
(1980) 08 DEL CK 0002

In the Delhi High Court

Case No : IT Reference No"s. 33 of 1972 and 61 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Gedore Tools India (P.) Ltd.

RESPONDENT

Date of Decision : 01-08-1980

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 80J, 80J(3), 84

Citation : (1981) 5 TAXMAN 68

Hon'ble Judges : S. Ranganathan, J; Leila Seth, J

Bench : Division Bench

Advocate : M.L. Vertna and S. Mukherjee, for the Appellant; G.C. Sharma and E.D. Helms, for the Respondent

Judgement

Leila Seth, J.—At the instance of the Commissioner of income tax, these four references, u/s 256(1) of the income tax Act, 1961 to be referred to in short as "the Act"), have been referred to us for our opinion. They pertain to the assessment years 1968-69, 1969-70, 1970-71 and 1971-72. The common question of law framed in these references is:

Whether, on the facts and in the circumstances of the case, the assessee was entitled to relief u/s 80J of the income tax Act, 1961, by reference to the capital employed in the industrial undertaking at Faridabad set up in the accounting period relevant to the assessment year 1968-69?

2. The respondent-assessee is a private limited company. It had a factory at Faridabad where it manufactured hand tools. During the assessment year 1968-69 (the corresponding previous year ending on 30th June, 1967) the assessee-company set up another factory to manufacture hand tools. This second factory was housed in a newly constructed separate building at Faridabad across the road from the original factory. New machinery was installed in this new factory, which was operated by electric power, and more than ten persons were employed therein. The assessee-company maintained separate accounts for the two units/factories, both in respect of assets and in respect of liabilities, as

also purchases and sales.

3. during the accounting period ending on 30th June, 1966 assets worth Rs. 16.57 lakhs were acquired for the new factory which was under construction. There were additions worth Rs. 25.50 lakhs in the year ending 30th June, 1967. The assets of the first factory on 30th June, 1966, were about Rs. 43.86 lakhs and there was an addition during the year ending 30th June, 1967, of Rs. 5.95 lakhs. The share capital of the company was Rs. 40 lakhs while its reserves and surplus were Rs. 39.04 lakhs.

4. The assessee-company claimed an exemption as permissible u/s 80J of the Act on the capital employed in the new factors/industrial undertaking. Though for the assessment year 1968-69, this/new undertaking suffered a loss, the assessee-company wanted to carry forward the exempted amount under the provisions of section 80J(3) of the Act. The ITO rejected the claim for exemption on the basis that the assessee-company maintained one set of head office accounts in which financial transactions of borrowing moneys and utilization took place and the/units were inter-linked not only financially but in the day-to-day transactions. Further, there was no increase in the capital of the company and the new unit was producing the same items as were being manufactured by the first unit. He, therefore, concluded that it was a case of expansion of business and the exemption u/s 80J of the Act was not available.

5. On appeal, the AAC felt that it was not necessary to raise separate capital for the new unit in view of the capital and reserve available with the assessee-company. Moreover, holding that the provisions had to be construed liberally so as to encourage the establishment of new undertakings and relying on the decision of the Supreme Court in Commissioner of Income Tax, Delhi and Rajasthan Vs. Webbing and Belting Factory Ltd., , to this effect, he directed the ITO to allow the assessee-company the benefit claimed u/s 80J.

6. Thereafter, the department appealed to the income tax Appellate Tribunal contending that the new undertaking was formed by a reconstruction of the old unit and was not entitled to the exemption. However, the Tribunal held that it was not necessary for the assessee-company to issue additional capital in order to employ it in the new industrial undertaking, and that since it already had adequate internal resources, it could draw on these resources and need not go in for fresh capital or borrowings. In fact the assessee had a capital of Rs. 80 lakhs whereas its investment in the equipment of the first unit was Approximately Rs. 43.8 lakhs only. The Tribunal further held that the assessee had maintained systematic accounts allocating assets and liabilities and transactions in general to the two units to which they related. No exception could be taken to the fact of co-ordination of working of the two units at the head office. Further, the new factory was a well defined viable unit, and the old unit had remained intact and there was no question of reconstruction. It, therefore, endorsed the conclusion of the AAC that the assessee-company was prima facie entitled to relief u/s 80J by reference to the capital employed in the new undertaking.

7. Before us, learned counsel for the Commissioner has strenuously urged--- that as no fresh capital had been raised for the new factory/undertaking, it was not entitled to the exemption u/s 80J. He also argued that the fact that the capital used was the capital of the assessee-company and, therefore, of the old business and that the new factory manufactured the same items as the old factory and was located in close proximity to it, would indicate that it was a case of splitting up or reconstruction. He, therefore, contended that the unit was not entitled to the exemption u/s 80J of the Act.

8. Section 84 of the Act dealt with the income of new industrial undertakings. By the Finance (No. 2) Act, 1967, section 84 was deleted with effect from 1st April, 1968, and section 80J inserted. In the Indian income tax Act, 1922, Act, section 15C dealt with this matter. Though there are a number of differences in the abovementioned three sections, yet for the purposes of this case, they are not relevant. Section 80J stipulates that a new industrial undertaking would be entitled for a deduction of 6 per cent, on return on the capital employed provided it fulfils the conditions set out therein. These, in brief are:

- (i) it is not formed by the splitting up or reconstruction of the existing business;
- (ii) there is no transfer of building other than rented, or machinery or plant previously used;
- (iii) it manufactures articles; and
- (iv) it employs ten or more workers if power oriented, otherwise twenty workers.

9. In the present case, admittedly, the above conditions (ii), (iii) and (iv) have been complied with by the new factory/Undertaking. Therefore, the point in issue is, has it been formed by the splitting up or reconstruction of the existing business.

10. In *Textile Machinery Corporation Limited, Calcutta Vs. The Commissioner of Income Tax, West Bengal*, the Supreme Court has dealt with an analogous provision to section 80J of the Act. The steel foundry division and the jute mill division were the two new units seeking exemption. They were manufacturing articles mostly to be used in the assessee's business of manufacturing wagons, machinery parts, boilers, etc. Dealing with the case u/s 15C of the Indian income tax Act, 1922, the Supreme Court held that to qualify for the exemption, it is important that the new undertaking be an integrated unit wherein articles are produced and at least a minimum of 10 persons with the aid of power and a minimum of 20 persons without the aid of power have been employed. Such a new industrially recognizable unit cannot be said to be a reconstruction of an old business if there is no transfer of any assets of the old business to the new undertaking. Further, the fact that the new activity launched by the assessee is to produce the same commodities as the old business or produce under distinct marketable products which feed the old business, would not amount to reconstruction of the old business. However, the establishment of a new unit with

new and separate plant and machinery by investing substantial funds is essential.

11. Applying these principles to the present case, it is clear that the new unit has not been formed by the splitting up or reconstruction of the existing business. The second unit has not derived anything from the old unit either by way of equipment or by way of factory buildings. No assets of the old unit have been transferred to the new unit nor has the identity of the first unit been impaired in anyway. The mere fact that the second unit manufactures some of the items which were manufactured by the first unit, does not make it an integral part of the first unit. It would survive independently of the first unit. In the words of the Tribunal, the new factory is a viable unit, can run by itself, and has "a separate and distinct personality".

12. "But in order to avail of the exemption it is apparent that a substantial employment of new capital is imperative. Section 80J of the Act is intended to encourage, inter alia, the setting up of new industrial undertakings. This is obviously with a view to expand industry, employment, opportunities and production of goods. The section provides for a deduction from the profits and gains derived from the new industrial undertaking to the extent it does not exceed "six per cent, per annum on the capital employed" in an industrial undertaking calculated in the prescribed manner. It is, therefore, clear that the employment of capital is a condition precedent to attract the exemption u/s 80J of the Act. However, the question posed is, must fresh capital be issued or raised by the assessee-company for the new unit or can it employ the surplus reserves which are available with it?

13. It would appear to us that it is not necessary for the employment of the capital to be formal in the sense of actually raising the capital and putting it into the new industrial undertaking. Employment of capital in a new industrial undertaking is different from the capital belonging to the assessee-company. If surplus/reserve capital is/available with the assessee-company, it can utilize a specific amount of this capital for the purchase of the plant, machinery, buildings and other assets of the new undertaking. As soon as the capital is so utilized for acquiring assets for the new undertaking, it will be an employment of capital. The actual amount of capital so utilized/employed in the new undertaking would then qualify for the purpose of calculating the deduction. The utilization of a definite amount of capital appears to be contemplated in order to attract the provisions of the section. Further, as the reserves of the assessee-company are distinct from the assets employed in the old unit it would not be a case of transfer of assets of the old unit or business to the new undertaking.

14. Our view appears to be in consonance with the Above-mentioned decision of the Supreme Court in *Textile Machinery Corporation Limited, Calcutta Vs. The Commissioner of Income Tax, West Bengal*, which speaks of investing substantial funds in the new unit without transfer of assets of the old business. In fact, in that case raw materials were supplied to the new jute mill division by the old boiler division which were later on returned to the boiler division after

forging and mechanising, and yet it was not held to be a transfer of assets if the old business.

15. As above noticed, the purpose of the section is apparently to provide tax incentives, to stimulate industry and the manufacture of articles, resulting in more employment and economic gain for the country. In order to see that this end is achieved it is necessary to guard against an assessee availing of the benefit of the exemption by the device of camouflaging or converting an old undertaking into a new one. Since the assessee before us is not guilty of this and the new undertaking fulfilled the required conditions, the assessee was entitled to claim the relief u/s 80J of the Act by reference to the capital employed in the new Industrial undertaking at Faridabad. In the result the question is answered in the affirmative and in favour of the assessee and against the revenue. The assessee will be entitled to costs. Counsel's fee is Rs. 250.