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COMMISSIONER OF INCOME-TAX, ERNAKULAM. (KERELA)

v.

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THE OFFICIAL LIQUIDATOR, PALAI CENTRAL BANK LTD, (IN LIQUIDATION)

October 16, 1984

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[V.D. TULZAPURKAR, V. BALAKRISHNA ERADI AND D. P. MADON JJ.]

Super Profits Tax Act, 1963 (Act XIV of 1963), ss.2 (5), 2 (9) and 4 read with second Schedule to the Act—Company in liquidation—Whether chargeable to super profits tax.

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Capital, reserve and accumulated profits—Distinction between—Whether disappears on winding up of company.

The assessee-company went into liquidation on August 8, 1960. The Income-tax Officer, while determining the taxable income of the assessee-company at Rs. 5,79,678 for the assessment year 1963-64, was of the opinion that this amount would attract liability for super profits tax also and therefore asked the assessee company to file its return. The assessee-company submitted its return showing the chargeable profits as 'nil', contending that there could be no liability to super profits tax in respect of a company in liquidation since the formula laid down in the Second Schedule to the Super Profits Tax Act 1963 for calculation of the 'standard deduction' was inapplicable on account of the fact that a company in liquidation could not be said to have paid-up share capital as on the first day of the previous year relevant to the assessment year which was long subsequent to the winding up. The Income-Tax Officer however overruled the aforesaid contention and worked out the chargeable profits at Rs. 2,04,740 after adopting a minimum amount of Rs. 50,000 mentioned in s.2 (9) of the Act as a "standard deduction". The said order was confirmed in appeal by the Appellate Assistant Commissioner. But, on further appeal by the assessee-company the Income-tax Appellate Tribunal while allowing the appeal held : (1) that in the hands of the liquidator there is only one integral fund which could not be split up into share capital, reserve profits and therefore s.27 of the Act was clearly attracted to the case ; and (ii) that no assessment to super profits could be made on a company in liquidation since section 4 of the Act would not apply to the assessee company in liquidation as the standard deduction was incapable of ascertainment. The High Court, rejected the reference made at the instance of the Revenue.

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Dismissing the appeal by the Revenue,

HELD : (1) After a company has gone into liquidation it cannot be said that as on the first day in any subsequent year forming the previous year relevant to the assessment year, there exists in the hands of the liquidator any amount distinctly forming the paid-up share capital of the company or any sum that can be characterized as "reserve." The distinction between capital, reserve and the accumulated profits disappears in respect of a company in liquidation after the date of its winding up and there is only one integrated or consolidated fund in the hands of the liquidator. The concept of a fluctuating share capital or reserve which is the basic premise necessary to attract the applicability of rule 1 of the Second Schedule is wholly foreign in respect of a company in liquidation. [977H; 978E-F]

(2) It is clear from the definition of "standard deduction" that for the purpose of calculation of "standard deduction" one has to ascertain the capital of the company as computed in the manner specified in Second Schedule. But, it is important to notice from the terms of Rule 1 of Second Schedule that unless the company can be said to have a paid-up share capital as on the first day of the previous year relevant to the assessment year the formula laid down in the rule for computation of capital of the company cannot have any application and the calculation of "standard deduction" being based wholly on the capital of the company, it becomes wholly incapable of ascertainment.

[976B ; 977F-G]

Commissioners of Inland Revenue v. George Burrell, 1924 2 [K.B.] 52, 63 and *Birch v. Cropper* [1889] L.R. 14 App. Cas. 525, 546 referred to.

Commissioner of Income-tax v. Girdhar das and Co. Private Ltd, 63 I.T.R. 300 ; followed.

(3) Under the scheme of the Income-tax Act 1961, charge of tax will not get attracted unless the case or transaction falls under the governance of the relevant computation provisions. The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. The scheme of the Super Profits Tax Act 1963 being similar to that of the Income-tax Act 1961, it has to be held that inasmuch as the provisions contained in the Act for computing the capital of the company and its reserves and cannot have any application in respect of a company in liquidation and consequently the 'standard deduction' is incapable of ascertainment, the charge of super profits tax under section 4 of the Act is not attracted to such a case.

[978G-H ; 979A-C]

Commissioners of Income-tax, Bangalore v. B.C. Srinivasa Setty, 128 I.T.R 294 ; referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2090 of 1980

Appeal by Special leave from the Judgment and Order dated the 30th January, 1979 of the Kerala High Court in I.T.R. No. 76 of 1977. A

Abdul Khadder and *Miss. A. Subhashini* for the Appellant.

P. Gobindan Nair, N. Sudhakaran and *Mrs. Baby Krishnan* for the Respondent. B

The Judgment of the Court was delivered by

BALAKRISHNA ERADI, J. Whether a company in liquidation is chargeable to super profits tax under the Super Profits Tax Act, 1963-Act XIV of 1963 (hereinafter called 'the Act') is the short question arising for determination in this appeal. The answer thereto C will depend upon whether during the period subsequent to the date of winding up, any part of the funds in the hands of the official liquidator can be distinctly classified as representing paid-up share capital of the company as on the first day of the year of account relevant to assessment year and whether any portion of the fund can D be similarly identified as forming as, "reserve".

The assessee is a banking company, namely, The Palai Central Bank Ltd., which went into liquidation on August 8, 1960. On that date the Official Liquidator took charge of the assets and liabilities of the company and a balance-sheet had been prepared as on the E same date. Thereafter, for every year, the liquidator used to prepare only an income and expenditure statement for submission to the Reserve Bank of India. The assessment year, with which we are concerned is 1963-64 i.e., the year ended March 31, 1963. For the said assessment year the taxable income of the assessee was F determined by the Income-tax Officer at Rs. 5,76,678. The Officer was of the opinion that this amount would attract liability for super profits tax also and since the assessee had not submitted any return under the Act, a notice under section 9 (a) of the Act calling for the return was issued. The assessee thereupon, submitted a return showing the chargeable profits as 'nil'. In support of the G said return the assessee conteended *inter alia* before the Officer that there could be not liability to super profits tax in respect of a company in liquidation since the formula laid down in the Second Schedule to the Act for calculation of the 'standard deduction' was inapplicable on account of the fact that a company in liquidation could not be said to have paid-up share capital as on the first day of H

A the previous year relevant to the assessment year which was long subsequent to the winding up. Certain other contentions were put forward by the since they are are not of any material relevance at this stage, it is unnecessary to refer to them.

The Income-tax Officer overruled the contentions raised by
B the assessee and worked out the chargeable profits at Rs. 2,04,740 after adopting minimum amount of Rs. 50,000 mentioned in 2 (9) of the Act as a "standard deduction" applicable to the case. The Appellate Assistant Commissioner, before whom the assessee filed an appeal, confirmed the order of the Income-tax Officer. The assessee carried the matter in further appeal before the Income-tax
C Appellate Tribunal, Cochin Bench. The Tribunal held that in the hands of the liquidator, there is only one integral fund which could not be split up into share capital, reserve and profits. In the opinion of the Tribunal the exemption provision contained in section 27 of the Act which states that nothing contained in the Act shall apply
D to any company which has no share capital was clearly attracted to the case. It was further held by the Tribunal that even if the exemption under section 27 of the Act did not get attracted, section 4 of the Act, which is the charging section would not apply to the assessee company in liquidation as the 'standard deduction' was
E incapable of ascertainment. The Tribunal, accordingly, allowed the appeal of the assessee and held that no assessment to super profits tax could be made on a company in liquidation.

Thereafter, at the instance of the revenue, the Tribunal referred the following question of law to the High Court of Kerala for its opinion :

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> "Whether, on the facts and in the circumstances of the case, was the Tribunal justified in holding that no assessment under the Super Profits Tax Act, 1961, can be made on the assessee company (in liquidation)" ?

G The High Court agreed with the view taken by the Tribunal that after a company has gone into liquidation there cannot be said to be in the hands of the liquidator any amount that can be distinctly designated as paid-up share capital of the company or as 'reserve' with respect to which the capital of the company is to be worked out as provided in Second Schedule to the Act in order to
H arrive at the amount of standard deduction. The question referred

was accordingly answered by the High Court in the affirmative, that is, in favour of the assessee and against the revenue. Aggrieved by the said decision, the revenue has preferred this appeal to this Court by special leave.

After hearing Counsel appearing on both sides, we have unhesitatingly come to the conclusion that the view taken by the High Court is perfectly correct and that this appeal is devoid of merit.

Section 4 of the Act which is the charging section reads :

"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 1st day of April,1963, a tax (in this Act referred to as the super profits tax) in respect of so much of its chargeable profits of the previous year or previous years, as the case may be, as exceed the standard deduction, at the rate or rates specified in the Third Schedule."

The expression "chargeable profits" has been defined in clause (5) of section 2 thus :

"2(5)"Chargeable profits" means the total income of an assessee computed under the Income-tax Act, 1961 (XLIII of 1961), for any previous year. of years. as the case may be, and adjusted in accrodance with the provisions of the First Schedule."

The next definition, that is relevant is contained in clause (9) of the same section which deals with the expression "standard deduction". That clause reads as follows :

2(9) "Standard deduction" means an amount equal to six per cent, of the capital of the company as computed in in accrodance with the provisions of the Second Schedule or an amount of fifty 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 six per cent or, the case may be, of fifty thousand rupees shall be increased or decreased proportionately :

A 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.

B It is seen from the above definition that for the calculation of 'standard deduction' one has to ascertain the capital of the company as computed in the manner specified in second Schedule. That makes it necessary for us to examine the provisions of Second Schedule of the Act which contains the rules for computing the C capital of a company for the purpose of levy of super profits tax. The relevant provision is contained in rule 1 of the said Schedule which is in the following terms :—

"1. Subject to the other provisions contained in this Schedule, the capital of a company shall be the sum of the D amounts, as on the first day of the previous year relevant to the assessment year, of its paid-up share capital and of its reserve, if any, created under the proviso (b) to clause (vi-b) of sub-section (2) of section 10 of the Indian Income-tax Act, 1922 (XI of 1922), or under sub-section (3) of section 34 of the Income-tax Act, 1961 (XLIII of 1961), and E of its other reserves in so far as the amounts credited to such other reserves have not been allowed in computing its profits for the purpose of the Indian Income-tax Act, 1922 (XI of 1922) or the Income-tax Act, 1961 (XLIII of 1961), disminished by the amount by which the cost to it F of the assets the income from which in accordance with clause (iii) or clause (vi) or clause (viii) of rule 1 of the First Schedule is not includible in its chargeable profits, exceeds the aggregate of—

(i) any money borrowed by it which remains outstanding ; G and

(ii) the amount of any fund, any surplus and any such reserves is not to be taken into account in computing the capital under this rule.

Explanation 1—A paid-up share capital or reserve brought into existence by creating or increasing (by revaluation or H otherwise) any book asset is not capital for computing the

capital of a company for the purposes of this Act. A

Explanation 2—Any premium received in cash by the company on the issue of its shares standing to the credit of the share premium account shall be regarded as forming part of its paid-up share capital.

Explanation 3—Where a company has different previous years in respect of its income, profits and gains, the computation of capital under rule 1 and rule 2 of this Schedule shall be made with reference to the previous year which commenced first." B

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It is maifnest from the terms of rule that the essential components which will together go to make up the capital of a company are :

(i) Its paid-up share capital on the first day of the previous year relevant to the assessment year.

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(ii) Its reserves, if any, created under the proviso (b) to clause (vi-b) 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 ; and

(iii) Other reserves in so far as the amounts credited thereto have not been allowed in computing the profits of the company for the purposes of the assessment to income-tax. E

From the aggregate of the aforesaid amounts certain deductions as specified in the section have to be made but the details of such deductions are not relevant for the purposes of the present case. What is important to notice is that unless the company can be said to have a paid-up share capital as on the first day of the previous year relevant to the assessment year the formula laid down in the rule for computation of capital of the company cannot have any application and calculation of "standard deduction" being based wholly on the capital of the company it becomes wholly incapable of ascertainment. After a company has gone into liquidation, can it be said that as on the first day in any subsequent year forming the previous year relevant to the assessment year, there exists in the hands of the liquidator any amount distinctly forming the paid up share capital of the company or any sum that can be F G H

A characterized as "reserve"? In our opinion the answer must clearly be in the negative.

In *Commissioners of Inland Revenue* v. *George Burrell*,(1) Pollock M.R. observed :

> ".....it is a misapprehension, after the liquidator has
> B assumed his duties, to continue the distinction between surplus profits and capital. Lord Macnaghten in *Birch* v. *Cropper*(2) the case which finally determined the rights inter se of the preference and ordinary shareholders in the Bridgewater Canal, said' : I think it rather leads to con-
> C clusion to speak of the assets which are the subject of this application as "surplus assets" as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company-part and parcel of the joint stock or common fund—which at the date of the winding up represented the capital of
> D the company."

The above statement of the law was cited with approval and adopted by this Court in *Commissioner of Income-tax* v. *Girdhardas and Co. Private Ltd.*,(3) and it was held that in respect of a company in liquidation after the date of its winding up, the distinction bet-
E ween capital, reserve and the accumulated profits disappears and there is only one integrated or consolidated fund in the hands of the liquidator. The concept of a fluctuating share capital or reserve which is the basic premise necessary to attract the applicability of rule 1 of the Second Schedule is wholly foreign in respect of a
F company in liquidation.

In *Commissioner of Income-tax, Bangalore* v. *B.C. Srinivasa Setty*(4), this Court pointed out that under the scheme of the Income-tax Act, 1961, charge of tax will not get attracted unlese the case or transaction falls under the governance of the relevant
G computation provisions. "The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together

(1) [1924] 2 K.B. 52, 63
(2) [1889] L.R. 14 App. Cas. 525, 546
(3) 63 I.T.R. 300
H (4) 128 I.T.R. 294.

constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion". Exactly similar being the scheme of the Super Profits Tax Act, 1963; the above observations fully apply to case before us. Hence, it has to be held that inasmuch as the provisions contained in the Act for computing the capital of the company and its reserves and cannot have any application in respect of a company in liquidation and consequently the 'standard deduction' is incapable of ascertainment, the charge of super profits tax under section 4 of the Act is not attracted to such a case. The judgment of the High Court does not, therefore, call for any interference.

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This appeal is accordingly dismissed with costs.

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M.L.A. *Appeal dismissed.*