
(1997) 07 P&H CK 0138

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No. 12 of 1984

Commissioner of Income Tax

APPELLANT

Vs

Beco Engineering Co.

RESPONDENT

Date of Decision : 30-07-1997

Acts Referred:

Income Tax Act, 1961 — Section 33(1), 33(2), 34(3)

Citation : (1998) 232 ITR 102

Hon'ble Judges : N.K. Agrawal, J; Ashok Bhan, J

Bench : Division Bench

Advocate : R.P. Sawhney and S.K. Sharma, for the Appellant; M.S. Jain, Senior Advocate and Adarsh Jain, S.K. Hiraji and Ramesh Kumar, for the Respondent

Judgement

Ashok Bhan, J.—At the instance of the Commissioner of Income Tax, Haryana, Rohtak, the Income Tax Appellate Tribunal, Delhi Bench "E", New Delhi (hereinafter referred to as "the Tribunal"), after drawing up the statement of the case, has referred the following question of law to this court, being the jurisdictional High Court, for its opinion :

"Was the Tribunal correct in holding that the assessee was not required to create development rebate reserve during the year, even though it had sufficient business income during this year, which was reduced to nil on account of brought forward losses from the earlier year ?"

2. Shortly stated, the facts are :

The respondent-assessee is a limited company. The accounting year relevant to the assessment year 1973-74 ended on December 31, 1972. It is engaged in the business of manufacture and sale of machine tools at its head office at Ballabgarh in Haryana and rolling mill foundry unit and machine tools unit at its branch office at Batala in Punjab. The assessee purchased machinery worth Rs. 1,71,023 during the assessment year 1973-74. The assessee claimed development rebate of Rs. 42,756 being 25 per cent. of Rs. 1,71,023. The

Income Tax Officer did not allow the claim of development rebate on the ground that the development rebate reserve was not created. The Commissioner of Income Tax (Appeals) confirmed the disallowance on the reasoning that the assessee had made profits of Rs. 49,961 as per profit and loss account and, therefore, it could have created 75 per cent. reserve of the development rebate allowable. Since the assessee had not complied with the requirements provided under Sections 33 and 34 of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), it was not entitled to claim the development rebate.

3. The assessee filed a further appeal before the Tribunal, which was accepted. After noticing conflicting decisions in regard to the allowability of development rebate without creating the development rebate reserve, relying upon a decision of the Andhra Pradesh High Court in Commissioner of Income Tax Vs. Agro Insecticides and Allied Industries, and Circular No. 189 (see [1976] 102 ITR 90), dated January 30, 1976, it was held by the Tribunal that the assessee was not bound to create the statutory development reserve in the year in which it did not make the profits.

4. Aggrieved against the order of the Tribunal, the Revenue filed a petition u/s 256(1) of the Act, for making a reference of the question of law to the jurisdictional High Court, said to be arising from the order of the Tribunal. The Tribunal, accordingly, referred the question of law, which has been reproduced in the earlier part of this judgment,

5. Section 33(1)(a) of the Act provides for development rebate in respect of a new ship or new machinery or plant (other than office appliances or road transport vehicles) which is owned by the assessee and is wholly used for the purposes of the business carried on by him subject to the fulfilment of certain conditions provided u/s 34 of the Act, amongst other things, in respect of the previous year in which the ship was acquired or new machinery or plant was installed or, if it is first put to use in the immediately succeeding previous year, then, in respect of that previous year.

6. Section 33(2) of the Act, inter alia, provides that the sum to be allowed by way of development rebate for a particular assessment year shall be only such amount as is sufficient to reduce the total income as referred to therein to "nil" and further makes provision that the balance unabsorbed development rebate, if any, is to be allowed in the same way in the following year or years but no portion of the unabsorbed rebate is to be carried forward for more than eight years, immediately succeeding the relevant assessment year.

7. Section 34(3)(a) of the Act provides that the deduction of development rebate envisaged u/s 33 of the Act shall not be allowed unless an amount equal to 75 per cent. of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to the reserve account to be utilised by the assessee during the period of eight years next following for the purposes of the business of the undertaking other than for

distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

8. The Central Board of Direct Taxes issued Circular No. 189, dated January 30, 1976--[1976] 102 ITR 90, providing that the assessee was not bound to create the statutory reserve in the year in which it did not make profits. Relying upon Circular No. 189 (see [1976] 102 ITR 90), dated January 30, 1976, issued by the Board, the Andhra Pradesh High Court in Commissioner of Income Tax Vs. Agro Insecticides and Allied Industries, , held (reproduced from the headnote) :

"(i) that the controversy which arose as a result of conflicting decisions of various courts as regards allowing of development rebate had been set at rest by the circular of the Central Board of Direct Taxes No. 189 (see [1976] 102 ITR 90), dated January 30, 1976, which clearly said that the assessee was not bound to create the statutory reserve in the year in which it did not make profits. Hence, the assessee could not be denied the benefit of development rebate, merely because the reserve was not created during the year of installation of the machinery."

9. Thereafter, the matter was examined by the Supreme Court in Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat, , The Supreme Court took a view contrary to the one taken by the Andhra Pradesh High Court in Commissioner of Income Tax Vs. Agro Insecticides and Allied Industries, . Interpreting Sections 33 and 34 read with the Explanation to Section 34, which was added by the Finance Act of 1966, it was held (page 197) :

"Having considered the matter at some length in the present case, it seems to us clear that in order to claim the deduction on account of development rebate under Sub-section (1) of Section 33, it is obligatory that the debit entries in the profit and loss account and the credit entry in a reserve account should be made in the relevant previous year in which the machinery or plant is installed or first put to use. The development rebate contemplated by Sub-section (1) of Section 33 cannot be allowed as a deduction unless a reserve account has been created in the previous year in which the installation or first use occurs. Any doubt in so reading the provisions because of want, or insufficiency, of profit in such previous year has been removed by the Explanation to Clause (a) of Sub-section (3) of Section 34. The significance of the words "actually allowed" in Clause (a) of Sub-section (3) of Section 34 has been considered by the High Court in the judgment under appeal and we are in entire agreement with the view taken by the High Court in that regard."

10. The question was answered in favour of the Revenue and against the assessee.

11. After the judgment of the Supreme Court in Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat, , the Legislature intervened with a view to redress the hardship of taxpayers and amended Section 34(3)(a) by Section 11 of the Finance Act, 1990. Section 11 of the Finance Act, 1990,

reads as under (see [1990] 184 ITR 5) :

"11. Amendment of Section 34. In Section 34 of the Income Tax Act, in Sub-section (3), in Clause (a),--

(i) for the words "the relevant previous year", the words, brackets and figure "any previous year in respect of which the deduction is to be allowed under Sub-section (2) of that section or any earlier previous year (being a previous year not earlier than the year in which the ship was acquired or the machinery or plant was installed or the ship, machinery or plant was first put to use) shall be substituted and shall be deemed to have been substituted with effect from the first day of April, 1962 ;

(ii) the Explanation shall be omitted and shall be deemed to have been omitted with effect from April 1, 1962."

12. The amendment was to take effect retrospectively from April 1, 1962, in relation to the development rebate, thus, making it applicable from the assessment year 1962-63 and subsequent years. It was primarily done to secure that the condition of creation of reserve even in the year of loss or insufficiency of profits will not be a mandatory requirement in making the claim for allowance of the development rebate. The object of this amendment was to take away the rigour of the judgment of the Supreme Court in *Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat*, , with a view to redress the hardship of the taxpayers. The object and scope of the amendment, as given in the memorandum explaining the provisions of the Finance Bill, 1990, is (see [1990] 182 ITR 336) :

"20. The provisions of Section 33 read with Section 34 of the Income Tax Act relating to development rebate provide for a deduction of a percentage of the actual cost of a ship acquired or machinery or plant installed. One of the conditions for allowance of the deduction is that an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account. The Finance Act, 1966, by inserting an Explanation in Section 34 allowed the creation of such a reserve out of the profits or reserves of earlier previous years also. Further, the Central Board of Direct Taxes through a circular has clarified that the requirement of creation of reserve will be considered to have been satisfied if the accumulated reserves in respect of the said machinery or plant up to the year or years of actual allowance is equal to seventy-five per cent of the amount of development rebate to be actually allowed. In fact, this meant that in a year when profits are insufficient or there are no profits, the creation of reserve was not mandatory. However, the Supreme Court in the case of *Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat*, has held that in order to claim the deduction on account of development rebate, it is obligatory that the reserve should be created in the year of acquisition/installation of machinery or plant, etc., even in a case where there are no profits. In coming to

this conclusion, the Supreme Court relied principally on its interpretation of the Explanation to Section 34 referred to above. If the decision of the Supreme Court is to be followed, then taxpayers who have been following the Board's circulars for many years would be placed in a very difficult situation as their assessments already completed could be reopened. Apart from this, it may run contrary to accounting principles and the assurance given by the Central Board of Direct Taxes through its circulars.

Though the decision of the Supreme Court has been pronounced only with regard to the provisions of development rebate, it may apply equally to the grant of investment allowance. It is, therefore, proposed to provide by way of an amendment that the condition of creation of reserve even in a year of loss as laid down by the Supreme Court will not be mandatory in respect of both development rebate and investment allowance.

These amendments will take effect retrospectively from April 1, 1962, in relation to the development rebate and April 1, 1976, in relation to the investment allowance and will, accordingly, apply from assessment years 1962-63 and 1976-77 and subsequent years respectively."

13. In view of the amendment, the judgment rendered by the Supreme Court in *Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat*, is of no assistance to the Revenue. The effect of amendment of Section 34(3)(a) by Section 11 of the Finance Act, 1990, was considered by the Allahabad High Court in *Commissioner of Income Tax Vs. Raza Buland Sugar Co. Ltd.*. It was held that it was not mandatory to create the development reserve in the year of loss or insufficiency of profits in which the machinery or plant, etc., is installed or first put to use to claim development rebate in the subsequent years. It was observed (page 196) :

"Now, advertent to the amended provision of Section 34(3)(a), a bare reading of it clearly manifests that for seeking allowance of development rebate u/s 33 of the Act, which has been made subject to Section 34, the creation of the statutory reserve is a condition precedent. The assessee is not entitled to the allowance if the requisite reserve as required by Section 34(3)(a) has not been made. Creation of the reserve is a sine qua non for the allowance. However, there is no mandatory requirement in the amended provisions to create development reserve even in the year of loss or insufficiency of profits in which the machinery or plant, etc., is installed or first put to use. The amendments effected in Section 34(3)(a) by the Finance Act, 1990, referred to earlier, are significant in this respect. It is now provided that the statutory reserve may be created in any previous year in respect of which the development rebate is to be allowed, or any earlier previous year, the limitation being that the earlier year is not prior to the year in which the ship was acquired or the machinery or plant was installed or first put to use. Section 34(3)(a) which lays down the conditions for the grant of development rebate, inter alia, provides that no deduction on account of development rebate u/s 33 of the Act shall be allowed, unless an amount equal

to 75 per cent. of the development rebate to be actually allowed is debited to the profit and loss account and credited to the reserve account of any previous year in respect of which deduction is to be allowed, or any earlier year, not being a previous year earlier than the year in which the machinery or plant is installed or first put to use, or the ship is acquired. The legislative intent in the provisions under discussion is that the requisite reserve may be made in the year or years in which, either the whole or a part of the development rebate reserve is to be allowed in terms of Sub-section (2) of Section 33 of the Act, or in any earlier previous year which is not a year earlier to the year in which the machinery or plant, etc., was installed or first put to use. An assessee is not obliged to create the reserve in the year of installation if there is no total income (before deduction of development rebate) in that year for the purpose of carrying forward the development rebate to the following years. It is sufficient if he creates the reserve in the subsequent years in which there is such income from which the development rebate is to be actually deducted."

14. It has also held that the amendment of law with retrospective effect can be taken notice of by the High Court while deciding a pending reference petition u/s 256 of the Act. While answering the question referred u/s 256(1), the High Court is duty bound to apply the law as amended and answer the question in accordance with the amendment.

15. We concur with the reasoning adopted by the Allahabad High Court in Commissioner of Income Tax Vs. Raza Buland Sugar Co. Ltd., . With the omission of the Explanation to Section 34 with retrospective effect from April 1, 1962, it was not necessary to create the development rebate reserve in the year of loss as was laid down by the Supreme Court in Shri Shubhlaxmi Mills Limited Vs. Additional Commissioner of Income Tax, Gujarat, . We hold that the Tribunal did not commit any error in law in holding that the assessee was not bound to create the statutory development rebate reserve in the year in which it did not make profits.

16. Accordingly, the question referred to us is answered in the affirmative, i.e., against the Department and in favour of the assessee.