PETITIONER:
M/S. THE ANDHRA BANK LTD.,HYDERABAD.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME TAX,A.P. III, HYDERABAD.

DATE OF JUDGMENT22/09/1995

BENCH:
SEN, S.C. (J)
BENCH:
SEN, S.C. (J)
AHMADI A.M. (CJ)
PARIPOORNAN, K.S.(J)

CITATION:
1995 SCC Supl. (4) 133 JT 1995 (7) 373
1995 SCALE (5)477

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T

SEN,J.

These are appeals from a judgment of the Andhra Pradesh High Court which answered the following question of law in the affirmative and against the assessee:-

> "Whether on the facts and in the circumstances of the case, the sums of Rs.4,12,780/- and Rs.5,50,000/- are liable to be excluded under Rule 1(xi) (a) of the Surtax Rules in computing the chargeable profits in Surtax assessments for the assessment years 1971-72 and 1972-73?"

The assessment years involved in this case are 1971-72 and 1972-73 for which the relevant previous years were calendar years 1970 and 1971 respectively.

The dispute in this case is about computation of chargeable profits of a banking company. 'Chargeable Profits' has been defined in sub-section (5) of Section 2 of The Companies (Profits) Surtax Act, 1964 (for short 'the Act') to mean the total income of an assessee computed under the Income Tax Act, 1961 for any previous year or years, ... and adjusted in accordance with the provisions of the First Schedule."

There is a specific rule in the First Schedule of the Act relating to computation of chargeable profits of a banking company which is as under :

> "In computing the chargeable profits of a previous year, the total income computed for that year under the Income-Tax Act shall be adjusted as follows:-
> 1. Income, profits and gains and other sums falling within the following clauses shall be excluded from such

total income, namely:-

x x x x x x x x x

(xi) in the case of a banking company-

(a) any sum which during the previous year is transferred by it to a reserve fund under sub-section (1) of section 17 of the Banking Companies Act, 1949....., not exceeding the amount required under the aforesaid provisions to be so transferred or deposited, as the case may be, or"

The language of clause (xi) (a) is clear. Whatever amount as deposited in the reserve fund created under Section 17 (1) of the Banking Regulation Act will not qualify for deduction. The deduction will be limited only to the amount which is required to be transferred to the reserve fund by sub-section (1) of Section 17 of the Banking Regulation Act, 1949. Sub clause (a) of clause (xi) clearly states that when an amount is transferred to the statutory reserve fund, deduction will be limited to a sum 'not exceeding the amount required under the aforesaid provisions to be so transferred.'. The legislative intent is not to allow the entire sum transferred to the reserve fund as deduction but to limit it to the amount which is actually required by the provisions of Section 17 (1) of the Banking Regulation Act to be transferred to the reserve fund.

Section 17 of the Banking Regulation Act, 1949 makes it necessary for a banking company to create a reserve fund and transfer not less than 20/ of its profits to that reserve fund.

"17. Reserve Fund- (1) Every banking company incorporated in India shall create a reserve fund and shall, out of the balance of profit of each year as disclosed in the profit and loss account prepared under Section 29 and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than twenty per cent of such profit."

The mandate of Section 17 is that every banking company will have to transfer to a reserve fund every year, a sum equivalent to "not less than twenty per cent of such profit". In other words, at least 20% of the profit as shown in the Profit and Loss Account before declaration of any dividend has to be transferred to the reserve fund. This is the statutory requirement. If a banking company transfers any amount in excess of 20% of its profit of any year to this reserve fund, the exclusion in clause (xi) (a) will be limited to 20% of the profit which is the requirement of Section 17 (1) of the Banking Regulation Act.

Mr. Ramachandran on behalf of the assessee has contended that in this case, a reserve fund was created by the assessee bank to comply with the provisions of Section 17 of the Banking Regulation Act. Even though the amount of contribution for the relevant accounting period was higher than 20% of its balance of profits, the entire amount will have to be deducted from its total income in order to arrive at chargeable profit under clause (xi) of Rule 1 of the First Schedule to the Act, because the amount in excess of the statutory minimum was contributed pursuant to the

direction given by the Reserve Bank of India under Section 35A of the Banking Regulation Act is binding on a banking company. Therefore, the Bank was under a legal obligation to transfer more than 20% of its profits to the reserve fund. Since this transfer was made pursuant to direction given by the Reserve Bank of India, the entire amount so transferred must be allowed as deduction for computation of chargeable profit.

We are unable to uphold this argument for several reasons. In the first place, clause (xi) of Rule c 1 of the First Schedule to the Act specifically restricts the allowable amount to a sum not exceeding the amount required under the provisions of Section 17 to be so transferred. Any other sum transferred to a reserve fund under the direction of Reserve Bank or any other law will not qualify for deduction. For example, under the Banking Regulation Act, a bank has to maintain a cash reserve under Section 1 of the Banking Regulation Act. Any sum transferred to this reserve will not be eligible for deduction from total income computed under the Income Tax Act. Only the amount transferred to the reserve fund created under Section 17 will be eligible for deduction and the quantum of deduction is restricted to the amount required under the provisions of Section 17 of the Banking Regulation Act to be transferred. Section 17 lays down that before any dividend is daclared, out of the balance of profit of each year as disclosed in the profit and loss account, a sum not less than 20% of such profit will have to be transferred to the reserve fund. Deduction under clause (xi) has been specifically limited to this amount which is required by Section 17 to be transferred to the reserve fund. The phrase 'not exceeding the amount required ..... to be so transferred' indicates that any other sum in excess of the requirement of Section 17 will not be eligible for deduction.

Assuming that the assessee bank was under a legal obligation to transfer a sum in excess of 20% by virtue of a. direction given by the Reserve Bank of India, then the excess contribution to the reserve fund was not because of any requirement of Section 17 but because of the provisions of some other Section. The exclusion permissible under clause (xi) of Rule 1 of the first Schedule of the Act is limited only to the sum "not exceeding the amount required under the aforesaid provisions to be so transferred ....". The 'aforesaid provisions' in this clause means the provisions of Section 17 (1) of the Banking Regulation Act. If any further sum is transferred to the reserve fund by virtue of provisions of some other Sections of the Act, such sum will not quality for exclusion in computation of chargeable profits.

Moreover, from the various circulars relied upon by the assessee Bank, it does not appear that the Reserve Bank of India gave any direction under Section 35A to transfer more than 20% to the reserve fund. A circular letter dated 27.12.1961 was issued by the Governor, Reserve Bank of India, to all the scheduled Banks in which it was stated:-

> "I am aware that several banks obliged to transfer 20 per cent of their declared profits in terms of section 17, actually transfer a quantum larger than that, I have no doubt such banks will continue to maintain this practice."

This cannot be construed as a direction by the Reserve Bank of India under Section 35A. Similarly, the circular letter written on 25th January, 1962 deals with 'a point which has been raised by the Bank'. In reply the Executive Director of

the Reserve Bank of India stated:-

> "In this connection, we advise as under:
> 2. Certain banks have already reserves which are equal to or exceed their paid-up capital. The intention is that such banks should transfer not less than twenty per cent of their disclosed profits arrived at after making the usual and necessary provisions and after deduction of the provision for taxation.
> 3. There are several banks the reserves of which are not equal to their paid-up capital. The intent of the Governor's letter is that such banks should, till they reach parity of paid-up capital and reserves, follow the same basis of computation as they observed in their profit and loss account for 1960. That is to say, if they compute transfers to reserves on profits before tax they should continue to Co so till parity is reached."

This letter is in the nature of advice and contains direction as to how profit should be calculated before transfer of the requisite 20% is made to the reserve fund. Banks having reserves equal to or in excess of their paid-up capital should transfer 20% of the profits after making the usual provisions and after deduction of provisions for taxation. But those Banks whose reserves are not equal to their paid-up capital should transfer 20% of their profits Deforo tax to the reserve fund till the parity of paid-up capital is reached. This circular letter was written by the Executive Director of the Reserve Bank of India.

Reliance has been placed upon two other letters written by the Reserve Bank of India to the assessee Bank. The first letter is dated 29th March, 1971 in which the Bank's practice of effecting transfer to the statutory reserve, after making provisions for Income Tax, has been commented upon. In this letter, the Deputy Chief Officer of the Reserve Bank has made it clear that lin future, bank should transfer to the above reserves a sum not less than 20% of its profits before providing for income tax. We may add that our approval does not affect in any way the obligation imposed on your bank by or under any other provisions of the Banking Regulation Act, 1949 or of the Companies Act, 1956 or any other law for the time being in force.'

The other letter dated 25.5.1972 is also in the same vein.

None of these circular-letters sent by the Reserve Bank of India nor the letters written specifically to the assessee-Bank go to show that the Reserve Bank of India had directed the Banks or the assessee-bank to transfer a larger amount than what was required by Section 17 (1) of the Banking Regulation Act. Therefore, this argument that the assessee had been directed by the Reserve Bank of India under Section 35A to contribute a larger amount to the reserve fund than what was required by Section 17(1) is misconceived.

In view of the aforesaid, we hold that the question referred to the High Court was correctly answered by it. These appeals are dismissed. These will be no order as costs.

CIVIL APPEAL NO.861 OF 1985

In view of our Judgment in Civil Appeals Nos.4895-96 of 1964, this appeal is also dismissed.

JUDIS