ASSOCIATED POWER CO. LTD. A

v.

COMMISSIONER OF INCOME TAX

NOVEMBER 28, 1995

[S.P. BHARUCHA, FAIZAN UDDIN AND S.B. MAJMUDAR, JJ.] B

Income Tax Act, 1961 :

Contingency Reserve Account—Amount set apart to meet contingencies—Assessee owner thereof—Not a business expenditure—Hence not allowable as a deduction in arriving at the taxable business income. C

Electricity (Supply) Act, 1948 :

Sixth Schedule—Clauses III, IV and V—Contingencies Reserve—Created from the revenue of each year of account—Invested in securities authorised under the Indian Trusts Act, 1882—Within a period of six months—Not to be drawn upon during currency of licence—Except to meet specified charges with the approval of State Government—To be handed over to the purchaser on purchase of the undertaking. Doctrine of diversion of income—Applicability of. D

E

These are references by the Income Tax Appellate Tribunal to this Court under Section 257 of the Income Tax Act, 1961. The references have been made because of a divergence of opinion between several High Courts.

The appellant - assessee is a company engaged in the business of generation of electricity and distribution thereof to consumers. It is governed by the Electricity (Supply) Act, 1948. F

By reason of the provisions of the Electricity (Supply) Act and of the Sixth Schedule thereto, the appellant - assessee appropriated the sum of Rs. 46,460 out of its revenue to a Contingency Reserve account during the previous year relevant to the Assessment Year 1973 - 74. This amount was claimed by the appellant - assessee as a deduction in the computation of its total income for the purpose of income tax. The I.T.O. rejected the claim. The Appellate Assistant Commissioner allowed the assessee's appeal. The Revenue filed an appeal before the Tribunal which set aside the order of the Appellate Assistant Commissioner, but referred the following G H

A question to, this Court

"Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was correct in holding that the sum of Rs. 46,460 transferred to the Contingencies Reserve Account is not allowable as a deduction in arriving at the taxable business income of the assessee-company?"

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On behalf of the appellant—assessee it was contended that there was no distinction between the Consumers' Benefit Reserve and the Contingencies Reserve; that the amount credited to the Contingencies Reserve is a business deduction; and the doctrine of diversion of income is applicable.

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Disposing of the references, this Court

HELD : 1. It is particularly noteworthy that the electricity company can make good from out of the Contingencies Reserve even a loss of profit arising out of strikes, accidents and other circumstances over which it has not control. There can be no doubt, in the circumstances, that the monies in the Contingencies Reserve belong to the electricity company. These are all expenses which the electricity company has to incur. The amount paid into the Consumers' Benefit reserve has to be returned to the consumers. It is as if the electricity company had not received the amount which it was obliged to return. The amount that it was obliged to return was not a part of its income. This is altogether different from the case of monies standing to the credit of the Contingencies Reserve which are set apart to be utilised by the electricity company for the purposes set out in clause V of the Sixth Schedule to the Electricity (Supply) Act, 1948. [735-C-D; 734-H; 735-A]

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Poona Electric Supply Co. Ltd. v. *C.I.T., Bombay City*, 57 ITR 521, held inapplicable.

Vellore Electric Corporation Ltd. v. *C.I.T. Madras*, 109 ITR 454 and *Commissioner of Income Tax, West Bengal* v. *Sijua (Jharriah) Electric Supply Co. Ltd.*, 145 ITR 740, approved.

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Cochin State Power & Light Corporation Ltd. v. *C.I.T., Kerala*, 93 ITR 582 and *Amalgamated Electricity Co. Ltd.* v. *C.I.T. Bombay*, 97 ITR 334, overruled.

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2. The amount credited to the Contingencies Reserve is set apart to

meet possible exigencies. It is not a provision for known existing liabilities. [736-E] A

Commissioner of Income Tax, West Bengal **v.** *Sijua (Jharria) Electric Supply Co. Ltd., 145 ITR 740, approved.*

3. The doctrine of diversion of income by reason of an over-riding title is quite inapposite. The doctrine applies when, by reason of an over-riding title or obligation, income is diverted and never reaches the person in whose hands it is sought to be assessed. In the present case, the statute requires the electricity company to create certain reserves if its clear profit exceeds reasonable return (clause II, Sixth Schedule to the Act). Again, the Contingencies Reserve is to be created from existing reserves or from "the revenues of the undertaking". This clearly indicates that the monies which have to be put into the Contingencies Reserve reach the electricity company and are not diverted away from it. The investment would be in its name and it would be owner thereof. The amount credited to the Contingencies Reserve is not diverted by reason of an overriding obligation or title and, in determining the business profits of the assessee, it must be taken into account. [735-E-F; 736-C] B C D

CIT **v.** *Sitaldas Tirathadas*, **41 ITR 367 (S.C.), relied on.**

CIVIL APPELLATE JURISDICTION : Tax Ref. Case Nos. 13-16 of 1981. E

From the Order dated 29.12.78 of the Income Tax Appellate Tribunal, Calcutta in R.A. No. 176 (Cal)/79 (Arising out of I.T.A. No. 2643/Cal of 1977-78.

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Rajinder Sachar, Bimlesh Ghosh, A.K. Ghosh for Fox Mondal & Co., for the Appellant.

J. Ramamurthy, S.N. Terdol, R. Satish, Manoj Arora and Ms. A. Subashini for the Respondent.

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The Judgment of the Court was delivered by

BHARUCHA, J. These are references by the Income Tax Appellate Tribunal to this Court under Section 257 of the Income Tax Act, 1961. The references have been made because of a divergence of opinion between several High Courts. H

A The Assessment Year in question in Tax Reference Case No. 13 of 1981 is 1973-74; in Tax Reference Cases Nos. 14 & 15 of 1981 they are 1972-73 and 1973-74; and in Tax Reference Case No. 16 of 1981 it is 1972-73.

B Each of the assessees is a company engaged in the business of generation of electricity and distribution thereof to consumers. It is governed by the Electricity (Supply) Act, 1948.

For the sake of convenience the facts in Tax Reference Case No. 13 of 1981 are set out. By reason of the provisions of the Electricity (Supply) C Act and of the Sixth Schedule thereto, the assessee appropriated the sum of Rs. 46,460 out of its revenues to a Contingency Reserve account during the previous year relevant to the Assessment Year 1973-74. This amount was claimed by the assessee as a deduction in the computation of its total income for the purposes of income tax. The I.T.O. rejected the claim. The D Appellate Assistant Commissioner allowed the assessee's appeal, relying upon the decision of the Kerala High Court in the case of *Cochin State Power & Light Corporation Ltd.* v. *C.I.T. Kerala*, 93 I.T.R. 582, and of the Bombay High Court in the case of *Amalgamated Electricity Co. Ltd.* v. *C.I.T., Bombay*, 97 I.T.R. 334. The Revenue filed an appeal before the Tribunal and cited the judgment of the Madras High Court in the case of E *Vellore Electric Corporation Ltd.* v. *C.I.T., Madras*, 109 I.T.R. 454. The Tribunal relied on the decision of the Madras High Court, which had disagreed with the view taken by the Kerala High Court and the Bombay High Court. It set aside the order of the Appellate Assistant Commissioner, but referred the following question to this Court :

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> "Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was correct in holding that the sum of Rs. 46,460 transferred to the Contingencies Reserve Account is not allowable as a deduction in arriving at the taxable business income of the assessee-company?"

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Section 57 of the Electricity (Supply) Act reads thus :

> "57. Licensee's charges to consumers—The provisions of the Sixth Schedule shall be deemed to be incorporated in the licence of H every licensee, not being a local authority -

(a) in the case of a licence granted before the commencement of this Act, from the date of the commencement of the licensee's next succeeding year of account; and

(b) in the case of a licence granted after the commencement of this Act, from the date of commencement of supply,

and as from the said date, the licensee shall comply with the provisions of the said schedule accordingly, and any provisions of the Indian Electricity Act, 1910 (9 of 1910), and the license granted to him thereunder and of any other law, agreement or instrument applicable to the licensee shall, in relation to the licensee, be void and of no effect in so far as they are inconsistent with the provisions of Section 57-A and the said Schedule."

The Sixth Schedule to the Electricity (Supply) Act sets out financial principles applicable to electricity companies and their application. Clause I requires a licensee to so adjust his charges for the sale of electricity that his clear profit in any year of account shall not, as far as possible, exceed the amount of reasonable return. The expressions "clear profit" and "reasonable return" are defined in the Sixth Schedule. Sub-clauses (1) and (4) of clauses II reads thus :

"II. (1) If the clear profit of a licensee in any year of account is in excess of the amount of reasonable return, one- third of such excess, not exceeding five per cent of the amount of reasonable return, shall be at the disposal of the undertaking. Of the balance of the excess, one-half shall be appropriated to a reserve which shall be called to Tariffs and Dividends Control Reserve and the remaining half shall either be distributed in the form of a proportional rebate on the amounts collected from the sale of electricity and meter rentals or carried forward in the accounts of the licensee for distribution to the consumers in future, in such manner as the State Government may direct.

"(4) On the purchase of the undertaking, after the expiry, or on the revocation, of its licence or otherwise, all amounts of rebate lying undistributed to the consumers on the date of such purchase shall be handed over to the purchaser who, in turn, shall enter the same in his books of account, under the heading Consumers'

A Rebate Reserve and any amount lying undistributed in that Reserve shall be carried forward for distribution to the consumer concerned :

Provided that the share of money in the Consumers' Rebate Reserve payable to the consumers who are not traceable or who B have ceased to be consumers in relation that undertaking, may be utilised in the development works of the purchaser."

Clauses III, IV & V are most relevant to our purpose and they read thus:

C "III. There shall be created from existing reserves or from the revenues of the undertaking a reserve to be called "Contingencies Reserve".

IV. (1) The licensee shall appropriate to Contingencies Reserve from the revenues of each year of account a sum not less than D one-quarter of one per centum and not more than one-half of one per centum of the original cost of fixed assets, provided that if the said reserve exceeds, or would by such appropriation be caused to exceed five per centum of the original cost of fixed assets, no appropriation shall be made which would have the effect of increasing the reserve beyond the said maximum.

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(2) The sums appropriated to the Contingencies Reserve shall be invested in securities authorised under the Indian Trusts Act, 1882, (2 of 1882), and such investment shall be made within a period of six months of the close of year of account in which such appropriation is made. F

V. (1) The Contingencies Reserve shall not be drawn upon during the currency of the licence except to meet such charges as the State Government may approve as being -

G (a) expenses or loss of profits arising out of accidents, strikes or circumstances which the management could not have prevented;

(b) expenses on replacement or renewal of plant or works other than expenses requisite for normal maintenance or renewal;

H (c) compensation payable under any law for the time being in force

and for which no other provision is made. A

(2) On the purchase of the undertaking, the Contingencies Reserve, after deduction of the amounts drawn under sub-paragraph (1), shall be handed over to the purchaser and maintained as such Contingencies Reserve:

B

Provided that where the undertaking is purchased by the Board or the State Government the amount of the Reserve computed as above shall, after further deduction of the amount of compensation, if any, payable to the employees of the outgoing licensee under any law for the time being in force, be handed over to the Board or the State Government, as the case may be. C

Before we advert to the judgments of the High Courts that took divergent views, it is appropriate to refer to the judgment of this Court in *Poona Electric Supply Co. Ltd.* v. *C.I.T., Bombay City*, 57 I.T.R. 521. This was a case that related to the Consumers' rebate Reserve. The Poona D Electric Supply Co. Ltd., the assessee in that case, claimed deduction of the amount credited to this reserve from its taxable income. This Court noted the provisions of the Electricity (Supply) Act and its Sixth Schedule and observed that their object was to statutorily rationalize and regulate the rates chargeable for energy supplied in the interest of the public and E for electrical development. Under the rules embodied in the Sixth Schedule certain appropriations and deductions had to be made to arrive at the clear profit; otherwise, the items might be manipulated to sustain a demand for abnormal rates. These rules had no concern with income-tax; though for the purposes of arriving at the clear profit, the taxes paid were deductible. The Court then said : F

"Under section 10(1) of the Income-tax Act, tax shall be payable by an assessee under the head "profits and gains of business" in respect of profits and gains of any business carried on by him. The said profits and gains are not profits regulated by any statute, but G profits in a business computed on business principles. They are business profits and not statutory profits. They are real profits and not notional profits. *The real profit of a businessman under section 10(1) of the Income-tax Act cannot obviously include the amounts returned by him by way of rebate to the consumers under statutory compulsion. It is as if he received only from the consumers the* H

A *original amount minus the amount he returned to them.* In substance there cannot be any difference between a businessman collecting from his constituents a sum of Rs. Y in addition to Rs. X by mistake and returning Rs. Y to them and another businessman collecting Rs. X alone. *The amount returned is not a part of the profits at all.*"

B (Emphasis supplied)

After considering various judgments, this Court was led to observe that income tax was a tax on real income, i.e., the profit arrived at on commercial principles subject to the provisions of the Income-tax Act. The real C profit could be ascertained only by making the permissible deductions. There was a clear-cut distinction between deductions made for ascertaining the profits and distributions made out of profits. In a given case, whether the outgoings fell in one or the other of the heads was a question of fact to be found on the relevant circumstances, having regard to business principles. Another distinction that had to be borne in mind was that D between real profits and statutory profits, that is, between commercial profits and statutory profits; the latter were statutorily fixed for a specified purpose. The assessee was a commercial undertaking. It did the business of supply of electricity subject to the provisions of the Electricity (Supply) Act. As a business concern its real profit had to be ascertained on the E principles of commercial accountancy. As a licensee governed by the statute its clear profit was ascertained in terms of the statute and its Schedule. The two profits were for different purposes - one was for commercial and tax purposes and the other was for statutory purposes in order to maintain a reasonable level of rates. For the purposes of the Electricity (Supply) Act, during the accounting year the assessee credited F an amount to the Consumers Rebate Reserve. It was a part of the excess amount paid to it and it was reserved to be returned to the consumers. It did not form a part of the assessee's real profit. So, to arrive at the taxable income of the assessee from the business, that amount had to be deducted from its total income.

G In *Cochin State Power & Light Corporation Ltd.* v. *C.I.T. Kerala*, 93 I.T.R. 582, the question referred to the Kerala High Court was whether the Tribunal was right in holding that the sums transferred to the Contingencies Reserve, the Development Reserve and the Special Reserve were not to be deducted in arriving at the taxable income of the assessee, which was H a company carrying on the business of distribution and supply of electricity

and was governed by the provisions of the Electricity (Supply) Act, 1948. The High Court considered the nature of the Contingencies Reserve and observed :

> "Paragraph III of the Sixth Schedule indicates that the creation of the contingencies reserve is from out of the revenues of the undertaking. This is quite significant. The term "revenue" in the context in which it has been used in that Paragraph refers to the total receipts and not to what is left as profit after meeting the expenses. Therefore, the creation of a reserve is irrespective of the profit of the licensee. It is either out of the existing reserves or from the revenues of the undertaking. As Paragraph IV of the Sixth Schedule indicates, the amount that has to be appropriated to such reserve has no relation to the profit made in any year, but is a fixed percentage of the original cost of fixed assets. The paragraph further provides that on no account shall such appropriation be made to such reserve to exceed five per cent, of the original cost of fixed assets. Sub- clause (2) of Paragraph IV is also significant. The sums appropriated to the contingencies reserve have to be invested in securities within a fixed period and it is that which could be drawn upon for specified purposes as provided under Paragraph V(1). Sub-clause (2) of Paragraph V indicates that on the purchase of the undertaking this reserve has to be handed over to the purchaser and maintained as such subject to the proviso therein."

The High Court referred to this Court's Judgment in the case of *Poona Electric Supply Co. Ltd.* and the passage therein which is extracted above. It said that the view expressed by this Court appeared to it to be that in computing the commercial or real profit such diversions as the Consumers' Benefit Reserve must be deducted. Though before the Kerala High Court, counsel for the assessee urged that the amount of this reserve was not a part of the assessee's income, what he really meant, the High Court said, as elaborated in the argument, was that in determining the real profits the statutory diversion in regard to these amounts had to be noticed and deducted. The Contingencies Reserve had been created from out of revenues and not out of profits and it was to be done irrespective of whether the assessee made a profit or not. Though the amount of the reserve could be utilised for certain purposes, the nature of the purposes

A indicated in clause V of the Sixth Schedule was sufficient to show that the purposes were not general. The Contingencies Reserve could be utilised only in certain specified contingencies. The amount of the reserve had to be invested in securities authorised under the Indian Trusts Act, 1882, and that had to be done within a specified time. Clause V provided that the
B Contingencies Reserve should not be drawn upon during the currency of the licence. This was subject to the exception that it could be drawn upon for meeting the charges therein specified as the State Government might approve. On the purchase of the undertaking the reserve had to be handed over to the purchaser, who had to maintain it as such. If the undertaking was purchased by the Electricity Board or the State Government, after
C deduction of the compensation payable to the employees of the out-going licensee, the reserve had to be handed over to the Electricity Board or the State Government. In the provisions in the Indian Electricity Act, 1910, relating to price fixation, when such Board or the State Government took over, no allowance was made in the purchase price for the amount of the
D Contingencies Reserve. All these provisions indicated that though to a very limited extent the assessee might have a benefit from out of the Contingencies Reserve, in that in certain contingencies which the State Government approved he might get the benefit of the amount reserved, Generally, the amount was not one which was at the disposal of the assessee in the matter of its application. The creation of the reserve was apparently with the prime
E object of making available sufficient resources for meeting commitments necessary for the efficient running of the business, commitments which, if the licensee failed to meet them, would really affect the consumers. An uninterrupted supply of electric energy and proper maintenance of the supply from time to time by the licensee were amenities which had to be
F assured to the public and the object of the clause concerning this reserve appeared to be to assure them these. The High Court then said :

> "Bearing in mind the fact that the amount under the contingencies reserve is not available to the assessee for any purpose of his own
G or even for any purpose other than those indicated in Paragraph V of the Sixth Schedule and also noticing the object of the creation of this reserve and further noting the provision that it is a diversion from the revenue, we think that the diversion is one which is deductible in determining the real profit. There is the further fact that the assessee does not get even compensation on account of
H this reserve as an and when the undertaking is purchased and even

the purchaser has to maintain the reserve as such. Therefore, in spite of the distinction that we have pointed out in regard to certain features between this reserve and the consumers' benefit reserve with which the Supreme Court was concerned in the *Poona Electric Supply Company* case, we feel that the amount covered by the contingencies reserve is a diversion by reason of overriding obligation created by the statute and, therefore, for determining the commercial profits of the assessee, the amount of this reserve has to be deducted."

The question that was referred was, insofar as it related to the deduction of the amount credited to the Contingencies Reserve, answered in favour of the assessee.

The Bombay High Court followed the judgment in *Cochin State Power & Light Corporation Ltd.*, in a Tax Reference. It said :

"In other words it is clear that the Kerala High Court was considerably influenced, and in our view rightly, by three or four aspects of this contingencies reserve, namely, the source from which this reserve is created, the purpose for which this reserve could be drawn upon as mentioned in paragraph V, that this reserve was not available to the assessee for any purposes of its own, that the assessee would not get any compensation on account of this reserve as and when the undertaking would be purchased and that the purchaser is required to maintain the reserve as such. We, therefore, feel that substantial reasons have been given by the Kerala High Court for coming to the conclusion that the transfers or appropriations made by the assessee to the contingencies reserve should be deducted while computing the real profit of the assessee. In this view of the matter, the question, so far as it relates to transfers or appropriations made by the assessees to the contingencies reserve in the instant case before us, will have to be answered in favour of the assessee. We accordingly answer the question in favour of the assessees."

It is, interesting to note that the same Bench of the Bombay High Court had thereafter occasion to consider the Contingencies Reserve in the context of the Wealth Tax Act, that is to say, whether the amount standing to the credit of that reserve was liable to be included in determin-

A ing the net wealth of the assessee, which was also a company that generated and supplied electrical energy and was governed by the provisions of the Electricity (Supply) Act, 1948. This was the case of *Commissioner of Wealth Tax, Bombay* v. *Bombay Suburban Electric Supply Co. Ltd.* The judgments in *Cochin State Power & Light Corporation Ltd.* and *Amal-*
B *gamated Electricity Co. Ltd.* were cited on behalf of the assessee. It was submitted that in both these cases it had been held that the amount standing to the credit of the Contingencies Reserve was deductible under the Income-tax Act and, therefore, it could not be regarded as an asset. The Court said :

C "At the outset it should be pointed out that in both these cases the court was really concerned with the question of determination of the income of the assessee-company under the head of profits and gains of business. Questions which may be relevant for the purpose of determining the liability to pay income-tax may not be germane
D or applicable while deciding a question whether a particular asset is an asset belonging to the assessee and can be subjected to a liability for payment of wealth-tax. Under the Income-tax Act "income-tax" is a tax on the real income, i.e., profits arrived at on commercial principles subject to the provisions of the Act. The real profit can be ascertained only by permissible deductions. We
E are not concerned in the present case with the question of determination of real profits or real income. As shown in paragraph III of Schedule 6, contingencies reserve can be created either from the existing reserves or from the revenues of the undertaking which by itself shows that it is created from assets which form part of the
F net wealth of the assessee-company. It can never be said that existing reserves do not form part of the assets of a company. Even in the case of revenue it is first received by the assessee and thereafter it is appropriated in the manner permitted by paragraph IV of Schedule 6 of the Electricity (Supply) Act. In either event it will be treated as part of the assets belonging to the assessee. The
G character of the asset is not altered by the fact that there are restrictions upon the user of the contingencies reserve and that in the event of a compulsory purchase under law it has to be handed over to the purchaser like the Electricity Board, the State Government or local authority who are under an obligation to maintain
H such reserve and continue the undertaking."

The Madras High Court in *Vellore Electric Corporation Ltd.* v. *C.I.T. Madras*, 109 I.T.R. 454, was required on a reference by the Tribunal to determine whether the Tribunal had been right in holding that the amount transferred to the Contingencies Reserve was not to be deducted in arriving at the taxable profits of the assessee, which was a company engaged in the business of generating and supplying electrical engergy and was governed by the provisions of the Electricity (Supply) Act, 1948. The decision of this Court in *Poona Electric Supply Co. Ltd.* was cited on behalf of the assessee. The Madras High Court said that it was of no assistance to the assessee. The amount standing to the credit of the Contingencies Reserve could not be said to be an amount which had gone out of the hands or control of the assessee and become the subject matter of ownership of somebody else. The statute had imposed certain restrictions over the disposal of that amount by the assessee, but that did not mean that the amount had ceased to be money belonging to the assessee. What was meant by diversion of profits by overriding title was that a part of the profits earned by an assessee was not really his profit but it belonged to somebody else and the assessee had no title. As far as the Contingencies Reserve was concerned, the statute had clearly indicated the purposes for which it could be spent and those purposes clearly showed that they were connected with the business of the assessee and it was the assessee which would have to utilise it. Equally, the fact that the assessee was required to invest the amount standing to the credit of Contingencies Reserve in securities authorised under the Indian Trusts Act, 1882, did not in any way affect this position. The assessee continued to be the owner of the investment and, however limited be the benefit that the assessee might derive from such an investment, it could not be held that the investment was not the assessee's investment but somebody else's investment. Simply because the statue required a licensee like the assessee to make an appropriation out of its revenue for a particular purpose, and it was a compulsory appropriation which the assessee had to make, did not mean that for the purpose of income-tax such appropriation must necessarily be deducted for arriving at the profits and gains of the assessee's business. The judgments in the case of *Cochin State Power and Light Corporation Ltd.*, was, therefore, not followed.

The Calcutta High Court in *Commissioner of Income Tax, West Bengal* v. *Sijua (Jharriah) Electric Supply Co. Ltd.*, 145 I.T.R. 740, was also concerned with a case in which the assessee was an electric supply com-

A pany governed by the Electricity (Supply) Act, which had appropriated and amount towards the Contingencies Reserve and had claimed its deduction in the computation of its business income. The cases aforementioned were considered. The Calcutta High Court held that there had been no diversion of income by an overriding title. The amount appropriated to the Contingencies Reserve was Collected by the assessee as its revenue from sale of electricity. The amount remained at the disposal of the assessee and for the benefit of the assessee. It could be used only for a few specified purposes, but the purposes for which the fund could be used were all business purposes of the assessee. Payment of compensation to workers, replacement of plant and machinery and other expenditure envisaged in clause V of Schedule 6 were all normal business expenditure of a company. This was not a case of diversion of income before it reached the assessee but only a case of setting apart of a portion of the assessee's income under compulsion of law for the use and benefit of the assessee although the mode and the objects of the expenditure was statutorily restricted. A portion of the revenue earned by the assessee had been set apart and kept in a reserve fund for some specific purposes of the assessee. That fund belonged to the assessee, the assessee had the use of it. Under those circumstances, it could not be said that there had been any diversion of income of source by an overriding title from the assessee or that the amount that had been appropriated did not form part of the real income of the assessee. It was contended before the Calcutta High Court that the appropriation to the Contingencies Reserve was, in any event, expenditure wholly and exclusively laid out for the assessee's business and should be allowed as a deduction. This argument was not accepted for the appropriation that had been made was not towards any known liability. The money had been set apart for meeting unknown future liabilities. It was not a provision but a reserve. There had been no expenditure in the real sense of the term.

Mr. Sachar learned counsel for the assessee before us, submitted that there was no distinction between the Consumers, Benefit Reserve which had been considered by the Supreme Court in the case of *Poona Electricity Supply Co. Ltd.* and Contingencies Reserve. The argument is fallacious. We have quoted the appropriate passage of this Court's earlier judgment. The emphasis is on the fact that the amount paid into the Consumers' Benefit Reserve has to be returned to the consumers. Therefore, it is as if the electricity company had not received the amount which it was obliged to

return. The amount that it was obliged to return was not a part of its income. This is altogether different from the case of monies standing to the credit of the Contingencies Reserve which are set apart to be utilised by the electricity company for the purposes set out in clause V of the Sixth Schedule. These are to meet expenses or recoup loss of profits arising out of accidents, strikes or other circumstances which the electricity company could not have prevented; to meet expenses on replacement or renewal of plant or works; and for payment of compensation required by law for which no other provision has been made. These are all expenses which the electricity company has to incur. The reservation is made so that money is always available for meeting these expenses and the supply of electricity is not interrupted. For the same reason, payments out of the contingencies Reserve can be made only with the State Government's approval. It is particularly noteworthy that the electricity company can make good from out of the Contingencies Reserve even a loss of profit arising out of strikes, accidents and other circumstances over which it has no control. There can be no doubt, in the circumstances, that monies in the Contingencies Reserve belong to the electricity company.

The application of the doctrine of diversion of income by reason of an over-riding title is quite inapposite. The doctrine applies when, by reason of an over-riding title or obligation, income is diverted and never reaches the person in whose hands it is sought to be assessed [See *CIT* v. *Sitaldas Tirathdas*, 41 I.T.R. 367 (S.C.).] In the present case, the statute requires the electricity company to create certain reserves if its clear profit exceeds a reasonable return (clause II, Sixth Schedule). Again, the Contingencies Reserve is to be created from existing reserves or from "the revenues of the undertaking". This clearly indicates that the monies which have to be put into the Contingencies Reserve reach the electricity company and are not diverted away from it.

It is the electricity company which has to invest the sums appropriated to the Contingencies Reserve. The investment would be in its name and it would be the owner thereof. The restriction that the investment can be made only in securities mentioned in the Indian Trusts Act makes no difference to this position.

That on the purchase of the undertaking the Contingencies Reserve has to be handed over to the purchaser and maintained as such is only to

A make explicit the obvious for the reserve is for the purposes of the undertaking that is being transferred. There is nothing in the statute to suggest, as argued, that the amount standing to its credit cannot be taken into consideration in arriving at the purchase price. For the purposes of sale to a State Board or Government, a different statute lays down how the B price is to be fixed, and with it we are not here concerned.

We must add that we asked Mr. Sachar to whom, in his submission, the amounts credited to the Contingencies Reverse were diverted. Mr. Sachar replied that they were diverted to and vested in the State Government. This, for the reasons set out above, is quite unacceptable.

C

We hold that the amount credited to the Contingencies Reserve is not diverted by reason of an overriding obligation or title and, in determining the business profits of the assessee, it must be taken into account.

Mr. Sachar contended that if the amount credited to the Contingen- D cies Reserved was includible in the computation of the business income of the assessee, the amount so appropriated should be allowed as a business deduction, being expenditure necessary to carry on the assessee's business. As the Calcutta High Court has pointed out, there is no expenditure. The amount appropriated to the Contingencies Reserve is set apart to meet possible exigencies. It is not a provision for known, existing liabilities.

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In the result, the identical question referred to us in the three references is answered in the affirmative and in favour of the Revenue.

The assessee shall pay to the Revenue the costs of the references, quantified in the sum of Rs. 10,000.

V.S.S. References disposed of.