

(1994) 10 MAD CK 0062

In the Madras High Court

Case No : Tax Cases No"s. 1158 and 1159 of 1981 (Reference No"s. 602 and 603 of 1981)

Commissioner of Income Tax

APPELLANT

Vs

Gopal Plastic (P.) Ltd.

RESPONDENT

Date of Decision : 25-10-1994

Acts Referred:

Income Tax Act, 1961 — Section 139, 32, 32(1), 33, 34

Citation : (1995) 215 ITR 136

Hon'ble Judges : Mishra, J;A.S. Venkatachala Moorthy, J

Bench : Division Bench

Advocate : N.V. Balasubramanian, for the Appellant; Janarthana Raja, for the Respondent

Judgement

Mishra, J.—There questions, viz., (i) Whether the assessee was entitled to initial depreciation u/s 32(1)(vi) of the Income Tax Act, 1961, for

the assessment year 1976-77 as a small-scale industrial undertaking within the meaning of Explanation 3 to section 32(1)(vi) of the Act; (ii)

whether it was disentitled to relief u/s 80J although the old machinery was less than the prescribed percentage of 20 per cent. during the relevant

year, but in excess of 20 per cent. in an earlier year; and (iii) whether borrowed capital could be taken as part of the capital base for the purpose

of refund u/s 80J in view of sub-rule (3) of rule 19A, fall for consideration in the instant case.

2. The above are questions modified in form by us, but in substance the same as referred by the Tribunal at the instance of the Commissioner of

Income Tax on the basis of an agreed statement of case, which is as follows :

The assessee, Gopal Plastics Private Limited, is a company manufacturing plastic

industrial components and other allied articles. For the assessment year 1976-77, the accounting year ended with the financial year on March 31, 1976, the assessee claimed depreciation on the basis that it was engaged in an industry manufacturing articles specified in the Ninth Schedule of the Act and was a small-scale industrial undertaking u/s 32(1)(vi) of the Income Tax Act, 1961. It claimed that the aggregate value of the machinery and plant in stock during the relevant year did not exceed the value of Rs. 7,50,000 with reference to the cost thereof. The Income Tax Officer, however, took the view that the amount spent by the assessee, i.e., a sum of Rs. 10,005 as service and installation charges in respect of the machinery purchased by it, was required to be taken into account in calculating the aggregate value of the machinery and plant in stock. The assessee claimed relief u/s 80J of the AM on the ground that it had used second-hand machinery, the value of which was less than 20 per cent. of the total cost of machinery in the assessment year. The Income Tax Officer, however, thought otherwise, as according to him, the industry was in operation, before the year of assessment and in the years previous to the year of assessment, the value of the second-hand machinery in the industry was less than 20 per cent. The assessee claimed borrowed capital as part of the capital base. The same was not accepted by the Income Tax Officer. On appeal, the Appellate Assistant Commissioner decided the first two questions in favour of the assessee, but the third question against it. The Tribunal, in the appeal by the Revenue, found no merit and allowed the cross-objection filed by the assessee against the decision of the Appellate Assistant Commissioner on the third question.

3. The third question whether the borrowed capital could be taken as part of the capital base for the purpose of relief u/s 80J in view of sub-rule

(3) of rule 19A, is not required to be answered by us, as the law in this behalf has already been settled by the Supreme Court in the case of Lohia

Machines Ltd. and Another Vs. Union of India (UOI) and Others, .

4. The two questions, however, as to the claim of the assessee u/s 32(1)(vi) of the Income Tax Act for initial depreciation in the value and

deduction u/s 80J of the Act, need, in our view, a careful note. Income Tax is chargeable for any year at such rate or rates of tax in accordance

with and subject to the provisions of the Income Tax Act in respect of the total income of the previous year of every individual, Hindu undivided

family, company and local authority and all other firms and other associations of persons or partners of the firm or the members of the association

individually in any year of assessment. Section 32 which falls in the group of the provisions dealing with profits and gains of business or profession,

provides for depreciation of buildings, machinery, plant or furniture owned by the assessee and used for the purpose of the business or profession,

provides for depreciation of buildings, machinery, plant or furniture owned by the assessee and used for the purpose of the business or profession

and allows deduction in the case of buildings, machinery, plant or furniture other than ships covered by clause (i) of this section on the written down

value thereof as may in any case or class of cases be prescribed (see section 32(1)(ii)). Clause (vi) of this section 32(1) with which we are

concerned, provides as follows :

(vi) in the case of a new ship or new aircraft acquired after the 31st day of May, 1974, by an assessee engaged in the business of operation of

ships or aircraft or in the case of new machinery or plant (other than office appliances or road transport vehicles) installed after that date for the

purposes of business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any

one or more of the articles or things specified in items 1 to 24 (both inclusive) in the List in the Ninth Schedule or in the case of new machinery or

plant (other than office appliances or road transport vehicles) installed after that date in a small-scale industrial undertaking for the purposes of

business of manufacture or production of any other:articles or things; a sum equal to twenty per cent. of the actual cost of the ship, aircraft,

machinery or plant to the assessee, in respect of the previous year in which the ship or aircraft is acquired or the machinery or plant is installed. or if

the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year; but any

such sum shall not be deductible in determining the written down value for the purposes of clause (ii) :

Provided that the assessee may, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139, whether fixed

originally or on extension, for furnishing the return of income for the assessment year in respect of which he first becomes entitled to deduction

under this clause, furnish to the Income Tax Officer a declaration in writing that the provisions of this clause shall not apply to him, and if he does

so, the provisions of this clause shall not apply to him for that assessment year and for every subsequent assessment year; so however, that the

assessee may, by notice in writing furnished to the Income Tax Officer before the expiry of the time allowed under sub-section (1) or sub-section

(2) of section 139, whether fixed originally or on extension, for furnishing the return of income for any such subsequent assessment year, revoke his

declaration and upon such revocation, the provisions of this clause shall apply to the assessee for that subsequent assessment year and for every

assessment year thereafter :

Provided further that no deduction shall be allowed under this clause in respect of -

(a) any machinery or plant installed in any office premises or any residential accommodation, including any accommodation in the nature of a guesthouse;

(b) any ship, aircraft, machinery or plant in respect of which the deduction by way of development rebate is allowable u/s 33; and

(c) any ship or aircraft acquired after the 31st day of March, 1976, or any machinery or plant installed after that date.

5. The above has three Explanations, Explanation 3 contains as follows :

(3) an industrial undertaking shall be deemed to be a small-scale industrial undertaking, if the aggregate value of the machinery and plant installed,

as on the last day of the previous year, for the purposes of the business of the undertaking does not exceed seven hundred and fifty thousand

rupees; and for this purpose the value of any machinery or plant shall, be, -

(a) in the case of any machinery or plant owned by the assessee, the actual cost thereof to the assessee; and

(b) in the case of any machinery or plant hired by the assessee, the actual cost thereof as in the case of the owner of such machinery or plant.

6. The Income Tax Officer, however, noted in the assessment order that from the balance-sheet, it was found that the cost of the machinery and

plant installed as on the last day of the previous year exceeded Rs. 7,50,000. He,

however, noted the case of the assessee that while determining the nature of an industry, the cost of equipment such as tools, etc., and service charges, bank charges, etc., should be excluded, for which the assessee placed reliance on a letter of the Government of India, Ministry of Industries and Civil Supplies, dated February 25, 1977, and noted :

If the abovesaid circular where installations, service charges, bank charges, etc., are excluded, it followed the company would then be entitled to

initial depreciation and, hence, the company should be given an allowance of Rs. 1,02,285. I have carefully examined the circumstances under

which the assessee is claiming initial depreciation. The definition given by the Ministry of Industries and Civil Supplies which is mainly to facilitate

loans and licences cannot be applied to the definition of a small-scale industry under the Income Tax Act. The cost of the machinery as per the

Income Tax Act includes all the abovesaid items, namely, installation charges, service charges paid to the National Small Industries Corporation,

cost of implements, etc., and hence, the assessee's claim of Rs. 1,02,285 as initial depreciation is disallowed.

7. The Appellate Assistant Commissioner, however, considered in some detail the contentions that the assessee had purchased the plant and

machinery on hire purchase and, hence, the Income Tax Officer should have considered Explanation (3)(b) to clause (vi) of section 32(1) and held

in favour of the assessee in these words :

Thus, during the period under consideration the appellant has taken the two items of machinery referred in the earlier paragraph of this order on

hire and hence the provisions of Explanation (3)(b) will apply. In these circumstances for the purpose of determining whether the appellant is a

small-scale industrial undertaking or not we have to take the actual cost as in the hands of the owner of such machinery or plant. This means we

have to take the cost in the hands of the National Small Industries Corporation. According to them, the cost would come to Rs. 5,00,241 referred

to in paragraph 4. This means the service charges amounting to Rs. 10,005 which have been included as forming part of the cost in the balance-

sheet should be excluded. Thus the cost of the plant and machinery will come to Rs. 7,45,259 which is below Rs. 7,50,000. Hence, the appellant

is entitled to initial depreciation in terms of section 32(1)(vi) and the Income Tax

Officer is directed to give suitable deduction. The appeal is allowed on this point.

8. The Tribunal has agreed with the Appellate Assistant Commissioner in these words :

Having considered the matter, we are of the opinion that the interpretation placed by the Appellate Assistant Commissioner on Explanation (3) to

section 32(1)(vi) has to be upheld. That definition does not determine whether the assessee is the owner of the machinery or not. It is a deeming

provision and only for the purposes of finding out whether an industry is a small-scale industrial undertaking it has been inserted. Therefore, there is

nothing anomalous to hold that in the case of a hirer only the cost to the owner has to be taken ignoring the cost of installation. It is open to the

Legislature to say something in the deeming section which may in certain circumstances appear to be in conflict with the main section, namely,

granting of initial depreciation to the owner and then for the purpose of ascertaining the actual cost to the owner who is a hirer to limit the actual

cost by deducting the cost of installation. It may be then the rationale, is that the cost of acquisition should also include the installation charges, yet

because it is a deeming provision the interpretation placed by the Appellate Assistant Commissioner is tenable. Accordingly, we see no merit in this

ground of appeal.

9. Learned counsel for the Revenue has raised a contention that depreciation is permissible in respect of buildings, machinery, plant or furniture

owned by the assessee and used for the purposes of business or profession. He has drawn our attention to the use of the words owned by the

assessee and used for the purposes of business or profession in sub-section (1) of section 32 for deduction subject to the provisions of section 34

under various clauses including clause (vi) as above and submitted that what is found in Explanation (3)(b) above cannot affect the value or the cost

of the machinery which is put to use by the assessee only after its installation in his industry.

10. In SHREE VALLABH GLASS WORKS LTD. Vs. COMMISSIONER OF Income Tax, GUJARAT-III., , the Gujarat High Court has

considered the case of an assessee who claimed deduction of various expenses before the commencement of production by debiting such

expenditure to factory buildings and various plant and machinery. The Income Tax Officer had, however, noted that they included an aggregate

amount representing payment of salary, pocket money, etc., to the foreign technicians employed in erection work. When the Income Tax Officer

did not allow any depreciation of such expenses, the assessee appealed and finally when the matter came before the Tribunal, the Tribunal held that

the exact nature of the work done by the foreign technicians had not been explained. Referring to the judgment of the Supreme Court in the case of

Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad, in which the Supreme Court considered the question, how the

interest paid before the commencement of production on amounts borrowed by the assessee for the acquisition and installation of plant and

machinery should be treated, viz., whether they should be treated as part of the actual cost of acquisition of the capital asset in question; in other

words, whether depreciation was allowable in respect of this component of the actual cost, the component being the interest paid before

commencement of production on amounts borrowed for the acquisition and installation of the plant and machinery and the observations of the

Supreme Court (page 172 of 98 ITR) (at page 43 of 127 ITR) :

"It has not been disputed that so far as the question before us is concerned, the legal position for determining the actual cost for the purpose of

development rebate is the same as for the purpose of depreciation.

It would appear from the above that, while considering the question of deduction on account of depreciation and development rebate, we have to

take into account the written down value. The written down value in its turn depends upon the actual cost of the assets to the assessee. The

expression "actual cost" has not been defined in the Act, and the question which engages our attention is whether the interest paid before the

commencement of production on the amount borrowed for the acquisition and installation of the plant and machinery can be considered to be part

of the actual cost of the assets to the assessee.

and further (at page 43 of 127 ITR and page 175 of 98 ITR) :

"It would appear from the above that the accepted accountancy rule for determining the cost of fixed assets is to include all expenditure

necessary to bring such assets into existence and to put them in working

condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets which have been created as a result of such expenditure. The above rule of accountancy should, in our view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary".

11. The Gujarat Court has concluded as follows (at page 45) :

Therefore, all items of expenditure incurred during the period of construction of the plant were capitalised and such capitalisation of expenditure

incurred prior to the machinery going into production was approved by the Supreme Court. It must be pointed out that in Challapalli Sugar Ltd.

Vs. The Commissioner of Income Tax, A.P., Hyderabad, before the Supreme Court the only dispute was with reference to the item of interest

paid on the amounts borrowed by the assessee-company, being interest for the period prior to the actual commencement of the production of the

company, but as regards the capitalisation of the rest of the amounts before the Supreme Court there was no dispute whatsoever and the

observations of the Supreme Court were that all expenses necessary for putting the plant into production were part of the actual cost of the plant

and machinery to the assessee and it was in the light of that actual cost that depreciation and development rebate would have to be worked out.

12. The Madhya Pradesh High Court in the case of D. and H. Secheron Electrodes v. CIT [1981] 132 ITR 1 has also taken the above view and

has said (headnote) :

The accepted accountancy rule for determining the cost of fixed assets was to include all expenses necessary to bring such assets into existence

and to put them in working condition.

13. Learned counsel for the Revenue has drawn our attention to a judgment of the Rajasthan High Court in the case of Chaganlal Automobiles Vs.

Commissioner of Income Tax, , which has taken the view that no depreciation can be allowed in the manner provided in section 32 of the Income

Tax Act, 1961, to a hirer who is yet to become the owner of the machinery, plant or furniture. The said judgment, however, has been delivered

without taking into consideration Explanation (3)(b) and has proceeded on the principle that a transaction of hire purchase is in the nature of a contract of bailment with an element of sale added to it, in such an agreement, the hirer may or may not be bound to purchase the thing hired, but, in either case, if there is an obligation to buy or an option to buy the goods delivered to the hirer by the owner, on the terms that the hirer on payment of a premium as also of a number of instalments, shall enjoy the use of the goods, which ultimately may become his property, the transaction amounts to one of hire purchase, even though the title to the goods has remained with the owner and shall not pass to the hirer until a certain event has happened, viz., that all the stipulated instalments have been paid or that the hirer has exercised his option to finalise the purchase on payment of a sum, nominal or otherwise and, thus, the hire purchase agreement is not only a contract of bailment simpliciter, but it has also an element of sale added thereto.

14. It is not possible to find any exception to the above rule, but for the instant case, we get no help from it, as actual cost in the case of any machinery or plant hired by the assessee has to be the actual cost thereof as in the case of the owner of such machinery or plant, i.e., the actual cost which the owner of the machinery plant disclosed or incurred and not the hirer. It is not possible to ignore that deduction is allowed in respect of depreciation to the owner who is using the machinery for the purposes of business or profession. In such a case, the written down value is relevant and the first proviso to clause (ii) of section 32(1) says, provided that where the actual cost of any machinery or plant does not exceed seven hundred and fifty rupees, the actual cost thereof shall be allowed as a deduction in respect of the previous year in which such machinery or plant is first put to use by the assessee for the purposes of his business or profession. This will naturally lead to a meaning as above to the expression "actual cost" incurred in putting the machinery or plant to use by the assessee for the purposes of his business or profession. In the case of a hirer, the machinery or plant is put to use by him, but the actual cost thereof has to be worked out on the basis of the cost that the owner of such machinery or plant had incurred. The additional cost incurred by the hirer in putting the plant or machinery to use by him, thus, is excluded

from the actual cost for the purposes of deduction in respect of depreciation of machinery or plant. The view that the Tribunal has taken in this

behalf appears to us to be correct and the only way to put to use Explanation (3) (b) above.

15. We have reasons to ignore for the purpose of deduction in respect of depreciation of a building, machinery, plant or furniture is use by a hirer

any consideration as to the nature of the transactions between the owner and the hirer. In determining the value of depreciation, what is required to

be considered is the actual cost incurred by the owner and not the hirer. Section 80J of the Act provides for deduction in respect of profits and

gains from newly established industrial undertakings or ships or hotel business in certain cases. An industrial undertaking shall be deemed for the

purpose of the Act to be a small-scale industrial undertaking if the aggregate value of the machinery and plant installed as on the last day of the

previous year for the purposes of the business of the undertaking does not exceed Rs. 7,50,000 and, for this purpose, the value of any machinery

or plant shall be, in the case of any machinery and plant owned by the assessee, the actual cost thereof to the assessee, and in the case of any

machinery or plant hired by the assessee, the actual cost thereof as in the case of the owner of such machinery or plant. There can be no disputed

that in the case of new machinery or plant installed after May 31, 1974, in an industrial undertaking, engaged in the business of the generation or

distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things

specifics in the list in the Ninth Schedule or in the case of new machinery or plant other than office appliances or road transport vehicles installed

after that date in a small-scale industrial undertaking for the purpose of business of manufacture or production of any other articles or things, a sum

equal to 20 per cent. of the actual cost of the ship, aircraft, machinery or plant to the assessee in respect of the previous year in which the ship or

aircraft is acquired or the machinery or plant is installed or if the ship, aircraft, machinery or plant is first put to use in the immediately succeeding

previous year, but any such sum shall not be deductible except in cases falling under the proviso. Such deductions are contemplated u/s 80J of the

Act where the gross total income of an assessee which includes any profits and gains derived from an industrial undertaking is subject to a rebate

of six per cent. per annum on the capital employed for the said purpose. This section, however, applies to any industrial undertaking which fulfils all

the following conditions, viz. :

(i) it is not formed by the splitting up, or the reconstruction, of a business already in existence;

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;

(iii) it manufactures or produces articles, or operates one or more cold storage plant or plants, in any part of India and has begun or begins to

manufacture or produce articles or to operate such plant or plants at any time within the period of thirty-three years next following the 1st day of

April, 1948, or such further period as the Central Government may, by notification in the Official Gazette, specify with reference to any particular

industrial undertaking;

(iv) in a case where the industrial undertaking manufactures or produces articles, the undertaking employs ten or more workers in a manufacturing

process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

Explanation 2, however, provides :

Where in the case of an industrial undertaking any machinery or plant or any part thereof previously used for any purpose is transferred to a new

business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or

plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been

complied with and the total value of the machinery or plant or part so transferred shall not be taken into account in computing the capital employed

in the industrial undertaking.

16. Small-scale industries, is conceded, were granted, at the relevant time, a tax holiday for a period of five years on their fulfilling the conditions

under sub-section (4) of section 80J and the condition as to the capital employed in it. It is obvious that it could be an industry not formed by the

splitting up or the reconstruction of a business already in existence and also not formed by the transfer to a new business of machinery or plant

previously used for any purpose. If, however, it is formed by the transfer to a

new business of machinery or plant previously used for any purpose

and the total value of the machinery or plant or part so transferred does not exceed 20 per cent. of the total value of the machinery or plant used in

the business, then, it will not be deemed to have been formed by the transfer to a new business of machinery or plant previously used for any purpose.

17. There is a judgment of the Gujarat High Court, however, which has taken the view that an undertaking which did not fulfil the conditions for the

relief in the first year after commencement of production, but subsequently, during the period of tax holiday, fulfilled the conditions, enjoyed the

benefit of section 84 (new section 80J) as it then was. In the case of Commissioner of Income Tax, Gujarat-I Vs. Satellite Engineering Ltd., , the

Gujarat High Court considered the case of the assessee- company which was incorporated on April 12, 1962, for carrying on business as

manufacturers of starters and switches used in fluorescent lamps. The assessee-company, for the said purpose, had purchased land and building

from a company E, for a consideration. It also purchased from a company P previously used plant and machinery together with licences and stock-

in-trade on April 16, 1962. The assessee-company started its manufacturing activity on June 1, 1962, with the aid of the machinery so purchased.

Subsequently, the assessee purchased a fully automatic Swiss lathe and also an extrusion press from Germany for manufacture of brass spans and

aluminium containers. A fully automatic vacuum machine was also installed to increase the output of fluorescent starters and switches with minimum

waste of labour. In the course of assessment proceedings for the assessment years 1966-67 and 1967-68, the assessee claimed the relief of tax

holiday u/s 84 of the Act inasmuch as having regard to the acquisition and installation of new machinery, the provisions of section 84(2)(ii) read

with the Explanation to sub-section (3) were satisfied in the years of assessment and as such it became entitled to the relief which was available to

newly established undertakings as from the said years. The Gujarat High Court upon this had said (at page 221) :

As explained earlier, the scheme of the statute is to make available the benefit of tax holiday for a period of consecutive years, the commencement

point of such period being the assessment year relevant to the previous year in

which the industrial undertaking begins to manufacture or produce articles. According to this scheme, there are two limitations on the claim of a new industrial undertaking to the benefit of tax holiday, first, that the benefit will be available for a total period of five consecutive years only and, secondly, that the starting point of such period would be the year in which the manufacture or production of the article begins. We find nothing in the language of the relevant statutory provisions which, however, imposes a further limitation, namely, that if the condition laid down in section 84(2)(ii) is not satisfied in the very year of commencement of manufacture or production, the benefit of tax holiday will not be available, even if such condition is satisfied in the course of any of the subsequent four years. It cannot be overlooked in this connection that the profits and gains derived from business are assessable in each assessment year. Therefore, in each assessment year falling within the five-year period, the question will arise whether the new industrial undertaking, which claims the benefit of tax holiday, satisfies the conditions laid down in clause (ii) of sub-section (2). In other words, according to the legislative scheme, it is apparent that in each assessment year commencing from the assessment year relevant to the previous year in which such new industrial undertaking begins manufacture or production the taxing authority will have to consider whether the industrial undertaking was formed by the transfer to its new business of building, machinery or plant previously used for any purpose, and, if so, whether the total value of such transferred asset exceeded 20 per cent. of the total value of the building, machinery or plant used in the business of such undertaking during the relevant year. If the new industrial undertaking, which has not satisfied such test in any one of the earlier assessment years comprised in the five-year period, acquires new building, machinery or plant during any one of the succeeding assessment years and as a result of such acquisition the condition prescribed in clause (ii) of sub-section (2) is fulfilled, then, as from the assessment year in which such condition is satisfied, the benefit of tax holiday will be available to it for the remaining period of the five-year term. This appears to us to be the only reasonable construction possible having regard to the plain words of the statutory enactment.

The view which we are inclined to take as aforesaid on the plain language of the

supported also by the object behind the enactment and avoids the frustration of such object. We have already adverted to the object of the enactment, namely, to encourage the setting up of new industrial undertakings in which there is substantial investment of fresh capital. The Legislature could not have intended that the outlay of substantial capital for the purpose of new machinery, plant or building should necessarily be in the very first year of the commencement of manufacture or production.

In fact, there are many industrial units which add to their building, machinery or plant as the business grows and more capital becomes available. If the construction for which the Revenue contends were accepted, such industrial units would be denied the benefit of tax holiday, even though they are still going through teething troubles and are still in their infancy. Such a construction would totally nullify the object of the enactment. A converse case than the one illustrated above would, however, still clearly show how the construction for which the Revenue contends will lead to a manifest contradiction of the apparent purpose of the enactment. Take the case of an industrial undertaking which in the year in which it undertakes or begins manufacture or production, satisfies the condition enacted in section 84(2)(ii) read with the Explanation but in the immediately succeeding year adds to its manufacturing unit building, machinery or plant which has been previously used and thereby varies the ratio of the new and old assets. If the only point of time at which the condition as to the applicability of the relevant provisions has to be satisfied is when the new undertaking starts the manufacturing activity, such an industrial undertaking which subsequently adds used assets to its new business will continue to have the tax holiday for the full period of five years even though it has in fact and reality ceased to be a new industrial undertaking. Could it ever have been intended by the Legislature that the benefit of tax holiday should still be available to such an industrial undertaking in all the subsequent years even though the essential condition for earning the tax holiday is not satisfied in the this assessment years ? It is well-settled that even if the language of a statute in its ordinary meaning and grammatical construction leads to a manifest contradiction of the apparent purpose of the enactment, or to some inconvenience or absurdity, hardship or injustice, presumably not intended, a construction may be put upon it which

modifies the meaning of the words, and even the structure of the sentences (see *Tirath Singh Vs. Bachittar Singh and Others*,). This is not a case

where the meaning of the word is to be modified or the structure of the sentence is to be changed to achieve the legislative object. At the highest,

this is a case where the language employed by the Legislature might be capable of bearing more than one construction and, in such a case, in

arriving at the true meaning, regard must be had to the fact that such construction is not adopted which defeats the very purpose for which the

enactment was made. In our opinion, therefore, even the alternative submission made on behalf of the Revenue must be rejected.

18. The Gujarat High Court has not accepted the contention that the word "formation" or "formed" as found in section 80J (section 84(2)(ii) then)

is the same as the legal birth of an undertaking with the concept of its becoming a unit of production by acquisition and installation of plant and

machinery.

19. The Karnataka High Court, however, in the case of *Commissioner of Income Tax Vs. Nippon Electronics (India) Pvt. Ltd.*, has taken a

contrary view. It has held (headnote) :

The word "formed" also suggests that the transfer contemplated is one at the time of formation of the new undertaking. The eligibility for

exemption has to be tested in the initial assessment year. Therefore, the exemption would not be available if, in the initial assessment year, the

proportion of the old assets transferred or utilised for the new business is above 20 per cent. of the total investment, though in any subsequent year,

even if it be within five years, new investment is made so as to reduce the proportion of the value of old assets to below 20 per cent.

20. We have to direct help from any authority of the Supreme Court except to some extent from the judgment in the case of *Bajaj Tempo Ltd.*,

Bombay Vs. Commissioner of Income Tax, Bombay City-II, Bombay, . This is a case dealing with section 15C(2)(i) of the 1922 Act, which also

used for the purpose of deduction the expression "formed" in clause (i) of section 15C(2). The Supreme Court pointed out that (headnote) :

A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally; and since a provision for

promoting economic growth that has to be interpreted liberally, the restriction on it

too has to be construed so as to advance the objective of the provision and not to frustrate it.

21. The Supreme Court has in the said cause also observed (head note) :

If a provision for checking abuse is found to have resulted in nullifying the very purpose of its enactment and the Legislature intervenes, then it can

be assumed that the Legislature, having been satisfied of the failure of the purpose for which the provision was inserted, proceed to cure the defect

by suitably amending the provision or removing it.

22. We have no manner of doubt that section 80J(4)(ii) has indicated such conditions which must be found to have been satisfied before the benefit

of the deduction in respect of profits and gains from newly established industrial undertakings are extended to any new industrial under taking.

What is important is the formation of the industry with new machinery, plant, etc. The Supreme Court in the case of Bajaj Tempo Ltd., Bombay

Vs. Commissioner of Income Tax, Bombay City-II, Bombay, has said (at page 197) :

The initial exercise, therefore, should be to find out if the under taking was a new one.

and observed (at page 197) :

While doing so, various situations may arise, for instance, the formation may be without anything to do with any earlier business. That is, the

undertaking may be formed without splitting up or reconstruction any existing business or without transfer of any building, material or plant of any

previous business. Such an undertaking undoubtedly would be eligible to the benefit without any difficulty. On the other extreme may be an

undertaking, new in its form but not in substance. It may be new in name only. Such an undertaking would obviously not be entitled to the benefit.

In between the two, there may be various other situations. Difficulty arises only in such cases. For instance, new company may be formed, as in

this case - a fact which could not be disputed, even by the Income Tax Officer. But tools and implements worth Rs. 3,500 were transferred to it

from the previous firm. Technically speaking, it was transfer of material used in a previous business. One could say, as was vehemently urged by

learned counsel for the Department, that where the language of the statute was clear, there was no scope for interpretation. If the submission of

learned counsel is accepted, then once it is found that the material used in the undertaking was of a previous business, there was an end of the

inquiry and the assessee was precluded from claiming any benefit. The words of a statute are undoubtedly the best guide. But, if their meanings get

clouded, then the courts are required to clear the haze. Sub-section (2) advances the objective of sub-section (1) by including in it every

undertaking except if it is covered by clause (i) for which it is necessary that it should not be formed by transfer of building or machinery. The

restriction of denial of benefit arises not by transfer of building or material to the new company but that it should not be formed by such transfer.

This is the key to interpretation. The formation should not be by such transfer. The emphasis is on formation not on use. Therefore, it is not every

transfer of building or material but the one which can be held to have resulted in the formation of the undertaking.

23. The Supreme Court has referred to its earlier judgment in *Textile Machinery Corporation Limited, Calcutta Vs. The Commissioner of Income*

Tax, West Bengal, and quoted the observations, which are as follows (at page 198) :

"The true test is not whether the new industrial undertaking connotes expansion of the existing business of the assessee, but whether it is all the

same as a new and identifiable undertaking separate and distinct from the existing business. No particular decision in one case can lay down an

inexorable test to determine whether a given case comes u/s 15C or not. In order that the new undertaking can be said to be not formed out of the

already existing business, there must be a new emergence of a physically separate industrial unit which may exist on its own as a viable unit. An

undertaking is formed out of the existing business if the physical identity with the old unit is preserved.

24. The Supreme Court has then observed (at page 198) :

Even though this decision was concerned with the clause dealing with reconstruction of an existing business, the expression "not formed" was

construed to mean that the undertaking should not be a continuation of the old but emergence of a new unit. Therefore, even if the undertaking is

established by transfer of building, plant or machinery, but it is not formed as a result of such transfer, the assessee could not be denied the benefit.

25. The Supreme Court has approved, in its judgment, a judgment of the Calcutta High Court in COMMISSIONER OF Income Tax, WEST

BENGAL II Vs. SAINTHIA RICE AND OIL MILLS., and that of the Punjab and Haryana High Court in the case of Phagoo Mal Sant Ram Vs.

Commissioner of Income Tax, to the extent that ""previously used in any other business"" cannot be construed so narrowly as to confined it to the

building of the assessee only and disapproved the Bombay view that if a new undertaking is established in premises taken on lease, then, it always

amounts to formation of the undertaking by transfer of the building previously used. The test that follows from this judgment is, is the business or

the undertaking the same old one or has it changed beyond recognition and thus, is it a new business and a new undertaking, to which of course

some old plant or machine is transferred, but such transfer has a nominal effect, i.e., it is within the limits as indicated in the Explanation

aforequoted.

26. For the reasons above, we are inclined to agree with the Gujarat High Court's view and hold accordingly in the case of the assessee before us,

that it has made out a case that its undertaking is a small-scale industry and that in the year previous to the year of assessment, it has satisfied the

requirements of section 80J(4)(ii) of the Act. The reference is answered accordingly. No order as to costs.