CASE NO.:
Appeal (civil) 6694-6698 of 2004

PETITIONER:
M/s George Williamson (Assam) Ltd.

RESPONDENT:
Commissioner of Income Tax, Guwahati

DATE OF JUDGMENT: 19/09/2005

BENCH:
Dr. AR. Lakshmanan & P.P. Naolekar

JUDGMENT:
J U D G M E N T

Dr. AR. Lakshmanan, J.

The above appeals were filed against the judgment and order dated 17.07.2003 passed by the Division Bench of the Gauhati High Court whereby the Division Bench allowed the appeal filed by the Commissioner of Income Tax being I.T. Appeal No. 6 of 2000 and reversed the order of the appellate tribunal dated 04.04.2000.

The present case involves an important question of law with regard to the interpretation of Explanation 1 to Rule 2 of the Second Schedule to the Companies (Profits) Surtax Act, 1964.

The appellant company was formed mainly for the purpose of taking over the Indian undertakings of several sterling tea companies operating in India. These sterling tea companies were registered in UK and were operating in India. The acquisition of the Indian undertakings of the sterling tea companies was done in accordance with a Scheme of Arrangement under Sections 391 and 394 of the Companies Act. The said Scheme of Arrangement was granted approval by the High Courts of Calcutta and Gauhati. As per the Scheme of Arrangement, all the properties, rights and powers and all liabilities of the sterling companies were transferred to and vested in the appellant Company. The Reserve Bank of India was the designated authority for granting approval for the price at which the undertakings including the assets were to be taken over by the appellant.

The Reserve Bank of India, by its letter No. EC.CO.FCS.3517/T-117(Activity)/79 dated June 26, 1979 accorded the aforesaid approval whereunder it permitted the appellant to pay the aggregate lumpsum consideration at Rs. 490 lakhs. Para 2 of the said letter reads thus:
"2. We are agreeable to your acquiring the entire business and undertakings in India of (i) Attaree-khat Tea Company Attaree-khat Company Ltd., (ii) Bargang Tea Co. Ltd., (iii) Boroi Tea Co. Ltd., (iv) Corramore Tea Co. Ltd., (v) Koomsong Tea Co. Ltd., (vi) Moabund Tea Co. Ltd., (vii) Rajmai Tea Co. Ltd., (viii) Itakhooli Tea Co. Ltd., (ix) Tingri Tea Co. Ltd., (x) Bargang Tea Co. Ltd., (xi) Borelli Tea Co. Ltd. and (xii) Rupajuli Tea Co. Ltd. (hereinafter referred to as twelve sterling tea companies) with effect from the close of business as at 31st December, 1977 for a total consideration of Rs. 490 lakhs (Rupees Four Hundred Ninety lakhs only). You also have our permission under section 19(1)(d) of the Foreign Exchange Regulation Act, 1973 to issue at par 21,61,000 and 2,89,000 equity shares of Rs.10/- each of your company to Williamson Tea Holdings Ltd., U.K. and Borelli Tea Holdings Ltd., U.K. respectively, in part settlement of the consideration for the business and not assets in India of the said twelve sterling tea companies to be taken over by you under the scheme of Indianisation."

As per paragraph 3(i) of the said letter, the Reserve Bank of India specifically directed the appellant that there shall not be any depletion in the net assets as on the actual date of transfer of business from what was given in the balance sheets of the twelve sterling tea companies as on 31.12.1976. Para 3(i) reads as follows:-

"There shall not be any depletion in the net assets as on the actual date of transfer of business from what was given in the balance sheets of the twelve sterling tea companies as on 31st December, 1976 and an auditor's certificate to this effect shall be submitted to us after the formalities for transfer of business are completed."

As against the consideration of Rs.4,90,00,000/- permitted by RBI to be paid by the appellant, the value of the net assets which was to be maintained by the appellant as per the aforesaid requirement of RBI was Rs. 6,33,89,055/- i.e. higher by Rs. 1,43,89,055/- which was disclosed in the appellant company's balance sheet as a Capital Reserve as part of "other reserve".

In the assessment of the appellant company under the provisions of the Companies (Profits) Surtax Act, 1964, the question arose as to whether the said capital reserve was to be included while computing the capital of the appellant company. For the relevant years under appeal, Surtax was leviable under the said Act on chargeable profits of a year that exceeded the 'statutory deduction'. Statutory deduction was defined to mean an amount equal to 15% of the capital of the company as computed in accordance with the provisions of the Second Schedule or an amount of Rs.2,00,000/- whichever is greater. Under the Second Schedule to the Act which provides for the rules for computing the capital of a company for the purposes of Surtax, the capital of a company is the aggregate of the following as on the first day of the previous year relevant to the assessment year \026

1. Paid up Share Capital
2. Reserves created in accordance with the provisions of the Indian Income Tax Act, 1922 and Income Tax Act, 1961.
3. Other Reserves (as reduced by amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Income Tax Act, 1922 or the Income Tax Act, 1961.

Explanation 1 to Rule 2 of the Second Schedule to the said Act reads as under:
"Explanation 1 \026 A paid up share capital or reserve brought into existence by creating or increasing (by revaluation or otherwise) any book asset is not capital of a company for the purposes of this Act."
The Revenue treated the impugned reserve as being covered under the said Explanation 1. This contention is rejected by the Appellate Tribunal. However, the stand of the Revenue has been upheld by the High Court.

It was submitted by Mr. S.Ganesh, learned senior counsel for the appellant that the said Explanation 1 to Rule 2 operates only where the reserve in question was brought into existence by creating or increasing (by revaluation or otherwise) the value of any book asset. It was further contended that in the present case, the said Explanation 1 has no application at all since the assets taken over by the appellant company were all real and tangible assets and not book assets. Further, it is to be noted that the said reserve was not created by the appellant company but arose due to statutory requirements in following the directions of the RBI.

The Income Tax Appellate Tribunal has, in its order, holding in favour of the appellant, given the specific finding that the said reserve was not brought into existence by creating or increasing the value of any book asset. However, the High Court in its judgment and order completely overlooked this specific and categorical finding of the Tribunal and has come to the conclusion that the said reserve is hit by the provision of Explanation 1 to Rule 2.

Mr. S. Ganesh, learned senior counsel for the appellant invited our attention to the judgment of this Court in Commissioner of Income Tax (Central), Calcutta vs. Standard Vacuum Oil Co. reported in [1966] 59 ITR 685 which, according to him, directly and squarely covered in favour of the appellant and that the said judgment was followed by the Tribunal in deciding the case in favour of the appellant. However, even though strongly relied upon by the appellant before the High Court, the High Court has not dealt with the said judgment of this Court in its impugned judgment whereby the High Court has reversed the order of the Tribunal and allowed the appeal of the Revenue. He also drew our attention to the findings of the Commissioner of Income Tax and also of the Income Tax Appellate Tribunal.

Mr. Harish Chandra, learned senior counsel for the respondent submitted that

the RBI permitted the assessee company to pay a lump-sum consideration of Rs.4,90,00,000/- as against the book value of the assets at Rs. 6,33,89,055/- and that the difference of Rs.1,43,89,055/- between the approved consideration to be paid and the book value of the assets were shown by the company in its balance sheet as capital reserve as part of other reserve. He would further submit that the High Court has elaborately interpreted the Explanation 1 of Rule 2 of Second Schedule of Surtax Act, 1964 and has held that the assessee company, in the instant case, acted on the net value of its assets as appearing in the books of sterling tea companies resulting in difference between the book value and the consideration paid and by this exercise on the part of the assessee, the reserve equivalent to the short fall was brought into existence by the assessee. Arguing further, the learned senior counsel submitted that the assets were valued by the RBI at a lower price considering the real status of the assets which was the price fixed by the RBI and that the difference in the actual value of the assets as determined by the RBI and book value is nothing but a reserve came into existence due to the valuation process which can be termed as revaluation of assets. According to the learned senior counsel, the judgment of Standard Vacuum Oil Co. (supra) is not identical with the assessee's case as observed by the Assessing Officer. Concluding his argument, he submitted that the High Court has correctly observed that the difference between the book value of assets and consideration paid shown as other reserve could not be treated as capital for the purposes of Surtax assessment and, therefore, there is nothing on law or on facts which warrants the intervention of the judgment of this Court.

In the above background of facts, the present appeals give rise to the following questions of law of public importance and of recurring nature which requires to be decided by us:-

A. Has not the High Court misunderstood and has interpreted Explanation 1 to Rule 2 of the Second Schedule to the Companies (Profits) Surtax Act, 1964?

B. Can Explanation 1 to Rule 2 of the Second Schedule to the said Act possibly be considered to be attracted to the present case?

C. Is not the present case directly and squarely covered by the judgment of this Court in Commissioner of Income Tax (Central), Calcutta vs. Standard Vacuum Oil Co. reported in [1966] 59 ITR 685

We have perused the said case of Standard Vacuum Oil Co. (supra). In that case, the assessee was a company incorporated with the object of taking over the assets of certain other companies \026 Secony Vacuum Oil Co. and Standard Oil Co. On the date of acquisition of the assets of these two companies, the book value thereof as recorded in their books of accounts was

Secony Vacuum Oil Co. $ 97,715,701/-
Standard Oil Co. $ 46,767,397/-

In consideration of transfer of these, the assessee company allotted to each company 49,995 shares and to Secony Vacuum serial bonds of the value of $ 13,093,300/-. The remaining 10 shares were divided equally between the two transferor companies for cash at par. The assessee company entered in its books of account the book value of the assets so transferred over the par value of the stock issued and the serial bonds were entered in the books under an account styled "Capital Paid in Surplus". After some adjustments, the "Capital paid in Surplus" account was reduced to $ 117,561,317/- and thereafter stood unchanged at that figure. The question which arose for consideration by this Court was whether the said sum appearing in the balance sheet of the company under the head "Capital paid in Surplus" constituting the excess of the book value of the assets over the face value of the shares etc could be included in the capital base of the company. It is also to be noted that the above case was under the provisions of the Business Profits Tax Act, 1947 which had provisions similar to the Companies (Profits) Surtax Act, 1964. This Court was deciding the issue vis-'-vis the Explanation to Clause 2 of Schedule II of the said Act of 1947 (at page 689) which read as under:

"Explanation.- A reserve or paid-up share capital brought into existence by creating or increasing (by re-valuation or otherwise) any book asset is not capital for the purposes of ascertaining the abatement under this Act in respect of any chargeable accounting period."

It is to be noted that the provisions of the aforesaid Explanation and Explanation I of the Second Schedule to the Act of 1964 are in pari materia and the relevant portions are identical.

This Court, in the above case, held at page 694as follows:-
"The Explanation to rule 2 has no relevance in the present case. The difference between the assets received by the company and the par value of the shares issued cannot be called a book asset "brought into existence by creating or increasing (by re-valuation or otherwise)". The assets received by the assessee-company are real and tangible assets\005."

In this context, it is beneficial to refer to the specific finding of the Commissioner of Income Tax (Appeals) which reads as under:-
"Explanation 1 of Rule 2 of the Second Schedule of the Companies (Profits) Surtax Act, 1964 relied upon by the A/O reads as under:-

"Explanation 1. A paid-up share capital or reserve brought into existence by creating or increasing (by revaluation or otherwise) any book asset is not capital for computing the capital of a company for the purposes of this Act."

The A/O has noticed the words "brought into existence" without noticing the further words "by creating or increasing (by valuation or otherwise) any book asset". The appellant company in this case did not create or increase any book asset at all as evident from the account. As has already been stated the appellant took over all the existing assets and liabilities of the erstwhile sterling tea companies at their book values and incorporated them in its books of account which necessitated the creation of capital reserve as the consideration received fell short of the net worth of the businesses taken over by a consideration of Rs.1,43,89,055/-. In my view the A/O erred in holding that the capital reserve of Rs.1,43,89,055/- was not includible in the appellant's capital for sur-tax purposes by virtue of Explanation 1 of Rule 2 of the second schedule of the Companies (Profits) Surtax Act, 1964. With the aforesaid observation, I accordingly direct the A/O to include the said sum in the appellant's Capital for the purpose of its surtax assessments for the years 1980-81, 1981-82 and 1982-83 respectively.

Likewise, the Income Tax Appellate Tribunal while placing reliance on the judgment of Standard Vacuum Oil Co. (supra) in paras 8-12 has observed as under:
8. \005..To support his argument, he relied on the ratio of the Hon'ble Supreme Court in the case of Commissioner of Income Tax (Control) Calcutta vs. Standard Vacuum Oil Co. (59 ITR 685) where the Hon'ble Supreme Court discussed the Indian Income Tax Act, 1922 and also the similar Explanation (supra). The Hon'ble Supreme Court observed that the Explanation to Rule 2 has no relevance as the difference between the assets of Company and the par value of the shares issued cannot be called a book asset brought into existence by creating or increasing. The assets received by the assessee-company are real and tangible assets. Needless to mention that the said issue has already been discussed by the Commissioner of Surtax (Appeals) in his order.

9. We have heard both the parties at length and gone through the materials available on record including the order of both the High Courts and the amalgamation scheme. From the record it appears that the Reserve Bank of India has allowed the consideration perhaps on ad-hoc basis as no basis has appeared from the letter of the Reserve Bank of India dated 28th June, 1979, (at pages 29-32 of the paper book). The Reserve Bank of India in its approval mentioned at para 3 (i) that:-

"There shall not be any depletion in the net assets as on the actual date of transfer of business from what was given in the Balance sheets of the twelve sterling tea companies as on 31st December, 1976 and an auditor's certificate of this effect shall be submitted to us after the formalities for transfer of business are completed."
On query from the Bench, we were told that the actual taken over was on 31.12.77 i.e. after one year of the amalgamation scheme.

10. From the records the issue is whether the reserve of Rs.1,43,89,055/- is a reserve brought into existence by creating or increasing any book asset of not. At the cost of repetition it may be mentioned that the assets which were taken over were real and tangible assets and there was no tangible assets like goodwill etc. which can form a book asset or artificial assets because the Reserve Bank of India has not given any reason for allowing the lump-sum consideration, therefore, this confusion has arisen. Needless to mention that the value of the assets and consideration paid have bound to be differentiated. In other words, the real value of the book value has always a difference.

11. In the instant case, the said amount had to be shown in the accounts as other capital reserve in accordance with normal accounting principles because the consideration received on transfer of the erstwhile sterling 12 tea companies in India taken over by the assessee company as a going concern fell short of the net worth of business taken over and without such entry the balance sheet of the assessee company on the date of taken over of the business would not have tallied and the difference has created this legal dispute.

12. Therefore, such capital reserve has to be treated as forming a part of the capital under rule 1 (iii) of the second schedule (supra) surtax Act, 1964. Nonetheless, it may be mentioned that the words, "brought into existence" were read in isolation without reading the subsequent words "by creating or increasing, (by valuation or otherwise) any book assets". By considering the totality of the facts and circumstances of the case, we are of the view that the assessee had neither created nor increased any book asset in the instant case. At the time of taking over no exercise was taken place to tally the assets and the Reserve Bank of India has allowed the lump-sum consideration. We are also of the view that the assets received by the company are real and tangible assets as evidenced by the extracts of the balance sheet (pages 43-44) of the paper book). In the absence of any additional materials/evidence, we are of the view that the capital reserve of Rs.1,43,055/- representing the difference between the value of assets taken over and consideration allowed by the Reserve Bank of India was rightly included by the assessee company for computing the capital to determine the statutory deduction under the Companies (Profits) Surtax Act, 1964. Therefore, we find no infirmity with the direction given to the A.O. by the Commissioner of Surtax (Appeals) to include the said sum in the assessee's capital for the purpose of its surtax assessment for the assessment years under consideration."

As rightly pointed out by learned senior counsel for the appellant the judgment of Standard Vacuum Oil Co. (supra). was cited before the High Court, the Division Bench failed to appreciate the applicability of the said judgment to the case on hand. Likewise, the High Court has completely failed to appreciate the true meaning and real effect in law of Explanation 1 to Rule 2 of the Second Schedule to the Companies (Profits) Surtax Act, 1964. The Division Bench, in our view, has grossly erred in stating that the appellant had obviously received benefits in computation of income tax on account of assets taken over by the appellant from other tea companies and that, therefore, the reserve in question could not be treated as a component of the capital for the purposes of surtax assessment. Such a new case was neither at all advanced by the Revenue before the High Court, nor could such a case at all be considered by the High Court inasmuch as it did not at all arise out of the order by the Appellate Tribunal. The provisions of the Business (Profits) Tax Act, 1947 which were interpreted by this Court in Standard Vacuum Oil Co. (supra). are virtually identical to the provisions of the Companies (Profits) Surtax Act, 1964 and since the said judgment directly and squarely covered the instant case. In our opinion, the High Court has committed a patent error in completely dis-regarding the judgment of this Court in Standard Vacuum Oil Co. (supra). and in reversing the well-considered order of the Appellate Tribunal which has decided the matter in favour of the appellant and as a consequence of the impugned order of the High Court, the huge tax liability was created on the appellant without any warrant or justification whatsoever.

We, therefore, have no hesitation to set aside the order passed by the High

Court impugned in these appeals and restore the order passed by the Tribunal. In the result, these appeals are allowed. No costs.