

(1991) 11 CAL CK 0019
In the Calcutta High Court

Case No : Income-tax Reference No. 59 of 1991

Commissioner of Income Tax

APPELLANT

Vs

Rydak Syndicate Ltd.

RESPONDENT

Date of Decision : 26-11-1991

Acts Referred:

Companies (Profits) Surtax Act, 1964 — Rule 1A, 2
Companies Act, 1956 — Section 78

Citation : (1993) 203 ITR 1005

Hon'ble Judges : Shyamal Kumar Sen, J;Ajit K. Sengupta, J

Bench : Division Bench

Judgement

Ajit K. Sengupta, J.—As directed by this court u/s 256(2) of the Income Tax Act, 1961, the following two questions have been referred by the Tribunal at the instance of the Revenue for our opinion :

"(i) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the amount shown in the share premium account though not received in cash was not hit by Explanation 2 to Rule 2 of the Second Schedule to the Companies (Profits) Surtax Act ?

(ii) Whether, on the facts and in the circumstances, of the case, the Tribunal was correct in law in holding that the amount credited in the share premium account that arose out of amalgamation was other reserve within the meaning of Rule 1(iii) of the Second Schedule to the Companies (Profits) Surtax Act, 1964, and would be includible in computing the capital for the purposes of the said Act ?"

2. The facts found and/or admitted in this case are that the assessee-company follows the calendar year as its accounting year and the assessment years involved are 1975-76 to 1978-79. In the wake of an amalgamation of some other tea companies with the assessee-company with effect from the close of the business on December 31, 1968, with the approval of the High Court at Calcutta, a surplus of Rs. 44,84,866, representing the difference between the book value of the assets transferred and the par value of the capital stock issued, arose out

of such amalgamation. The assessee treated the surplus as a reserve of the company. The Surtax Officer negated the assessee-company's claim that the said sum of Rs. 44,84,866 should be treated as reserve for inclusion in the computation of the capital in accordance with Rule 1 of the Second Schedule to the Companies (Profits) Surtax Act, 1964. Before him, the assessee relied on the decision of the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, . But the Surtax Officer took the view that the share premium not having been received in cash, it was hit by Explanation 2 to Rule 2 of the Second Schedule. The assessee's contention that the amount standing in the share premium account should be treated as a reserve was also rejected by him on the ground that the acceptance of such a plea would render Explanation 2 as aforesaid redundant. The Surtax Officer, therefore, did not include the amount standing in the share premium account in the capital computable under the Second Schedule by invoking Explanation 2 to Rule 2 of the Second Schedule.

3. On appeal, the Commissioner of Income Tax (Appeals) observed that Explanation 2, on the face of it, was merely explanatory or clarificatory of the position as to when the share premium account would be treated as forming part of the paid-up share capital. According to him, what Explanation 2 clarifies is that the share premium received in cash on the issue of shares would form part of the paid-up share capital. But, it does not imply that the share premium not received in cash could not otherwise be taken into account for the capital computation as a reserve. Therefore, according to him, the surplus arising on amalgamation as share premium may not constitute share capital but would very well be a reserve and form part of the capital of the company. It would be a reserve under Rule 1(iii) of the Second Schedule though not share capital under Rule 2. He accordingly reversed the order of the Surtax Officer and directed him to include the amount credited to the share premium account in the computation of capital, impliedly not as paid-up share capital but as other "reserve".

4. The Revenue filed appeals before the Tribunal against the order of the Commissioner of Income Tax (Appeals). The Revenue's contention was that, since the premium was not received in cash, it could not be included in the computation of capital for surtax assessment. The Tribunal held that the share premium account was a reserve falling under item No. (3) under the head "Reserves and surplus" in Part I of Sixth Schedule to the Companies Act, 1956. Therefore, it was not hit by Explanation 2 to Rule 2 or under Rule 1A of the Second Schedule to the Companies (Profits) Surtax Act, 1964. The Tribunal found that the claim of the assessee and the decision of the Commissioner of Income Tax (Appeals) was covered by the decision of the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, and finally held that the sum of Rs. 44,84,866 representing the difference between the book value of the assets transferred and the par value of the stock issued arising out of the amalgamation is to be treated as "Other reserves" within the meaning of Rule 1(iii) of the Second Schedule.

5. Before us, it has been contended by learned counsel of the assessee that the facts of the present case are on all fours with the facts of the aforesaid case decided by the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, . In that case, the assessee, a non-resident company incorporated in Delaware in the U.S.A. with the object of taking over the assets of two other companies, the Socony Vacuum Oil Company and the Standard Oil Company (New Jersey), in consideration of the transfer of assets valued in their books at \$97,715,701 and \$46,767,397 allotted to each company 49,995 shares of \$ 100 each and to the Socony Vacuum Oil Company serial bonds of the value of \$ 13,093,000. The remaining ten shares of the share capital of the assessee-company were divided equally between the two companies for cash. The assessee-company entered in its books of account, the book value of the assets taken over from the companies and the excess of the net value of the assets transferred over the par value of the stock issued and the serial bonds were entered in an account styled "Capital paid in surplus".

6. A question arose as to whether the said amount shown in the books of the company as capital paid in surplus being the difference between the book value of the assets taken over from the two companies and the par value of the shares issued and the serial bonds entered in the accounts styled "capital paid in surplus" can be treated as a reserve within the meaning of Rule 2(1) of the Business Profits Tax Act. The said rule is said to be substantially in pari materia with Rule 1(iii) of the Second Schedule to the Companies (Profits) Surtax Act, 1964. The Supreme Court pointed out that Rule 2 of the Business Profits Tax Act does not expressly say that the reserve admissible in the computation of capital should be one built out of the profits and the Supreme Court, according to learned counsel, did not even suggest that the rule contained any such implication. It was further pointed out by learned counsel that the Supreme Court has distinguished the observation made in *Commissioner of Income Tax, Bombay City Vs. The Century Spinning and Manufacturing Co. Ltd.*, pointing out that the observation in that earlier case was made with reference to the facts of that case and was not intended to lay down that the reserve built up from sources other than profits will not be admissible for inclusion in the capital under Rule 2(1) of the Business Profits Tax Act.

7. Learned counsel for the Revenue, however, relied heavily upon Explanation 2 below Rule 2 of the Second Schedule which expressly required the share premium to be received in cash before it could be regarded as part of the paid-up share capital of the company.

8. From the rival contentions, the emerging point on which the whole question centres is whether the decision of the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, avails as an aid to advance the case of the assessee-company. We are in agreement with learned counsel thus far that, if we are to apply that decision, though taken in the context of the Business Profits Tax Act, we have to hold that wherever any

amount is credited by a company to its share premium account being attributable to the difference between the par value and the market value (representing the net assets taken over by the amalgamated company over and above the face value or paid-up value of the shares issued by it), the amounts so credited to the share premium account, by its quintessential nature, would represent a part of the company's capital by virtue of the premium being treated as the reserves of the company. The argument of learned counsel for the assessee that Rule 2(1) of the Business Profits Tax Act and Rule 1(iii) of the Surtax Act are substantially the same cannot be lightly dispensed with. That being so, the judgment of the Supreme Court cannot be said to have lost its relevance. The decision would have clinched the question in favour of the assessee but for Explanation 2 to Rule 2 of the Second Schedule. The argument of the assessee has consistently been at every stage that the surplus representing the net assets taken over by the amalgamated company in excess of the face value or paid-up value of the shares issued by it is in a sense not its share capital but its reserve. If the surplus is not computable as part of capital under Rule 2, it is to be so under Rule 1(iii). Learned counsel for the assessee has not either advocated that the surplus should be treated as paid-up share capital of the company. In fact, the ratio of the decision of the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, has been cited as an entrenched authority for the proposition that, in the event of such surplus arising out of amalgamation, the amount of the surplus should be the reserves of the company.

9. The question, therefore, is whether or not the proposition in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, still retains its force. If it does, then Explanation 2 to Rule 2 of the Second Schedule does not stand in the way of including the surplus in the Capital " computation as a reserve of the company.

10. The Surtax Officer has construed Explanation 2 as a blanket prohibition on any premium received otherwise than in cash against forming part of capital in any form because, under the Explanation, premium received in cash alone is to be treated as share capital of the company. Pitted against this prohibition, the ratio in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, has lost its relevance and this is the straight-forward case of the Revenue. Alternatively, if the said decision is held to be still operative, that would whittle down Explanation 2 on which the Surtax Officer has exclusively relied.

11. Doubtless, the plea involves a substantial issue. We cannot sideline Explanation 2 because it gives a clear mandate that share premium, unless received in cash, cannot be the paid-up share capital of the company. But the line taken by the assessee is not to undermine or ignore Explanation 2. The whole thrust of the assessee's argument is that wherever the shares are at a premium, the premium has to be received in cash so that the premium could be included in the paid-up share capital. Whether it is the intention of the

Legislature to extend this restrictive provision even to a case where premium arises on account of the surplus of the net assets taken over in amalgamation over and above the face value or paid up value of the shares issued by the amalgamated company. The issue of shares in amalgamation and the premium arising by way of surplus is a special contingency not to be taken at par with the issue of shares in the ordinary.

12. According to the assessee, its case stands quite apart from Explanation 2 to Rule 2. Its place is in Rule 1(iii) authorising inclusion of other reserves as part of capital and the argument draws strength, as we have indicated, from the decision of the Supreme Court under the Business Profits Tax Act in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*. There are clear indications in the said decision that the Supreme Court did not at all concern itself with the question whether the share premium being the difference between the par value and the market value arising in the event of amalgamation should be paid-up share capital. The principle that received attention and final approval in the said decision is the proposition that the surplus so credited to the share premium account would represent a part of the company's capital by virtue of the premium being treated as the reserve of the company.

13. Although the decision was rendered under the corresponding provisions of the Business Profits Tax Act, 1947, which are somewhat similar to those of the Surtax Act, the decision would continue to be applicable for surtax purposes as well because the treatment of the amount of the share premium as reserve is permissible even under the accounting principles.

14. From an analysis of the form of balance-sheet in the Sixth Schedule, Part I of the Companies Act, 1956, it will appear that share capital is a distinct category and reserves and surplus is another. The share premium account appears under the heading "Reserves and surplus" and not under the heading "Share capital". Notes "(CC)" below the statutory form of balance-sheet require the details of utilisation of the share premium in the manner provided in Section 78 to be furnished.

15. Therefore, any surplus received as capital otherwise than in cash shall, in accounting principles, fall within Rule 1(iii) of the Second Schedule. The difference between the assets received by the company and the par value of the shares represents tangible capital assets which Explanation 2 to Rule 2 of the Second Schedule cannot and does not intend to efface or blot out. Nor does that Explanation conflict with the principle laid down by the Supreme Court in *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*. The decision in the first instance treats the difference as premium realised from the issue of shares. Rule 3 of the Second Schedule to the Business Profits Tax Act says that so much of the premium realised by a company from the issue of any of its shares as is retained in the business shall be regarded as forming part of its paid-up share capital for the purposes of Rule 2.

16. No doubt there was no bar against premium received not in cash being treated as paid-up share capital under the present rule, i.e., Rule 2, Explanation 2 of the Second Schedule to the Surtax Act. But, what is material is that the Supreme Court held that in such a situation, the surplus could be premium as well as reserve. As a matter of fact, such surplus as in this case is accepted as capital with different appellations in different lands. In India, it is given the nomenclature premium, elsewhere it is known as paid-in surplus. But, essentially surplus is a reserve, In *The Commissioner of Income Tax (Central), Calcutta Vs. Standard Vacuum Oil Company*, , the Supreme Court observed :

"The High Court was, therefore, right in holding that the account "Capital surplus brought in" in the balance-sheet represents premium realised from the issue of its shares within the meaning of Rule 3, or in the alternative, represents reserves not allowed in computing the profits... ."

17. The alternative finding of the Supreme Court supports the view taken by the Tribunal.

18. We are, therefore, of the opinion that the share premium representing the difference between the book value and the par value arising on amalgamation of a few other companies with the assessee-company would be a reserve as shown in item No. (3) under the head "Reserves and Surplus" in Part I of the Sixth Schedule to the Companies Act and, therefore, it was not hit by Explanation 2 to Rule 2.

19. We, accordingly, answer both the questions in the affirmative and in favour of the assessee.

20. There will be no order as to costs.

Shyamal Kumar Sen , J.

21. I agree.