

4. For the previous year ending 31.3.2001, relevant to the assessment year 2001-02, the P & L Account showed the charge of depreciation at Rs.127,57,06,000/- which was reduced by transfer from revaluation reserve to the extent of Rs.26,11,74,000/- resulting in a net debit on account of depreciation of Rs.101,45,32,000/-. The A.O., while computing the book profit under Section 115JB of the Act, did not allow reduction of the afore-stated amount of Rs.26,11,74,000/- on the ground that the revaluation reserve stood created in the assessment year 2000-01 and had not been added back while computing the book profit in that year in terms of the proviso to clause (i) of explanation to Section 115JB. This order was upheld by the C.I.T. (A) and by the ITAT and by the High Court, hence, this civil appeal is filed by the assessee.

5. In the present case, the controversy is whether the amount transferred from the revaluation reserve and set off against the amount of depreciation debited to P & L Account can be excluded in terms of clause (i) of explanation to Section 115JB(2) read with the proviso.

Case of the Assessee

6. It is the case of the assessee that the main provision of clause (i) seeks to exclude from the net profit, as per P & L Account, any amount withdrawn from any reserves and credited to P & L Account. According to the assessee, the proviso introduces a caveat by providing that such exclusion can be made only in circumstances where the book profit of the year in which the reserve is created (out of which the withdrawal has been made in the subsequent years) has been increased to the extent of such reserve. Thus, according to the assessee, the said proviso has no application to cases like the present one because in this case the revaluation reserve is created, inter alia, for revaluation of assets, which are ordinarily stated in the balance sheet at the historical cost of acquisition by debiting the value of the fixed assets to the extent of revaluation with corresponding credit to the revaluation reserve. Such creation of the revaluation reserve does not impact the P & L Account in the year of creation of such reserves. That, such revaluation reserve is not a free reserve. It is not available for distribution of profits. Unlike revenue reserves, a "revaluation reserve" is not an Appropriation of Profits and the same is not debited by way of debit entry through the P & L Account. That, a revaluation reserve is in the nature of adjustment entry to balance both sides of the balance sheet. That, the treatment of revaluation reserve is governed by the Accounting Standards 10 and 6 and the Guidance Note on Treatment of Reserves Created on Revaluation of Fixed Assets issued by the Institute of Chartered Accountants of India (ICAI). That, in the year in which the revaluation reserve is created, the amount of such reserve is not debited to P & L Account and is credited directly to a revaluation reserve as provided by ICAI and, thus, the profit as reflected in the P & L Account is not depressed by the creation of the reserve and, is, therefore, effectively increased to that extent. Thus, there is no question of increasing the amount shown in the P & L Account further by the revaluation amount as per Section 115JB, as the profit has, in any case, not been reduced by such an amount in the first place. That, since in the year of creation of reserves the book profit suffers full tax, without the same being affected by creation of such revaluation reserves, in the year of withdrawal, the amount withdrawn would be liable to be reduced while computing the book profit. It cannot be said that even if the entire book profit has suffered tax in the year of creation of reserve, the revaluation reserve created in that year should artificially again be added back for computing such book profit. That, by the Finance Act, 2007, w.e.f. 1.4.2007, clause (iia) is inserted

in Section 115JB under which the depreciation on historical cost alone would be taken into account while calculating the book profit. In other words, depreciation attributable to the revaluation of the fixed assets to be debited to the P & L Account cannot be taken into account to calculate book profit w.e.f. the assessment year 2007-08.

Relevant Provisions

7. We quote hereinbelow the relevant provisions of Section 115JB, which reads as under:

Special provision for payment of tax by certain companies.

115JB. (1) Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2001, is less than seven and one-half per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half per cent.

(2) 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 (1 of 1956) :

Provided that while preparing the annual accounts including profit and loss account,--

(i) the accounting policies;

(ii) the accounting standards adopted for preparing such accounts including profit and loss account;

(iii) the method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the Companies Act, 1956 (1 of 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 (2), as increased by--

(b) the amounts carried to any reserves, by whatever name called, other than a reserve specified under section 33AC; or if any amount referred to in clauses (a) to (f) is debited to the profit and loss account, and as reduced by--

(i) the amount withdrawn from any reserve or provision (excluding a reserve created before the 1st day of April, 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account:

Provided that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below the second proviso to section 115JA, as the case may be;

8. Before answering the submissions advanced on behalf of the assessee, we wish to explain the history of MAT provisions, which is as follows:

History of MAT Provisions

9. MAT is applicable only where the normal total income computed is less than 30% of the book profit.

10. MAT was introduced by the Finance Act of 1996 w.e.f. 1.4.1997. This was necessary due to a rise in the number of zero-tax companies paying marginal tax which situation arose in view of preferences granted in the form of exemptions, deductions and high rates of depreciation. The rate of minimum tax was kept at 30% of the book profit as deemed total income. MAT was levied under Section 115JA from assessment year 1997-98. Section 115JA is made inoperative w.e.f. 1.4.2001. In its place, the Finance Act, 2000 inserted Section 115JB. The new provision provides that all companies having book profit under the Companies Act, shall be liable to pay MAT at a specified rate of the book profit. It further provides that every MAT company shall follow same accounting policies and standards as are followed for preparing its statutory account.

11. For the purposes of the afore-stated provision, "book profit" means the net profit as shown in the P & L Account in the relevant previous year in accordance with the provisions of Part II and Part III of the Schedule VI to the Companies Act, subject to certain adjustments which increases or decreases the book profit. Thus, even under Section 115J, certain adjustments were to be made to the net profits as shown in the P & L Account. One such adjustment stipulates that the net profit shall be decreased by the amount withdrawn from any reserves, if any such amount is credited to the P & L Account. Some companies have taken advantage of Section 115J by decreasing their net profit by the amount withdrawn from the reserve created in the same year itself, though the reserve when created had not gone to increase the book profit. Such adjustments led to lowering of profits and, consequently, the quantum of tax payable got reduced. Thus, by amending Section 115J, it was provided that "book profit" will be allowed to be decreased by the amount withdrawn from any reserves only in two cases:

(i) if such reserve has been created in the previous year relevant to the assessment year commencing w.e.f. 1.4.1998 OR

(ii) if the reserve so created in the previous year has gone to increase the book profit in any year when Section 115J was applicable.

12. The Finance Act, 2002 now specifically provides vide Section 115JB that the amounts withdrawn from any reserves, if credited to the P & L Account, shall be reduced from the book profit. It also provides that any amount withdrawn from such reserves created on or after 1.4.1997 and which is credited to P & L Account shall not be reduced from the book profit, unless the book profit in the year of creation of such reserves stood increased by the amount transferred to such reserves at that time.

Scope of Section 115JB

13. The expression "book profit" for the purposes of Section 115JB has been defined in the explanation to Section 115JB(2) to mean: -

the net profit as shown in the P & L Account for the relevant previous year prepared under Section 115JB(2), as increased by the amount(s) mentioned in clauses (a) to (f) and as reduced by the amount(s) covered by clauses (i) to (vii) of the said explanation.

14. It is, thus, clear that what is "book profit" has been defined and explained in the above explanation. Section 115JB is a self-contained code. It applies notwithstanding other provisions of the Act. There is no scope for any allowances or deductions under any other section from what is deemed to be total income of the company (assessee).

15. The first step for arriving at the "book profit" is that the net profit as shown in the P & L Account for the relevant previous year prepared under Section 115JB(2) has to be increased by the amount(s) in clauses (a) to (f) if such amount(s) is debited to the P & L Account. Clause (b) refers to amount(s) carried to any reserves by whatever name called. As stated above, such increase needs to be made only if any amount referred to in clauses (a) to (f) is debited to P & L Account.

16. The second step for arriving at the "book profit" is that the net profit as shown in the P & L Account for the relevant previous year prepared under Section 115JB(2) and as increased by any amount, as stated above, has to be reduced by the amount(s) in clauses (i) to (vii).

17. For the purposes of deciding this case it may be noted that we are concerned with clause (i) which inter alia refers to an amount(s) withdrawn from any reserves if any such amount(s) is credited to P & L Account. During the relevant assessment year, clause (i) had an exception to such exclusion. That exception was in the form of a proviso which inter alia stated that the exclusion in clause (i) to the explanation will not apply "to the amount(s) withdrawn from reserves created in a previous year relevant to the assessment year 1997-98 or any subsequent assessment year unless the

book profit of such year stood increased by those reserves (out of which the said amount(s) stood withdrawn)".

18. Thus, the book profits calculation would be as under:

Take profit as per P & L Account	xx
Add: (if debited to P & L Account)	
(a) Income tax paid/ payable & provision	xx
(b) Any transfer for reserves	xx
(c) Unascertained liabilities (contingent)	xx
(d) Provision for losses of subsidiaries	xx
(e) Dividend paid/ proposed	xx
(f) Expenses relating to exempt income under sections 10, 10A, 10B, 11, 12	xx
Less: (if credited to P & L Account)	
(i) Withdrawal from reserves or provisions subject to proviso	xx

Q.: Could Rs.26,11,74,000/-, being the differential

depreciation recouped from the revaluation reserves created during the earlier assessment year 2000-01, be said to be credited in the P & L Account during the assessment year in question in terms of clause (i) to the explanation to Section 115JB(2)?

19. The brief facts apropos this issue are that the assessee had revalued its fixed assets as on 31st March, 2000 and the resultant surplus of Rs.288,58,19,000/- stood added to the cost of the assets on the asset side of the balance sheet and to equalize both sides thereof the revaluation reserve of an equivalent amount was created on the liability side of the balance sheet. Thus, the said reserve was merely an adjustment entry. The figure of profit remained untouched during the assessment year 2000-01 so far as the revaluation of assets to the tune of Rs.288,58,19,000/- was concerned. During the assessment year 2001-02, an amount of Rs.26,11,74,000/-, being the differential depreciation, was transferred out of the said revaluation reserve of Rs.288,58,19,000/- and credited to the P & L Account which the AO disallowed and consequently the said sum of Rs.26,11,74,000/- stood added back to the net profits. Hence, this civil appeal is filed by the assessee.

20. Book profit is not defined in the Act. It is income computed under the company law. By virtue of the MAT provisions, in the case of a company whose total income as computed under the normal provisions of the Act is less than 30% of the book profit, the total income chargeable to tax will be 30% of the book profit as computed. For the purposes of Section 115J, book profit will be the net profit as shown in the P & L Account prepared in accordance with the provisions of Schedule VI to Companies Act, 1956 after certain adjustments. The net profit will be increased by income tax paid or payable, amount carried to any reserve, provision made for liabilities etc. provided the amount(s) is debited to the P & L Account. The amount so arrived at is to be reduced by item (i) to item (vii) including amounts withdrawn from reserves, if any such amount is credited to P & L Account. Clauses (i) to (vii) of the explanation to Section 115JB(2) represent items of reduction from the net profits. Clause (i) mandates reduction for the amount(s) withdrawn from the reserves earlier

created, provided such amount(s) is credited to P & L Account. Such credit is mandated so that the true working result gets reflected in the financial statement of the assessee-company. The said clause (i) contemplates only those reserves which actually affect the net profits as shown in the P & L Account (see also clause (ii) for comparison). The object of various clauses (i) to clause (vii) is to find out the true working result of the assessee-company.

21. In the present case, the adjustment made in the P & L Account was as per Accounting Standards 6 and 10 read with Guidance Note issued by Institute of Chartered Accountants of India which is in conformity with Section 211 of the Companies Act. The said adjustment was primarily in the nature of contra adjustment in the P & L Account and not a case of effective credit in the P & L Account (as contemplated in clause (i) of explanation). The credit in the P & L Account implies that the P & L Account per se has been effectively credited by the said amount. Thus, the amount withdrawn from any reserve must in effect impact the net profit as shown in the P & L Account. As per accounting principles, the contra adjustment does not at all affect any particular account to which it has been carried. Unless an adjustment has the effect of increasing the net profit as shown in the P & L Account, that entry cannot be said to be a credit to the P & L Account and, therefore, though the amount has been literally credited to the P & L Account, however, in substance there is no credit to P & L Account. MAT provisions were introduced as number of zero tax companies had grown. It was found that companies had earned substantial book profits and had paid huge dividends but paid no tax. In the present case, had the assessee deducted the full depreciation from the profit before depreciation during the accounting year ending 31.3.2001, it would have shown a loss and in which event it could not have paid the dividends and, therefore, the assessee credited the amount to the extent of the additional depreciation from the revaluation reserve to present a more healthy balance sheet to its shareholders enabling the assessee possibly to pay out a good dividend. It is precisely to tax these kinds of companies that MAT provisions had been introduced. The object of MAT provisions is to bring out the real profit of the companies. The thrust is to find out the real working results of the company. Thus, the reduction sought by the assessee under clause (i) to the explanation to Section 115JB(2) in respect of depreciation has been rightly rejected by the AO.

22. Take the facts of the present case. As stated above, the revaluation reserve of Rs.288,58,19,000/- was created during earlier assessment year 2000-01. During the accounting year ending 31.3.2001 (assessment year 2001-02), the profits of assessee stood at Rs.120,18,97,000/- whereas depreciation stood at Rs.127,57,06,000/-. Depreciation is a no-cash charge against the profits. Thus, company had a loss of Rs.7,38,09,000/- (i.e. Rs.127,57,06,000/- of depreciation as against profit of Rs.120,18,97,000/-). However, by withdrawing Rs.26,11,74,000/-, being the differential depreciation, from the revaluation reserve of Rs.288,58,19,000/- (which is only a notional adjustment entry to balance both sides of the balance sheet) and reducing it from the depreciation of Rs.127,57,06,000/-, the assessee artificially brings down the depreciation only to Rs.101,45,32,000/- which is then deducted from the profits before depreciation amounting to Rs.120,18,97,000/- so that there is a profit of Rs.18,73,65,000/-. This is how the loss of Rs.7,38,09,000 got converted to profit of Rs.18,73,65,000/-. Thus, the financial statement for the year ending 31.3.2001 is made to look healthy.

23. The reasons given hereinabove are in addition to the reasons given by the Authorities below while rejecting the claim of the assessee.

24. The matter could be examined from another angle. To recapitulate the facts, the fixed assets of the assessee were revalued in the earlier assessment year 2000-01 (i.e. financial year ending 31.3.2000) and amount of enhancement in valuation was Rs.288,58,19,000/- which was credited to the revaluation reserve. In other words, at the time of revaluation of assets, the said figure of Rs.288,58,19,000/- was added to the historical cost of assets on the asset side of the balance sheet and in order to equalize both sides of the balance sheet the revaluation reserve to that extent was created on the liability side. Thus, the figure of profit remained untouched so far as the revaluation of assets to the tune of Rs.288,58,19,000/- is concerned. The profits were not increased by the said amount when the asset was revalued. During the assessment year in question, i.e., assessment year 2001-02, an amount of Rs.26,11,74,000/-, being the differential depreciation, was transferred out of the said revaluation reserve of Rs.288,58,19,000/- and credited to the P & L Account which the A.O. disallowed by placing reliance on the proviso to clause (i) of the explanation to Section 115JB(2). Consequently, the A.O. added back the said amount of Rs.26,11,74,000/- to the net profits. We agree with the A.O. Under the provisions, as they then existed, certain adjustments were required to be made to the net profit as shown in the P & L Account. One such adjustment stipulated that the net profit shall be reduced by the amount(s) withdrawn from any reserves, if any such amount is credited to the P & L Account. Thus, if the reserves created had gone to increase the book profits in any year when the provisions of Section 115JB were applicable, the assessee became entitled to reduce the amount withdrawn from such reserves if such withdrawal is credited to P & L Account. Now, from the above facts, it is clear that neither the said amount of Rs.288,58,19,000/- nor Rs.26,11,74,000/- had ever gone to increase the book profits in the said year ending 31.3.2000 (being the financial year). Thus, when such amount(s) has not gone to increase the book value at the time of creation of reserve(s), there is no question of reducing the amount transferred from such revaluation reserves to the P & L Account. Thus, the proviso to clause (i) of the explanation to Section 115JB(2) comes in the way of the claim for reduction made by the assessee. In our view, the reduction under clause

(i) to the explanation could have been availed only if such revaluation reserve had gone to increase the book profits. As the amount of revaluation reserves had not gone to increase the book profits at the time it was created, the benefit of reduction cannot be allowed. One more fact needs to be highlighted. In this case, as indicated above, the revaluation reserve stood created during the earlier assessment year 2000-01. It has been vehemently argued on behalf of the assessee that creation of such reserve did not impact the profits of that year. The facts enumerated hereinabove shows that though the profit was not impacted, depreciation as the head of A/c. was impacted. By inter play of the balance sheet items with Profit & Loss A/c. items the assessee, as stated above, has sought to project the loss of Rs.7,38,09,000/- as profit of Rs.18,73,65,000/-.

Conclusion

25. For above reasons, we see no reason to interfere, hence, the civil appeal filed by the assessee shall stand dismissed with no order as to costs.

.....CJI (S. H. Kapadia)J. (K.S. Panicker
Radhakrishnan)J. (Swatanter Kumar) New Delhi;

January 5, 2011