

National Rayon Corporation Ltd. v. The Commissioner of Income Tax, Madras

Civil Appeal No. 431 of 1989; connected Civil Appeal Nos. 2/1995, 198/1989, 432/1989, 433/1989 and 2970/1981

[1997] Supp. 3 SCR 140 | 1997-07-29

Historical surtax capital computation: debenture redemption provision and gratuity reserve.

Companies (Profits) Surtax Act, 1964: section 2(8), Second Schedule rule 1 Explanation | Companies Act, 1956: Schedule VI Part III clause 7 | Super Profits Tax Act, 1963: capital computation in Civil Appeal 2970/1981

2-judge bench | Suhas C. Sen, J. | K. T. Thomas, J.

Assessment years: 1967-68 (lead appeal)

Historical surtax ruling; separate connected-appeal outcome

This is a Companies (Profits) Surtax Act / Super Profits Tax Act decision, not a general income-tax deduction ruling. Lead and four connected appeals were dismissed; the separate gratuity appeal was allowed. M.M. Aqua Technologies (2021), paragraphs 26-27, distinguishes this reserve question from actual payment of interest by issuing debentures.

01 FACTS OF THE CASE

The lead appeal concerned whether Rs. 79 lakh designated as a debenture redemption reserve could enter the company's capital computation for surtax. The debentures were secured borrowings and the amount earmarked for redemption was below the outstanding liability. The company argued that no redemption was due during the accounting year and that appropriation from profits available as working capital should be a reserve. A separate connected appeal concerned Rs. 6,66,159 appropriated to gratuity reserve under the Super Profits Tax Act.

Source: [SCR pp. 142-144 and 150 / PDF pp. 3-5 and 11](#)

02 DISCUSSION BY THE HON'BLE COURT

A borrowing creates a present repayment obligation even if payment falls due later. Under clause 7 of Part III of Schedule VI to the 1956 Companies Act, an amount retained for a known liability is excluded from reserve; only a qualifying excess over the amount reasonably necessary can be a reserve. No such excess was established for the debentures. The Court applied Vazir Sultan and Kesoram and rejected the contrary approach in Peico Electronics and Modi Industries. The Second Schedule Explanation also excludes the identified sinking-fund and surplus categories: availability as working capital or appropriation from profits does not itself establish an eligible reserve.

Source: [SCR pp. 143-149 / PDF pp. 4-10](#)

03 JUDICIAL DECISION

Civil Appeal 431/1989 was dismissed without costs; Civil Appeals 2/1995, 198/1989, 432/1989 and 433/1989 were also dismissed without costs. In Civil Appeal 2970/1981, Rs. 6,66,159 was held a gratuity provision, not reserve, and the High Court order was set aside to that extent; that appeal was allowed. The Court did not decide the asserted excess gratuity provision as a factual issue not shown to have arisen below, leaving the assessee to raise it before the Tribunal if legally permissible.

Source: [SCR p. 150 / PDF p. 11](#)

04 OUTCOME / IN WHOSE FAVOUR

In favour of Revenue on the identified debenture and gratuity classification issues. The procedural results differ across appeals. There is no finding that every amount described as a reserve is ineligible, and no adjudicated quantum of excess gratuity provision.

Source: [SCR pp. 144 and 150 / PDF pp. 5 and 11](#)

05 AKHB REVIEW POINT

AKHB analysis: identify the actual liability, the earmarked amount and the historical statutory definition before classifying a reserve for tax capital computation. Labels and liquidity are insufficient. Keep this historical surtax question separate from deduction or actual-payment questions under income-tax law. In the bounded later check, M.M. Aqua Technologies Ltd. v. CIT, decided 11 August 2021, paragraphs 26-27 (PDF pp. 20-23), expressly held this decision inapplicable to its question whether issuing debentures actually paid interest. That is a distinction, not a verified overruling; no comprehensive later-treatment clearance is claimed.

Source: [SCR pp. 144-149 / PDF pp. 5-10](#); later comparison: [M.M. Aqua paragraphs 26-27](#); [M.M. Aqua, paragraphs 26-27](#)

SOURCE & VERIFICATION

[Supreme Court Reports scan - public eSCR mirror](#)

11-page SCR scan. Judicial body begins at PDF p. 3 / SCR p. 142 and ends at PDF p. 11 / SCR p. 150; includes separately disposed connected gratuity appeal. Headnote and reporter ending are not substituted for operative orders.

Open cited source rendition

Complete source judgment body read, excluding editorial headnote as independent authority; source identity and ending visually checked.

Exact source bytes match the supplied consolidated-index SHA-256; public mirror scan, not a certified court copy.

The source cover names CIT, Madras but the jurisdiction block traces the lead appeal to the Bombay High Court; the printed title is preserved without guessing a corrected respondent.

Reporter closing line says Appeals dismissed, but the judicial text expressly allows Civil Appeal 2970/1981; individual operative outcomes govern.

STATUTORY SCOPE

Historical statutory text and assessment periods control. No automatic Income-tax Act, 2025 crosswalk or present-law certification.

LATER TREATMENT

Source checked 2026-10-09. Only the expressly identified bounded later comparison is verified. Comprehensive subsequent judicial treatment and current-law applicability have not been verified.

IDENTIFIED SOURCE LINKS

[M.M. Aqua Technologies Ltd. v. Commissioner of Income Tax, Delhi-III, 11 August 2021](#)

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