



* **THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment reserved on : 28.11.2008
 % Judgment delivered on : 17.12.2008

ITA 1128/2007

**COMMISSIONER OF INCOME TAX
 (CENTRAL)-I, NEW DELHI**

.....APPELLANT

versus

**SAIN PROCESSING & WEAVING
 MILLS (P) LTD**

..... RESPONDENT

Advocates who appeared in this case:

For the Appellant : Mr R D Jolly
 For the Respondent : Mr Ajay Vohra

CORAM :-

**HON'BLE MR JUSTICE BADAR DURREZ AHMED
 HON'BLE MR JUSTICE RAJIV SHAKDHER**

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| 1. | Whether the Reporters of local papers may be allowed to see the judgment ? | Yes |
| 2. | To be referred to Reporters or not ? | Yes |
| 3. | Whether the judgment should be reported in the Digest ? | Yes |

RAJIV SHAKDHER, J

1. The Revenue has preferred an appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') against the judgment of the Income Tax Appellate Tribunal (hereinafter referred to as



assessment year 1990-91. The only issue raised by the Revenue in the appeal, and which was considered by the Tribunal, in the impugned judgment was; whether the assessee could be permitted to deduct depreciation pertaining to the current year, amounting to Rs 16,47,417/-, which is not, debited to the profit and loss account, while arriving at 'book profits' under Section 115J of the Act. Accordingly, by our order dated 28.11.2008, we had framed the following substantial question of law:-

“Whether the Income Tax Appellate Tribunal was correct in law in allowing depreciation of Rs 16,47,417/- in computation of book profits under Section 115J, even though it was not debited in the profit and loss account, although mentioned in the notes to the account?”

2. Counsel agreed that the filing of paper books be dispensed with and that the appeal be heard straight away. Consequently, on the aforesaid date i.e., 28.11.2008 itself, we heard submissions advanced by the counsel for both parties in respect of the afore-mentioned question of law.

2.1 The aforesaid question of law arises in the background of the following facts:-

2.2 On 31.12.1990, the assessee had filed a return of income tax claiming a loss of Rs 1,04,16,643/-. However, for the accounting year, under consideration, in the profit and loss account, the assessee disclosed an income of Rs 25,51,856/-. The assessee's case was picked up for



scrutiny and accordingly, a notice under Section 143(2) of the Act was issued to the assessee.

2.3 In response to the notice under Section 143(2) of the Act, the authorized representative of the assessee, appeared before the Assessing Officer. During the course of the scrutiny, it was discovered that the assessee had not charged depreciation to the profit and loss account. It is not disputed that the assessee had disclosed the said fact in the notes appended to the accounts.

2.4 The Assessing Officer, after considering the stand of the assessee, disallowed the deduction claimed on account of current year depreciation amounting to Rs 16,47,417/- while, calculating 'book profit' under Section 115J of the Act.

2.5 It seems that the matter was carried in appeal to the Commissioner of Income Tax (Appeals) [hereinafter referred to as 'CIT(A)'], and thereafter, by way of a further appeal to the Tribunal. The Tribunal, vide order dated 17.12.2002 passed in ITA No. 2150/D/96, remanded the matter back to the CIT(A). These orders are not on record, however, on account of the limited scope of the controversy involved in the present appeal, they are not necessary for the disposal of the appeal. By virtue of the aforesaid order of remand, the CIT(A) was directed by the Tribunal to decide the case afresh, in accordance with, the judgment of the



Supreme Court in the case of *Surana Steels Pvt Ltd v. D.C.I.T. & Ors* (1999) 237 ITR 777.

2.6 The CIT(A), by his order dated 03.11.2003, disallowed the claim of the assessee with regard to the deduction of depreciation for the current year while, determining the “book profit” under Section 115J of the Act; on the ground that the depreciation for the current year had not been charged to the profit and loss account.

2.7 The CIT(A), however, directed the Assessing Officer, to examine, the past record of the assessee with respect to the assessment year 1983-84 so as to determine whether the amount of Rs 4,69,440/- which the assessee claimed, was duly charged to the profit and loss account and included in the brought forward unabsorbed depreciation; and if, found to be correct, to deduct the said amount from ‘book profit’. The CIT(A), accordingly, partly allowed the appeal of the assessee.

2.8 The assessee being aggrieved, carried the matter in appeal to the Tribunal. By the impugned judgment, the Tribunal allowed the appeal of the assessee and sustained its claim that a deduction, in respect of, depreciation for the current year will have to be allowed while, computing book profits under Section 115J of the Act.



3. SUBMISSION OF THE COUNSEL FOR PARTIES

Mr. R.D. Jolly, learned counsel representing the Revenue, has vociferously argued that the adjustments to the profit and loss account of the company can be carried out only in accordance with the provisions set out in the explanation to Section 115J. It was his contention that in view of the definition of “book profit” as given in the explanation to section 115J, the net profit as shown in the profit and loss account, in the relevant previous year, can only be adjusted i.e., increased or reduced, as the case may be, by reference to heads referred in clauses (a) to (ha) and clauses (i) to (iv) of the explanation to Section 115J. It was thus contended that, as the assessee admittedly, had not charged depreciation to the profit and loss account, no adjustment could be made to the ‘book profit’.

3.1 As against this, the learned counsel for the assessee, Mr. Ajay Vohra relied upon the provisions of sub-section (2) of Section 115J of the Act, to demonstrate ‘book profit’ as defined in the explanation mean ‘net profit’ as shown in the profit and loss account for the relevant assessment year which is prepared as prescribed under sub-section (1A) of section 115J of the Act. He contended that by virtue of sub-section (1A) of Section 115J of the Act, the provisions of Parts II and III of the Schedule VI of the Companies Act, 1956 (in short “the Companies Act”)



as prescribed in Parts II and III of Schedule VI to the Companies Act are relatable to Section 211 of the Companies Act. Mr Vohra further contended that, sub-section (6) of Section 211 of the Companies Act read with clause 3(iv) of Part II of Schedule VI provides a clear indicator that notes to the accounts form part of the accounts. It is his contention that what logically follows is that, in terms of clause 3(iv) of Part II of Schedule VI of the Companies Act, where depreciation is not provided for and/or charged to the profit and loss account, it would be obligatory on the part of the assessee/company to disclose by way of a note, the said fact, as well as, the quantum of arrears of depreciation not provided for in the accounts; computed, in accordance with Section 205(2) of the Companies Act. The sum and substance of the contention of the learned counsel for the assessee is that, the 'book profit' has to be determined in accordance with the accounts prepared under sub-section (1A) of Section 115J of the Act. The notes to accounts, by virtue of, the provisions of Section 211(6) read with the clause 3(iv) of Part II of Schedule VI of the Companies Act form an intrinsic part of the profit and loss account and hence, the quantum of depreciation disclosed therein would have to be taken into account in determining the 'book profit' under Section 115J of the Act.

4. Having heard both the learned counsel for the Revenue, as well as,



impugned judgment of the Tribunal deserves to be sustained for the reasons given hereinafter.

4.1 The purpose of insertion of Section 115J in the Income Tax Act has been brought out vividly by the Supreme Court in its judgment in the case of *Surana Steels Pvt Ltd (supra)*. The Supreme Court observed that the said section has been inserted in the statute to bring, within the tax net, prosperous companies which were paying zero tax, even though they had profits and were declaring dividends. The object being, that such companies, should be made to pay minimum amount of tax, which under the extant provision is equal to 30% of the book profits.

4.2 The issue, however, which has arisen repeatedly is: how are the ‘book profits’ required to be calculated? For this purpose we are required to note certain provisions from the Income Tax Act, as well as, the Companies Act.

4.3 Section 115J of the Act, in so far as it is relevant for the purpose of the appeal, is extracted hereinbelow:-

“(1A) Every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of parts II and III of Schedule VI to the Companies Act, 1956.

Explanation:- For the purposes of this section, “book profit” means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (1A), as increased by _____”



4.4 A perusal of the Section would show that the explanation makes it clear that “book profit” for the purposes of the said section means net profit as shown in the profit and loss account for the relevant previous year, prepared under sub-section (1A) of Section 115J of the Act. Sub-section (1A) imposes an obligation on every assessee to prepare its profit and loss account for the relevant previous year in accordance of provisions of Parts II and III of Schedule VI to the Companies Act, 1956.

4.5 There is no dispute that the assessee has prepared the profit and loss account in the form prescribed i.e. Part II and III of Schedule VI to the Companies Act, as also that, the assessee has not charged depreciation in the profit and loss account and instead, has disclosed this fact alongwith the quantum of current year depreciation computed in accordance Section 205(2) of the Companies Act, as per the requirement of clause 3(iv) of Part II of Schedule VI of the Companies Act, by way of a note to the accounts. The said note as appearing in the profit and loss account and in so far as it is relevant is extracted hereinbelow:-

SAIN PROCESSING & WEAVING MILLS (P) LTD: DELHI
CONTINGENT LIABILITIES & NOTES ON ACCOUNTS

Annexed to the forming part of the accounts for the year ending on 31st March, 1990

Current yr.	Previous yr.
<u>Figures</u>	<u>Period</u>

1. xxxxxx



c. xxxxxx	xxxxxx	xxxxxx
2. xxxxxx		
3. xxxxxx	xxxxxx	xxxxxx
4. No provision for depreciation has Been made due to inadequacy of profit. The unabsorbed amount of depreciation as Per Section 205(2)(b) of the Companies Act, 1956.		

Depreciation for the year	1647417/-	894275/-
Unabsorbed depreciation carried Forward	81,56,588/-	65,09,171/-

4.6 The requirement of disclosure on failure to provide for depreciation, in the profit and loss account, as also, the quantum of such arrears, flows from Section 211, read with, clause 3(iv) of Part II of Schedule VI of the Companies Act. The reason being; that there is, an obligation cast, on the company to present a true and fair view of its state of affairs to those who rely on its accounts. The provisions of Section 211 and clause 3(iv) of Part II of Schedule VI of the Companies Act, in so far, as they are relevant for the purposes of the present appeal are extracted below:-

“Section 211

(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and shall, subject to the provisions of this section, be in the form set out in Part I of Schedule VI, or as near thereto as circumstances admit or in such other form as may be approved by the Central government either generally or in any particular case and in preparing the balance sheet due regard shall be had, as far as may be, to the general instructions for preparation of



Provided that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of balance sheet has been specified in or under the Act governing such class of company.

- (2) Every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year and shall, subject as aforesaid, comply with the requirement of part II of Schedule VI, so far as they are applicable thereto.
- (6) For the purpose of this section, except where the context otherwise requires any reference to a balance sheet or profit and loss account shall include any notes thereon or documents annexed thereto, giving information required by this Act and allowed by this Act to be given in the form of such notes or documents.”

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“Part II

REQUIREMENTS AS TO PROFIT AND LOSS ACCOUNT

1. xxxxxx
2. xxxxxx
3. The profit and loss account shall set out the various items relating to the income and expenditure of the company arranged under the most convenient heads; and in particular, shall disclose the following information in respect of the period covered by the account:

I. xxxxxx

II. xxxxxx

III. xxxxxx



IV. The amount provided for depreciation, renewals or diminution in value of fixed assets. If such provision is not made by means of a depreciation computed in accordance with Section 205(2) of the Act shall be disclosed by way of a note.”

4.7 Thus disclosure, according to us, in the notes to the account is obligatory by virtue of the provision of sub-section (1A) of Section 115J of the Act which requires that every assessee shall prepare profit and loss account in accordance with the provision of Parts II and III of Schedule VI of the Companies Act, 1956.

4.8 Having said that, the issue still remains as to whether notes to accounts form part of the accounts, and whether the fact that the current year depreciation which has not been debited to the profit and loss account would in any way deprive the assessee of its claim for the deduction from the ‘net profit’ in arriving at the figure of “book profit” for the purposes of Section 115J of the Act.

4.9 The answer to this poser is found in sub-section (6) of Section 211 of the Companies Act, which provides that except where the context otherwise requires any reference to a balance sheet or profit and loss account shall include the notes thereon or documents annexed thereto, giving information required to be given and/or allowed to be given in the



is obligatory under clause 3(iv) of Part II of Schedule VI to Companies Act to give information with regard to depreciation, which has not been provided for alongwith the quantum of arrears. According to us, once this information is disclosed in the notes to the account it would clearly fall within the ambit of the explanation to Section 115J of the Act which defines “book profit” to mean ‘net profit’ as ‘shown’ in the profit and loss account for the relevant assessment year.

4.10 To our minds, as long as the depreciation which is not charged to profit and loss account but is otherwise disclosed in the notes of the accounts, it would come within the ambit of the expression ‘shown’ in the profit and loss account, as notes to the account, form part of the profit and loss account by virtue of a sub-section (6) of Section 211 of the Companies Act, 1956. This is quite evident if the provisions of sub-section (6) of the Section 211 of the Companies Act, are read in conjunction with, sub-section (1A), as well as, the explanation to Section 115J of the Act.

4.11 Another important aspect of the matter is that the expression used by legislature is ‘net profit’ in contra distinction to the well known accounting term ‘cash profit’. The net profit of a company cannot be determined till all items of income and expenses as recognized, as well as, depreciation are taken into account. Depreciation is nothing but loss



over a period of its useful life. Depreciation, undoubtedly has a major impact in determination of the financial position of a company/enterprise.

4.12 To our minds the use of the expression 'net profit' makes it clear that depreciation not debited to the profit and loss account will have to be taken into while determining "book profit" under Section 115J of the Act, as long as it forms part of the prescribed accounts.

4.13 This Bench, in the case of *CIT Vs. Khaitan Chemicals Fertilizers Ltd;* being ITA No 301/2007, in its judgment dated 27.09.2008 dealt with a similar situation. In that case the issue which arose for consideration of the Court was whether prior period expenses/extraordinary items were required to be reduced from 'net profit' as shown in profit and loss account in arriving at 'book profits' for the purposes of Section 115JA of the Act. The assessee in that case had shown prior period expenses/extraordinary items in the profit and loss account after the figure of net profit had been struck in the profit and loss account. In other words, prior period expenses/extraordinary items had been shown in the profit and loss account though separately from the figure of net profit, in consonance with the provisions of Accounting Standard 5 issued by the Council for the Chartered Accountants of India. The Revenue had submitted that no adjustment to the figure of 'net



the figure of net profit were those which were covered in Clause (i) to (ix) of Section 115JA (2) of the Act. It was contended that since prior period expenses/extraordinary items did not find mention in any of the clauses, referred to above, no adjustment could be made to the 'net profit' figure, as disclosed in the profit and loss account for arriving at the 'book profit' for the purpose of Section 115JA. We rejected the submission made by the Revenue and held that there was a fundamental flaw in the Assessing Officer's approach, in as much as, he was under the impression that the assessee was claiming a deduction in the net profit in terms of Clause (i) to (ix) of the explanation to Section 115JA (2). It was observed that assessee all along contended that the net profit was to be computed on the basis of the profit and loss account which, in turn, was required to be in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act. It was further observed that the computation of net profit in view of the prescribed Accounting Standard (AS-5) required prior period expenses/extraordinary items to be shown separately and the fact that these items were shown separately did not mean that they would not constitute part of the net profit.

4.14 The court also observed that the normal approach is to include prior period items in the determination of net profit or loss for the current period; however, the alternative approach was to show such items in the



profit or loss so as to indicate the effect of such items on the current profit and loss.

4.15 In our view, the ratio of the said judgment would apply notwithstanding the fact that there is no debit to the profit and loss account, in view of our discussion above that net profit cannot be determined without taking into account the information disclosed in the notes appended to the accounts which as observed by us hereinabove, form part of the accounts of the company/assessee.

5. The matter can be looked at from another angle. Under clause (iv) of the Explanation to Section 115J, the net profit as shown in the profit and loss account is to be reduced by, the amount of loss or depreciation which would be required to be set off against profit of the relevant previous year as if the provisions of clause (b) of the first proviso to subsection (1) of Section 205 of the Companies Act, are applicable. In other words Section 205(1) proviso (b) of the Companies Act read with clause (iv) of the explanation to Section 115J, permits reduction in the 'net profit' to the extent of past losses or unabsorbed depreciation whichever is less. This makes the legislative intent clear. According to us, if unabsorbed depreciation can be reduced from 'net profit' to arrive at book profit we see no reason why current year's depreciation even though,



appended to the accounts cannot be deducted from the ‘net profit’ in determining “book profit” for the purposes of Section 115J of the Act. In our opinion the assessee is entitled to seek deduction of current year depreciation from net profit to arrive at the ‘book profit’ even though it is not charged to the profit and loss account, though disclosed in the notes appended to the accounts.

6. In view of the discussions above, we answer the question of law framed by us in favour of the assessee and against the Revenue. In the result, the appeal is dismissed.

RAJIV SHAKDHER, J

December 17, 2008

BADAR DURREZ AHMED, J

kk/da