) of 1977.

From the Judgment and Order dated 13.12.76 of the Gujarat High Court in Income Tax Reference No. 36 of 1972.

Mrs. A.K. Verma, for JBD & Co. for the Appellant.

G.C. Sharma, E.U. Eradi and T.R. Talwar for the Respondent.

G The Judgment of the Court was delivered by

B.P. JEEVAN REDDY, J. This appeal is preferred by the assessee against the judgment of the Gujarat High Court answering the question, referred at the instance of Revenue, against the assessee. The following question was referred under Section 256(1) of the Income Tax Act for the opinion of the High Court:

"Whether on the facts and in the circumstances of the case, the following amounts are to be included in the computation of capital of the assessee Company under Rule 1 of the Second Schedule of the Super Profits Tax Act, 1963:-

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|-------|---|---------------|
| (i) | Amount set apart for contingent liability (taxation) | Rs. 4,50,000 |
| (ii) | Amount set apart for proposed dividend | Rs. 19,90,000 |
| (iii) | Reserve for Depreciation fund in excess of the amount allowed as depreciated in income-tax | Rs. 6,77,122 |
| (iv) | Excess provision in Revenue Accounts disallowed in income-tax assessment for the assessment years." | Rs. 3,61,876 |

Though the question refers to four items, we are concerned in this appeal only with the first item. We shall, therefore, state the facts only in so far as they are relevant to the said item.

The assessee is a Private Limited Company. The assessment year concerned is 1963-64. Sometime in 1955-56, a notice was issued to the assessee under Section 23A of the Income Tax Act, 1922. Apprehending that it may become liable to pay additional tax under the said provision, the assessee set apart a sum of Rs. 6,52,000 in its Books for the year ending March 31, 1956. Out of this amount an amount of Rs. 2,02,000 was transferred to the profit and loss account during the year 1958-59, with the result that a sum of Rs. 4,50,000 continued to remain and was shown as a provision set apart to meet the taxation liability which the assessee called a contingent liability. At the same time the assessee had been contesting the proceedings taken against it under Section 23A. Though it failed at the earlier stages, it succeeded ultimately in the Letters Patent Appeal filed by it in the East Punjab High Court. In the said appeal decided on May 24, 1965, it was held that no action can be taken against the assessee under Section 23A. With this order, all the orders passed and notices issued under the said provision prior to the date of the said judgment stood vacated.

In its assessment relating to the assessment year 1963-64 under the

- A Super Profits Tax Act, the assessee contended that the said sum of Rs. 4,50,000 is a reserve and should be included in its capital for the purposes of the Act. The Income Tax Officer did not agree and the matter was ultimately taken to the Income Tax Appellate Tribunal. By the date this appeal was taken up for hearing, another appeal preferred by the assessee relating to the subsequent assessment year (1964-65) was also before the Tribunal. That appeal arose under the provisions of the Companies Sur-tax Profits Act, 1964 which replaced the Super Profits Tax Act. The Tribunal first disposed of the appeal relating to the assessment year 1964-65. In so far as the item in question is concerned it held that it was a reserve. Following the said judgment, the appeal pertaining to the assessment year 1963-64 was also allowed. (It may be stated that the order of the Tribunal relating to assessment year 1964-65 was subsequently rectified by an order dated February 15, 1972 and the said item was held to be a provision. But no such order was passed with respect to the assessment year 1963-64).

- D Aggrieved by the judgment of the Tribunal the Revenue obtained the aforesaid reference. The High Court answered the same in favour of Revenue and against the assessee following the decision of this Court in *Metal Box Company of India Limited v. Their Workmen*, 73 I.T.R. 53. It held that the said amount being a provision made towards a liability which had attached on account of the issuance of a notice was a provision and not a reserve. In this appeal the correctness of the said view is questioned. The learned counsel for the appellant-assessee submitted that inasmuch as no order levying additional tax under Section 23A was made on or before the date relevant to the assessment year 1963-64 the said amount cannot be treated as a provision. We find it difficult to agree. In *Metal Box*, which has been followed in *Vazir Sultan Tobacco Co. Ltd. etc. etc. v. Commissioner of Income Tax, Andhra Pradesh etc. etc.*, 132 I.T.R. 559, the distinction between provision and reserve is stated in the following words:

- G "The distinction between a provision and a reserve is in commercial accountancy fairly well known. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the P. & L. accounts and the balance-sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital
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employed in the business. Provisions are usually shown in the balance-sheet by way of deductions from the assets in respect of which they are made whereas general reserves and reserve funds are shown as part of the proprietor's interest. (See Spicer and Pegler's Book keeping and Accounts, 15th Edn. p. 42)."

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While approving the said statement it was stated in *Vazir Sultan*:

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"In other words 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 P.&L. account, a reserve is in appropriation of profits, the asset or assets by which it is represented being retained to form part of the capital employed in the business. Bearing in mind the aforesaid broad distinction we will briefly indicate how the two concepts are defined and dealt with by the Companies Act, 1956."

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Applying the said test it must be held that the provision made by the assessee in its Books for meeting the anticipated liability of tax (under Section 23A) was indeed a provision and not a reserve. The assessee itself called it a provision. It did not call it a reserve nor was it set apart or appropriated as a reserve. We are not suggesting that the description given or the Book entries made by the assessee are conclusive. We are only emphasizing how the assessee understood the said item itself. In the circumstances of the case we must hold that the High Court was right in holding it to be a provision and not a reserve.

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The appeal accordingly fails and is dismissed. No costs.

G.N.

Appeals dismissed.