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19 November 2020

Securities premium utilised to set-off brought forward losses is not subject to tax on book profits

The Delhi Bench of the Income-tax Appellate Tribunal rendered its decision that securities premium utilised to set-off brought forward losses are not subject to minimum alternate tax on book profits under section 115JB of the Income-tax Act, 1961.

Background:

- The taxpayer¹ is a private limited company engaged in the business of manufacture and sale of aerated soft drinks. The taxpayer filed its return of income for the Financial Year (FY) 2002-03, corresponding to Assessment year (AY) 2003-04, declaring loss under the normal provisions of Income-tax Act, 1961 (ITA) and 'Nil' tax liability under the minimum alternate tax (MAT) provisions as per section 115JB of the ITA.

As per section 115JB of the ITA, where the tax payable by a company (computed under normal provisions of the ITA) is less than 15% of its book profit, then such book profit is deemed to be the total income and tax is payable thereon at 15% (plus applicable surcharge and education cess).

Book profit means the net profit as shown in the profit and loss account of the company and as increased / decreased by prescribed items.

- The Assessing Officer (AO), during the course of audit proceedings, observed that the taxpayer had utilised security premium account to set-off brought forward losses without debiting the same to its profit and loss account (P&L a/c).

The AO held that the treatment given by the taxpayer was not in conformity with company law provisions. Therefore, the AO held that the amount of securities premium set-off against brought forward losses was to be taken as P&L transaction which would have ultimately affected tax on the MAT account and accordingly, made addition in the hands of the taxpayer.

- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] deleted the addition made by the AO by giving detailed reasoning.
- Aggrieved by the CIT(A)'s order, the Revenue filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted the CIT(A) while deleting the addition had held that:

¹ DCIT v. Hindustan Coca Cola Beverages Private Limited (ITA no 236/Del/2007) (Delhi HC)

- Security premium account, being part of the capital of the company is not in the nature of an entry bearing the character of income. Since it was not created / credited by debiting the P&L a/c of the company, its reversal in any subsequent year was not required to be reflected in the P&L a/c.

Thus the applicability of clause (b) of Explanation to section 115JB(2) of the ITA was ruled out.

The said clause refers to the amounts carried to any reserves, by whatever name called other than a reserve specified under section 33AC of the ITA.

- Securities premium is not in the nature of any provision and therefore, clause (c) of Explanation to section 115JB of the ITA was not applicable.

The said clause refers to the amounts set aside to provisions made for meeting unascertained liabilities.

- The AO did not have power to recast the accounts which were audited and prepared in accordance with the relevant provisions of the Companies Act, 1956 (now Companies Act, 2013). Further, for making additions to the 'book profits' as shown in the P&L a/c, the AO could only invoke Explanation to section 115JB(2) of the ITA.

The CIT(A) had relied on the earlier cases² of the Supreme Court and High Court while arriving at the said conclusion.

Further, the ITAT noted that the CIT(A) while deleting the addition had considered the decision of the Delhi High Court (in the taxpayers' case) approving the adjustment of security premium account with brought forward losses in terms of the provision of the Companies Act, 1956 (now Companies Act, 2013).

- The ITAT noted that the Supreme Court in an earlier case³ had held that the AO did not have the jurisdiction to go beyond the net profit shown in the Profit & Loss a/c except to the extent provided in the Explanation to section 115J of the ITA (similar to section 115JB of the ITA) which was relied on by the CIT(A).

In view of the above and the detailed reasoning given in the CIT(A)'s order, the ITAT held that it did not find any infirmity in the CIT(A)'s order in absence of any contrary material brought to the ITAT's notice by the Revenue. Accordingly, the ITAT upheld the CIT(A)'s order and dismissed the Revenue's appeal.

Comment:

This ruling affirms the principles that securities premium does not bear the character of income and that Revenue cannot alter / recast the books prepared in accordance with the provisions of the Companies Act, 2013, except to the extent provided in the Explanation to section 115JB(2) of the ITA.

² Apollo Tyres Ltd v. CIT [2002] 255 ITR 273 (SC); Malayala Manorama Co. Ltd. v. CIT [2008] 216 CTR 102 (SC); Kinetic Motor Co Ltd vs DCIT [2003] 262 ITR 330 (Bom HC); Sri Hariram Hotels (P) Ltd vs CIT, 237 Taxman 564 (Kar HC); etc.

³ Apollo Tyres Ltd v. CIT [2002] 255 ITR 273 (SC)



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