REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 1265 OF 2007

THE PEERLESS GENERAL FINANCE AND INVESTMENT COMPANY LTD. APPELLANT(S)

VERSUS

COMMISSIONER OF INCOME TAX RESPONDENT(S)

J U D G M E N T

R.F. Nariman, J.

1) The question raised in this appeal is as to whether receipts of subscriptions in the hands of the assessee-Company for the previous years relevant to the assessment years 1985-86 and 1986-97 should be treated as income and not capital receipts inasmuch as the assessee has in its books of accounts shown this sum as income.

2) The assessee-Company has floated various schemes which require subscribers to deposit certain amounts by way of subscriptions in its hands, and, depending upon the scheme in question, these subscribed amounts at the end of the scheme are ultimately repaid with interest. The scheme at hand also contains

Signature Not Verified
Digitally signed by R NATARAJAN
Date: 2014.07.13 13:18:02 IST
Reason:

forfeiture clauses as a result of which if, mid-way, a certain amount is forfeited, then the said amount would immediately become income in the hands of the assessee. This is an admitted position before us.

3) In the present case, the assessee was asked to bring to tax such amounts as income for the two years in question, inasmuch as, according to the Assessing Officer, it had treated the whole amount as income, 3% of which is not disputed to be income before us for the years in question. The Assessing Officer treated these amounts as income inasmuch as under the accounting system followed by the assessee, these amounts were credited to the profit and loss account for the years in question as income. The Commissioner of Income Tax (Appeals) dismissed the appeal from the original assessment orders and confirmed the same. The Income Tax Appellate Tribunal, on the other hand, allowed the appeals by relying upon the judgment of this Court in *Peerless General Finance and Investment Co. Limited and Another* vs. *Reserve Bank of India*, (1992) 2 SCC 343 in which, according to the Appellate Tribunal, this Court finally decided the question in the assessee's own case stating that such amounts cannot be treated to be income but are in the nature of capital receipts. These were not only because of the interpretation of an RBI Circular of 1987, but

also because, on general principles, such amounts must be treated to be capital receipts or otherwise they would violate the provisions of the Companies Act. It further went through the various clauses contained in the scheme at hand, and found that in point of fact no subscription certificate had, in fact, been forfeited, as a result of which it was clear that there would be no income in the hands of the assessee for these two years. It also dealt with certificates that were surrendered prior to the stated time, and stated that in such cases as well whatever would remain as surplus in the hands of the assessee would be treated as income. It went on to state that there would be no estoppel in law against the assessee making a claim that these amounts were in the nature of capital receipts and not income, and also relied upon certain judgments of this Court to buttress the proposition that this Court had also held that what is the true position in law cannot be deflected by what the assessee may or may not do in its treatment of the matter at hand in its accounts. So doing, the appeal against the Commissioner of Income Tax was allowed by the Income Tax Appellate Tribunal. In the first round, the High Court, by its judgment dated 09.09.1999, stated that since no question of law arose, the reference applications before it were dismissed. This Court, by an order dated 03.12.2002, set aside the High Court judgment and referred the following questions to the

High Court:

> "(a) Whether the judgment of the Supreme Court in *Peerless General Finance and Investment Co. Ltd.* vs. *Reserve Bank of India* (1992) 2 SCC 343 lays down as an absolute proposition of law that all receipts of subscription in the hands of the assessee for the previous years relevant to the assessment years 1985-86 and 1986-87 must necessarily be treated as capital receipts?
>
> (b) If the answer to the first question is in the negative, on the facts and in the circumstances of the case, and having regard to the fact that the first year's subscriptions were consciously offered as revenue receipt for taxation by the assessee in the returns of income filed in respect of assessment years 1985-86 and 1986-87, whether the Tribunal was justified in accepting the assessee's contention that the first years' subscription was capital receipts and hence not taxable?
>
> (c) Whether on the facts and in the circumstances of the case and having regard to the observations of Hon'ble Supreme Court to the effect that the directions of Reserve Bank of India dated 15th May, 1987 had been made applicable from 15th May, 1987 and would only apply to the deposits made on or after 15th May, 1987, the tribunal was justified in law as well as on the facts in holding that the said directions of the Reserve Bank of India were retrospective and must be applied in all pending proceedings?"

4) When remanded to the High Court, by the impugned judgment dated 06.10.2005, the High Court of Calcutta allowed the appeal against the Appellate Tribunal holding that a perusal of the subscription scheme of the appellant company would show that

since forfeiture of the amounts deposited is possible, this amount should be treated as income and not as a capital receipt. Further, it relied heavily upon the fact that the assessee had itself treated such amounts as income and credited them to its profit and loss account for the years in question and would, therefore, be estopped by the same. On going through the judgment of this Court, namely, *Peerless General Finance and Investment Co. Limited (supra)* it went on to state that since the said judgment dealt with an RBI Circular of 1987, which itself was only prospective, any law declared as to the effect of Clause 12 of that Circular would be prospective in nature and would, therefore, not apply to the assessment years in question.

5) Mr. S. Ganesh, learned Senior Advocate, appearing for the appellant-Company has argued before us that the High Court is incorrect on all counts. According to him, the fact that forfeiture may take place under the clauses of the scheme has to be read with an interim order which he has brought to our notice by way of a supplementary affidavit dated 05.04.2017 in which it is made clear that, post the date of the order i.e. 03.09.1979, no amount can be forfeited under any of the schemes by the appellant-Company. He stated that, as a matter of fact, the supplementary affidavit states

that for the years in question and, in particular, for every year after 1979, no sum has in fact been forfeited by the Company under any of the schemes in question. He then argued that it was incorrect to go only by the accounting system of the assessee since it is well settled that the real position in law, *qua* deposits that are made by subscriptions, on first principle, would show that they are in the nature of capital receipts and cannot be possibly be said to be income, as they would enure to the benefit of the subscribers of the scheme and would have to be paid back at the end of the scheme together with interest thereof. He also argued that, in any event, that the judgment in *Peerless General Finance and Investment Co. Limited (supra)* was not merely grounded on an interpretation of Clause 12 of the RBI Circular of 1987 but it also specifically held that, as a general proposition, receipts of this nature would be capital and adverted to both the judgments of N.M. Kasliwal, J and K. Ramaswamy, J. in this behalf. He also argued that even for the period in question, this judgment would squarely apply as if such receipts were to be treated as income it would violate the Companies Act. He also argued that it would be incorrect to raise any question of estoppel against the appellant-Company and cited judgments of this Court to buttress this proposition.

6) On the other hand, Mr. Arijit Prasad, learned Senior Counsel, appearing for the Revenue has countered Mr. Ganesh's submissions. He read copiously from the Commissioner of Income Tax (Appeals) orders in order to buttress his submission that the ground reality of the situation in the facts of this case is that in point of fact the appellant-Company itself treated these amounts as income. Had it not done so, it would not have been able to face its subscribers for payments in future. He also argued based on *Ram Janki Devi and Another* vs. M/s Juggilal Kamlapat, (1971) 1 SCC 477 that the true form of the transaction must be looked at. He also cited *Poona Electric Supply Co. Ltd., Bombay* vs. *Commissioner of Income-tax, Bombay* AIR 1966 SC 30 to the effect that the ground reality must govern and not mere theoretical considerations. Also, according to the learned Senior Advocate, the issue at hand did not arise directly before this Court in the *Peerless General Finance and Investment Co. Limited (supra)* and, therefore, any observations made therein would not bind on the facts of this case. Further, in any event, the Commissioner of Income Tax (Appeals) was correct in stating that this judgment dealing only with an RBI circular 1987, being prospective in nature, would not apply to the assessment years at hand.

7) Having heard the learned counsel for both parties, we must first set out the answers given to the three questions by the High Court, in its judgment under appeal. The answers given are as follows:

> "10.1 The questions referred to us, therefore, having regard to the principles discussed above, are answered in the following manner:
>
> (a) that the decision of the Apex Court in Peerless General Finance and Investment Company Ltd. (supra) did not lay down any absolute proposition of law that all receipts of subscription at the hands of the assessee for the previous year relevant to the assessment years 1985-86 and 1986-87 must necessarily be treated as capital receipts.
>
> (b) Having regard to the facts and circumstances of the case the learned Tribunal was wrong in treating the first year's subscription relevant to the assessment years 1985-86 and 1986-87 as capital receipts and hence not taxable; and
>
> (c) the decision of the Apex Court in the second Peerless case that the deposits made after 15th May 1987 were to be treated in the manner directed in the 1987 directions are applicable to all pending proceedings so far as such deposits relate to the period after 15th May 1987, particularly, in relation to the assessee."

8) What is clear, even on general principle, on the facts of this case, is that subscriptions were received in the years in question from the public at large under a collective investment scheme, and

these subscriptions were never at any point of time forfeited. Indeed, the supplementary affidavit filed before this Court states this as a fact, being based on an interim order of the High Court dated 03.09.1979 which obtained during the assessment years in question. This being the case, and surrendered certificates not being the subject-matter of the appeal before us, it is clear that even on general principles, deposits by way of amounts pursuant to these investment schemes made by subscribers which have never been forfeited can only be stated to be capital receipts.

9) This Court, in *Peerless General Finance and Investment Co. Limited (supra),* was faced with a situation in which the RBI had, pursuant to this Court's earlier judgment in *Reserve Bank of India* vs. *Peerless General Finance and Investment Co. Ltd. And Others* (1987) 1 SCC 424, taken steps to remedy the concerns raised by this Court in that judgment. The steps taken were under powers conferred by Section 45 J & 45 K of the Reserve Bank of India Act, as a result of which directions were issued by the RBI dated 15.05.1987. These directions, in turn, were the subject matter of challenge by the *Peerless General Finance and Investment Co. Limited (supra)* i.e. the second Peerless case. The aforesaid directions are set out in full in para 9 of the said judgment. We are

concerned with para 12 which states as follows:-

> "12. Every residuary non-banking company shall disclose as liabilities in its books of accounts and balance sheets the total amount of deposits received together with interest, bonus, premium or other advantage, accrued or payable to the depositors."

It is true that the focus of this Court was a challenge, on various grounds, to the aforesaid directions. However, this Court did state, Kasliwal, J., in particular, holding:

> "The amount contributed by the depositors being a capital receipt and not a revenue receipt cannot under any circumstances be shown in the balance sheet otherwise than at its full value. Moreover, being a capital receipt, it cannot be credited to the profit and loss account since Part II of Schedule VI to the Companies Act, 1956 requires that the amounts to be shown in the profit and loss account should be confined to the income and expenditure of the company. Thus, crediting a part of the first and subsequent year's deposit instalments to the profit and loss account and not showing them fully as a liability in the balance sheet would be a contravention of the provisions of the Companies Act."

The learned Judge further went on to hold:

> "The method followed by the companies in carrying on the aforesaid business is that a certain portion of the subscriptions received by it is transferred to the profit and loss account, shown as income, and the same is used to defray inevitable working capital requirements of the company, namely, payment of agent's commission, management expenses, staff salaries and other overheads. However, the balance of the subscriptions (excluding the

> appropriated part) is transferred to a fund each year and the corpus of the fund is invested in turn in interest-bearing investment. The Peerless Company initially used to transfer approximately 95 per cent of the first year's subscriptions to the profit and loss account and used to invest the subscriptions received from the second year onwards."

K. Ramaswamy, J., in a separate concurring judgment, also turned down the challenge to the said guidelines and, in doing so, held as follows:

> "The deposit or loan is a capital receipt but not a revenue receipt and its full value shall be shown in the account books or balance sheet as liability of the company. It cannot be credited to the profit and loss account. Part II of Schedule VI of the Companies Act, 1956 requires that the amount shown in the profit and loss account should be confined to the income and expenditure of the company. Para (12) of the Directions is, thus, in consonance with the Companies Act."

10) While it is true that there was no direct focus of the Court on whether subscriptions so received are capital or revenue in nature, we may still advert to the fact that this Court has also, on general principles, held that such subscriptions would be capital receipts, and if they were treated to be income, this would violate the Companies Act. It is, therefore, incorrect to state, as has been stated by the High Court, that the decision in *Peerless General Finance and Investment Co. Limited (supra)* must be read as not

having laid down any absolute proposition of law that all receipts of subscription at the hands of the assessee for these years must be treated as capital receipts. We reiterate that though the Court's focus was not directly on this, yet, a pronouncement by this Court, even if it cannot be strictly called the *ratio decidendi* of the judgment, would certainly be binding on the High Court. Even otherwise, as we have stated, it is clear that on general principles also such subscription cannot possibly be treated as income. Mr. Ganesh is right in stating that in cases of this nature it would not be possible to go only by the treatment of such subscriptions in the hands of accounts of the assessee itself. In this behalf, he cited a decision of the Division Bench of the Allahabad High Court in *Commissioner of Income Tax* vs. *Sahara Investment India Ltd*., reported as Volume 266 ITR page 641 in which the Division Bench followed *Peerless General Finance and Investment Co. Limited (supra),* and then held as follows:

> "In *Peerless General Finance and Investment Co. Ltd.* v. *Reserve Bank of India* (1992) 75 Comp Cas 12, the Supreme Court on similar facts held that the deposits were capital receipts and not revenue receipts (vide paragraphs 67 & 68 of the aforesaid judgment). That case also pertains to a finance company which used to collect deposits, and credited part of its deposits to the profit and loss account, as in the present case. Hence, the ratio of the said decision, in our opinion, applies to this case also.

It is well settled in income-tax law that book keeping entries are not decisive or determinative of the true nature of the entries as held by the Supreme Court in *CIT* vs. *India Discount Co. Ltd*. [1970] 75 ITR 191 and in *Godhra Electricity Co. Ltd v. CIT* [1997] 225 ITR 746 (SC). It has been held in those decisions that the court has to see the true nature of the receipts and not go only by the entry in the books of account.

We agree with the Tribunal that these deposits are really capital receipts and not revenue receipts. In *Chowringhee Sales Bureau P. Ltd.* V. *CIT* [1973] 87 ITR 542 (SC) which was followed in *Sinclair Murray and Co. P. Ltd.* V. *CIT* [1974] 97 ITR 615, the Supreme Court observed (page 619):

"It is the true nature and quality of the receipt and not the head under which it is entered in the account books that would prove decisive. If a receipt is a trading receipt, the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as trading receipt.

It has been held by the Supreme court that the primary liability and onus is on the Department to prove that a certain receipt is liable to be taxed vide *Parimisetti Seetharamamma* v. *CIT* [1965] 57 ITR 532 (SC).

Sri Chopra then relied on the decision of the Supreme Court in *CIT* v. *Lakshmi Vilas Bank Ltd.* [1996] 220 ITR 305. In our opinion that decision is also distinguishable because in that case the deposit was forfeited and the result of the transaction was that the bank became full owner of the security and the amount lying in deposit with it became its own money. In the present case there is no such finding that the deposit was forfeited or that at the end of the

> transaction the security deposit became the property of the assessee or that changed from a capital receipt to a revenue receipt. Hence, that decision is clearly distinguishable."

This Court, on 21.07.2015, in appeal against the said judgment held as under:

> "After reading of the decision of the High Court, we find that the High Court has rightly relied upon the judgment of this Court in "*Peerless General Finance & Investment Co. Ltd. & Anr.* v. *Reserve Bank of India*" (1992) 2 SCC 343. Since the case is squarely covered by the judgment, we do not find any merit in these appeals and petitions which are accordingly, dismissed."

It is also correct to state that there can be no estoppel against a settled position in law [See *Commissioner of Income-Tax, Bombay* vs. *C. Parakh & Co. (India) Ltd.* 29 ITR 661 at 665 and *Commissioner of Income-Tax, Madras* vs. *V.MR.P. Firm, Muar* (1965) 56 ITR 67.

11) Shri Arijit Prasad, learned senior counsel, appearing on behalf of the Revenue, however, strongly relied upon the observations in **Ram Janki Devi and another** v. **M/s. Juggilal Kamlapat,** (1971) 1 SCC 477. In particular, he relied upon paragraph 12 of the judgment which reads as follows:-

> "The case of a deposit is something more than a

> mere loan of money. It will depend on the facts of each case whether the transaction is clothed with the character of a deposit of money. The surrounding circumstances, the relationship and character of the transaction and the manner in which parties treated the transaction will throw light on the true form of the transaction."

12) This judgment has no direct relevance to the facts of the present case. The vexed question in that case was as to whether a particular transaction in question was a loan or a deposit. It was in that context that paragraph 12 laid down that whether a loan of money could be called a deposit, would depend upon the facts of each case, having regard to the surrounding circumstances etc. In the present case, there is no such question raised by Revenue. The question raised is completely different, and as has been held by us above, the character of the transaction being clearly a capital receipt in the hands of the assessee cannot possibly be taxed as income in the assessee's hands.

13) Shri Prasad then relied upon the judgment of this Court in **Poona Electric Supply Co. Ltd., Bombay** v. **Commissioner of Income-tax, Bombay City I, Bombay,** AIR 1966 SC 30. In particular, he relied upon a quotation from a Bombay High Court judgment which was approved by this Court, as follows: -

> “The principle of real income is not to be subordinated as to amount virtually to a negation of it when a surrender or concession or rebate in respect of managing agency commission is made, agreed to or given on grounds of commercial expediency, simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the court would have more regard to the reality and specialty of the situation rather than the purely theoretical or doctrinaire aspect of it. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language.”

The “theoretical” aspect of the present transaction is the fact that the assessee treated subscription receipts as income. The reality of the situation, however, is that the business aspect of the matter, when viewed as a whole, leads inevitably to the conclusion that the receipts in question were capital receipts and not income.

14) In the circumstances, we set aside the judgment of the High Court and restore that of the Income Tax Appellate Tribunal. The appeal is allowed. There shall be no order as to costs.

…….....J.
(ROHINTON FALI NARIMAN)

.....J.
(SANJIV KHANNA)

New Delhi;
July 09, 2019.