

THE INDIAN OVERSEAS BANK LTD.

v.

THE COMMISSIONER OF INCOME-TAX, MADRAS.

April 23, 1970

[J. C. SHAH, K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922, s. 10(2)(vi-b), Proviso (b)—Development rebate—If can be claimed where no separate reserve created but only transfer to reserves in compliance with s. 17 Banking Companies Act, 1949.

The appellant was a public limited company carrying on banking business. For the calendar year 1958, which was the previous year relating to the assessment year 1959-60, the appellant claimed allowance by way of development rebate under proviso (b) of s. 10(2)(vi)(b) amounting to Rs. 1,37,836 in the computation of its business income. The admitted facts of the case were that during the accounting year the appellant had transferred a sum of Rs. 6 lakhs from the profit and loss account to the reserve fund; this was sufficient to meet the requirements of s. 17 of the Banking Companies Act, 1949 as well as of proviso (b) to s. 10(2)(vi)(b) of the Income-tax Act, 1922; but no separate reserve fund as required by proviso (b) to s. 10(2)(vi)(b) had been created. It was contended by the appellant that as the transfer to the reserve was sufficient to meet the requirements of s. 17 of the Banking Companies Act, 1949 as well as proviso (b) to s. 10(2)(vi-b) of the Act, in substance, if not in form, it had complied with the requirements of law and therefore it was entitled to the allowance claimed. The assessing authorities as well as the High Court, upon a reference, held against the appellant. On appeal to this Court.

HELD : The High Court had rightly held that the appellant, was not entitled to the allowance by way of development rebate claimed. [350 A-B]

The creation of reserve contemplated by proviso (b) to Explanation (2) to s. 10(2)(vi-b) is a condition precedent for obtaining the allowance of development rebate. The appellant had admittedly not created any such separate reserve. [350 D]

The reserve contemplated by s. 17 of the Banking Companies Act, 1949 is a separate reserve. The amount transferred to that reserve cannot be utilised for business purposes. The reserve contemplated by proviso (b) to s. 10(2)(vi-b) of the Act is an independent reserve. The amount to be transferred to that reserve is debited before the profit and loss account is made up. That amount is required to be credited to a reserve account to be utilised by the assessee during a period of ten years for the purposes of the business of the undertaking. The nature of the two reserves are different. They are intended to serve two different purposes. [350 E-H]

C.I.T. v. Veeraswami Nainar and Ors., 55, I.T.R. 35; referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 615 of 1967.

Appeal from the judgment and order dated June 21, 1966 of the Madras High Court in Tax Case No. 216 of 1963 (Reference No. 66 of 1966).

- A *C. V. Mahalingam and T. A. Ramachandran*, for the appellant.
R. N. Sachthey and B. Datta, for the respondent.

The Judgement of the Court was delivered by

- B **Hegde, J.** At the instance of the assessee, the Income Tax Appellate Tribunal (Madras Bench) referred to the High Court of Madras a statement of case under s. 66(1) of the Indian Income Tax Act, 1922 (to be hereinafter referred to as the Act). The High Court answered one of the questions submitted along-
C with the statement of case in favour of the assessee and the other in favour of the Revenue. The Revenue has not appealed against the decision of the High Court to the extent it went against it but the assessee has brought this appeal by certificate challenging the correctness of the view of the law taken by the High Court on question No. 1 submitted for its opinion.

- D The question of law that we have to consider in this appeal is :

- E “Whether the creation of a reserve in compliance with Section 17 of the Banking Companies Act is sufficient compliance with the requirements of s. 10(2) (vi-b), proviso (b) of the Indian Income-tax Act, 1922”.

The authorities under the Act as well as the High Court have answered this question in the negative.

- F The appellant is a public Limited Company carrying on banking business. For the calendar year 1958, the previous year relating to the assessment year 1959-60, the appellant claimed allowance by way of development rebate under proviso (b) of s. 10(2) (vi) (b) amounting to Rs. 1,37,836/- in the computation of its business income.

- G The admitted facts of the case are : that during the accounting year relating to the assessment year, the appellant Company had transferred a sum of Rs. 6 lakhs from the profit and loss account to the reserve fund. This sum is sufficient to meet the requirements of s. 17 of the Banking Companies Act, 1949 as well as of proviso (b) to s. 10(2)(vi)(b) of the Act; but no separate reserve fund as required by proviso (b) to s. 10(2)(vi)(b) had been created. The contention of the appellant is that as the transfer to the reserve is sufficient to meet the requirements of s. 17
H of the Banking Companies Act, 1949 as well as of proviso (b) to s. 10(2)(vi-b) of the Act, in substance, if not in form, it has

complied with the requirements of law and therefore it is entitled to the allowance of the rebate claimed. We are in agreement with the High Court that the appellant is not entitled to the allowance by way of development rebate, claimed. The rebate under proviso (b) of s. 10(2) (vi-b) is a concession granted but that concession is made subject to fulfilment of certain requirements. The grant of this allowance is made subject to the conditions prescribed in proviso (b) to Explanation (b) to s. 10(2) (vi-b). The relevant portion of that proviso reads :

“..... an amount equal to seventy-five percent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by him during a period of ten years for the purposes of the business of the undertaking except.....”

The creation of the reserve contemplated by this provision is a condition precedent for obtaining the allowance of development rebate. Admittedly the appellant has not created any such separate reserve. Section 17 of the Banking Companies Act, 1949 prescribed :

“Every banking company incorporated in India shall maintain a reserve fund, and shall, out of the net profits of each year and before any dividend is declared, transfer a sum equivalent to not less than twenty per cent of such profits to the reserve fund until the amount of the said fund is equal to the paid up capital.

Explanation.—For the purposes of this section, the expression ‘net profits’ shall have the meaning assigned to it in sub-section (3) of section 87C of the Indian Companies Act, 1913 (VII of 1913).”

The reserve contemplated by that provision is a separate reserve. The amount transferred to that reserve cannot be utilised for business purposes. The reserve contemplated by proviso (b) to s. 10(2) (vi-b) of the Act is an independent reserve. The amount to be transferred to that reserve is debited before the profit and loss account is made up. That amount is required to be credited to a reserve account to be utilised by the assessee during a period of ten years for the purposes of the business of the undertaking. The nature of the two reserves are different. They are intended to serve two different purposes. As observed by the Madras High Court in *C.I.T. v. Veeraswami Nainar and ors.*⁽¹⁾, that the object of the legislature in allowing a development of the assessee's business from out of the reserve fund is apparent from the terms of the proviso. The entries in the account books required by the

- A** proviso are not an idle formality. The assessee being obliged to credit the reserve fund for a specific purpose, he cannot draw upon the same for purposes other than those of the business and that amount cannot be distributed by way of dividend. It is also clear from the terms of the proviso that the transfer to the reserve fund should be made at the time of making up the profit and loss account.
- B**

The assessee not having complied with the requirements of s. 10(2)(vi-b) read with Explanations thereto, he is not entitled to claim the allowance in question.

- C** In the result our answer to the question formulated above is in the negative. This appeal is accordingly dismissed with costs.

R.K.P.S.

Appeal dismissed.