

(1992) 07 KAR CK 0029

In the Karnataka High Court

Case No : IT Reference Case No. 189 of 1987

Commissioner of Income Tax

APPELLANT

Vs

H.M.T. Ltd.

RESPONDENT

Date of Decision : 21-07-1992

Acts Referred:

Citation : (1992) 07 KAR CK 0029

Hon'ble Judges : R. Ramakrishna, J;K. Shivashankar Bhat, J

Bench : Division Bench

Advocate : H. Raghavendra Rao and M.V. Seshachala, for the Appellant; King and Partridge, for the Respondent

Judgement

K. Shivashankar Bhat, J.—The questions referred for our consideration u/s 256(1) of the income tax Act, 1961 ("the Act") in respect of the assessment year 1979-80 read thus:

1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner (Appeals) who directed the Inspecting Assistant Commissioner to allow depreciation on value of roads, walls and fences?
2. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner (Appeals) who directed the Inspecting Assistant Commissioner to include the value of work-in-progress, machinery and equipment in transit and under erection in the computation of capital for the purpose of calculating relief u/s 80J of the income tax Act, 1961?
3. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner (Appeals) who directed the Inspecting Assistant Commissioner to allow deduction u/s 35 of the capital as represented by work-in-progress and machinery in transit and under erection in the assessee's research division? and

4. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner (Appeals) who directed the Inspecting Assistant Commissioner to allow exemption u/s 80J on commercial profits?

There is no dispute that the first three questions are now covered against the revenue.

2. The first question is practically self-contained about the facts. This Court in Commissioner of Income Tax Vs. Bangalore Turf Club Limited, has held that the assessee is entitled to the depreciation on the value of roads, etc. Recently the Supreme Court has also expressed the same view by pointing out that a building cannot be confined to a structure having walls and roof over it. Roads within the factory premises are to be regarded as part of the buildings - CIT v. Gwalior Rayon Silk Mfg. Co. Ltd. Judgment Today 1992 (3) SC 158. The first question is accordingly answered in the affirmative and against the revenue.

3. Question Nos. 2 and 3 also contain the basic facts. Under similar circumstances the claim of the assessee was upheld by this Court in Ravi Machine Tools (P.) Ltd. Vs. Commissioner of Income Tax, Following the aforesaid decision, question Nos. 2 and 3 are also answered in the affirmative and against the revenue.

4. However, fourth question requires a detailed consideration.

5. The statement of the case is bald except stating that the assessee claimed relief u/s 80J of the Act based on commercial profits and not profit computed under the provisions of the Act. The order of the Tribunal again is sketchy. The Tribunal simply states that the Commissioner (Appeals) relied upon the orders of the Tribunal for earlier assessment years on this question and, therefore, the said order will have to be upheld.

The respective contentions of the parties could be gathered from the order of the Tribunal made in respect of the assessment year 1977-78. We are told that the revenue accepted the said order and the present question is agitated subsequently by seeking reference when the said order was followed by the Tribunal in the instant case.

6. In the assessment year 1977-78 the assessee contended that the profits before deduction of depreciation and investment allowance were sufficient to cover section 80J relief and, therefore, it should be granted. For example, it was pointed out that in respect of the assessee's unit, watch factory No. 3, the net profit prior to depreciation was Rs. 62,17,831. The depreciation as charged to the profit and loss account was Rs. 36,80,690 and the net profit as per the audited profit and loss account was Rs. 25,37,141. The contention was that this was sufficient to attract section 80J. It was pointed out that the profit before deduction of depreciation and investment allowance was the same, i.e., Rs. 62,17,831. However, if depreciation and investment allowance is deducted from

it, the profit will be only Rs. 21,58,739. In such a situation section 80J relief will not be available because the relief admissible thereunder inclusive of deficiency of past years was Rs. 47,02,207. Similar figures were given regarding other units also. According to the assessee, the depreciation and investment allowances should not be deducted while computing the profits and gains derived from the unit in question and that can be shifted to a later stage while considering the total income of the assessee from all sources.

7. The Tribunal accepted the contention of the assessee and relied on the decision of the Commissioner of Income Tax Vs. Patiala Flour Mills Co. P. Ltd., as well as an earlier decision of the Supreme Court in CIT v. Patiala Flour Mills Co. (P.) Ltd. [1978] 115 ITR 640 1. The learned counsel for the revenue also relied upon the said Supreme Court decision in support of his contention.

8. Section 80J provides for deduction in respect of profits and gains from newly established industrial undertakings or ships or hotel business in certain cases. We are not concerned with the ships or hotel business. The main section reads:

Deduction in respect of profits and gains from newly established industrial undertakings or ships or hotel business in certain cases. - (1) Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking or a ship or the business of a hotel, to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains reduced by the deduction, if any, admissible to the assessee u/s 80HH or section 80HHA of so much of the amount thereof as does not exceed the amount calculated at the rate of six per cent per annum on the capital employed in the industrial undertaking or ship or business of the hotel, as the case may be, computed in the manner specified in sub-section (1A) in respect of the previous year relevant to the assessment year (the amount calculated as aforesaid being hereafter, in this section, referred to as the relevant amount of capital employed during the previous year):

In spite of certain variations by amendments, the substance of the section is the same as above for the relevant year.

9. The assessee may have several units from which the assessee derives income and, therefore, the gross total income of the assessee would include the income from all these units. When one of the units is an industrial undertaking envisaged by section 80J, a deduction is given from the profits and gains derived from such industrial undertaking and this deduction is calculated at the rate of 6 per cent per annum. If there is no profit and gain from such a unit, the benefit of this deduction will not be available. In other words, the deduction based on the percentage of the capital employed given in respect of an industrial undertaking depends upon its profits and gains.

The assessee contends that while computing these profits and gains of the unit concerned, it is open to the assessee to ignore deductions available in respect of

the depreciation and investment allowances. In a given case the depreciation and investment allowances pertaining to one unit may be deducted out of the gross total income of the assessee since there is no such bar under the Act. Section 32 of the Act permits depreciation allowance. This can be deducted from the gross income of the assessee in view of section 28 read with section 29 of the Act. There is no restriction that the depreciation allowed u/s 32 has to be only from the income of the said unit.

Position u/s 32A of the Act regarding investment allowance also is the same. It is also contended on behalf of the assessee that since depreciation and investment allowances are taken note of at the end for the purpose of "profit and loss account", while considering the profits and gains from a particular unit, it need not be considered because section 80J nowhere restricts the concept of profits and gains and, therefore, if there is a commercial profit derived from the particular unit that should suffice to attract section 80J, subject to other conditions. Mr. Raghavendra Rao, the learned counsel for the revenue, strongly relied on certain observations of the Supreme Court in *Patiala Flour Mills Co. (P.) Ltd.*'s case (supra). In the said case the assessee had several units from which the assessee was deriving income. It had put up a cold storage plant during 1967-68. However, the assessee did not make any profit in the business of cold storage plant for several years but there was profit from other businesses of the assessee. The assessee adjusted its losses, depreciation allowance and development rebate in respect of the cold storage plant against the profit from the other businesses in computing the total income of the assessee during the earlier assessment years and these were completely absorbed. By the time of the assessment year 1970-71 there was nothing to be carried forward and set off in respect of the losses, depreciation allowance, etc., in respect of the cold storage plant. During the said year, however, the cold storage plant made a profit. Since there was deficiency u/s 80J regarding the cold storage plant the assessee claimed that the said amounts of deficiency were liable to be adjusted against the profit earned from the said plant during the assessment year 1970-71. The revenue contended that for the purpose of section 80J the losses as well as the depreciation allowance and development rebate in respect of the business of cold storage for the past assessment years should be first adjusted against the profit of the said year 1970-71. The ITO in the said case proceeded to assume that for the purpose of sub-sections (1) and (3) of section 80J, the cold storage business was to be treated in isolation and its profit was to be computed as if the earlier year's losses, etc., had not been set off against the profit from other businesses. The Supreme Court affirmed the decision of the High Court and negated the claim of the revenue. In this regard the Supreme Court held:

Now, it is clear from the language of sub-section (1) of section 80J that the profits or gains of a new industrial undertaking from which deduction of the relevant amount of capital employed during a particular assessment year is allowable under that provision, are the profits or gains includible in the computation of the total income chargeable to tax. Therefore, whatever be the

profits or gains of the new industrial undertaking computed for the purpose of arriving at the total income chargeable to tax, would have to be taken to be the profits or gains for applying the provision contained in sub-section (1) of section 80J. There are no two modes of computation of the profits or gains of the new industrial undertaking contemplated by sub-section (1) of section 80J, one for determining the total income chargeable to tax and the other for applying the provision contained in that sub-section. The language of sub-section (1) of section 80J is clear and explicit and leaves no doubt that the profits or gains of the new industrial undertaking for the purpose of allowing the deduction provided in that sub-section, have to be computed in the same manner in which they would be in determining the total income chargeable to tax and a deduction has then to be made from such profits or gains, of the relevant amount of capital employed during the assessment year in question. It is impossible to see how, by any process of construction, even by turning and twisting the language of sub-section (1) of section 80J, it can be held that for the purpose of allowing the deduction contemplated under that section the profits or gains of the new industrial undertaking must be computed in a manner different from that in which they would be computed in determining the total income chargeable to tax. Sub-section (1) of section 80J does not create a legal fiction that for the purpose of applying the provision contained in that sub-section, the profit or gains of the new industrial undertaking shall be computed as if the new industrial undertaking were the only business of the assessee right from the date of its establishment or the losses, depreciation allowance or development rebate in respect of the new industrial undertaking for the past assessment years were not set off against the profit from other businesses. If the construction of sub-section (1) of section 80J contended for and on behalf of the revenue were accepted, it would lead to the absurd result that there would be two species of profits or gains of the new industrial undertaking, one for inclusion in the total income chargeable to tax and the other for determining the availability of the deduction under sub-section (1) of section 80J. That would be plainly contrary to the express language of subsection (1) of section 80J. The proper construction of sub-section (1) of section 80J must, therefore, be taken to be that the profits or gains of the new industrial undertaking must be computed in accordance with the provisions of the Act in the same manner as they would be in determining the total income chargeable to tax and it must follow a fortiori that if the losses, depreciation allowance and development rebate in respect of the new industrial undertaking for the past assessment years have been fully set off against the profit of the assessee from other businesses or for the matter of that, against the income of the assessee under any other head by reason of sections 70 and 71 read with sub-section (2) of section 32 and sub-section (2) of section 32A, no part of such losses, depreciation allowance or development rebate would be liable to be adjusted over again in computing the profits or gains of the new industrial undertaking for applying the provision contained in sub-section (1) of section 80J. The same mode of computation must prevail also in applying the provision contained in subsection (3) of section 80J, because that sub-section

provides for setting of the carried forward amount of deficiency of the past assessment years against "the profits and gains referred to in subsection (1) " of section 80J, as computed after allowing, inter alia. deduction admissible under that sub-section and, therefore, if, for the purpose of sub-section (1) of section 80J, the profits or gains of the new industrial undertaking are to be computed in accordance with the provisions of the Act and no part of the losses, depreciation allowance or development rebate for the past assessment years which has been fully set off against the profit from other businesses or income under any other head is liable to be adjusted over again in computing the profits or gains of the new industrial undertaking, no such adjustment would equally be permissible in applying the provision contained in sub-section (3) of section 80J." [Emphasis supplied] (p. 646)

10. According to Mr. Raghavendra Rao, the profits and gains of the new industrial undertaking for the purpose of allowing the deduction u/s 80J, have to be computed in the same manner in which they would be in determining the total income chargeable to tax and a deduction is then to be made from such profits or gains of the relevant amount of capital employed. Therefore, necessarily the deductions regarding investment allowance and depreciation will have to be made from the total income of that unit. The implication of this contention is to apply the provisions of sections 28, 29, 32 and 32A separately to the unit in question. According to Mr. Raghavendra Rao that is the clear ratio of the Supreme Court. The following sentence as per the above observation was emphasised in support of this submission:

... It is impossible to see how, by any process of construction, even by turning and twisting the language of sub-section (1) of section 80J, it can be held that for the purpose of allowing the deduction contemplated under that section the profits or gains of the new industrial undertaking must be computed in a manner different from that in which they would be computed in determining the total income chargeable to tax.... (p. 646)

The next sentence immediately following the above, however, makes the position quite clear and negatives the contention now advanced by Mr. Raghavendra Rao. The same has been underlined by us in the above extract. The further observation also shows that the losses, depreciation allowance and development rebate in respect of the new industrial undertaking could be fully set off against the profit of the assessee from other businesses. We may also note here that, while computing the taxable income of an assessee nowhere the Act restricts the deduction pertaining to the depreciation and investment allowances regarding one unit, to be deducted only from the income of that unit.

11. *Rajapahayam Mills Ltd. v. CIT* [1978] 115 ITR 7771(SC) was referred by the learned counsel for the revenue. The matter arose regarding section 15C of the Indian income tax Act, 1922 ("the 1922 Act") phraseology of which is somewhat similar to the present section 80J of the 1961 Act. The Supreme Court was also concerned with the then section 84 of the 1961 Act which resembled the present

section 80J. The revenue relied on section 15C(3) of the 1922 Act which stated that the profits or gains of an industrial undertaking to which the said section applied, shall be computed in accordance with the provisions of section 10. From this it was contended that in effect the income from the unit in question will have to be separately computed and deductions are also to be made accordingly regarding depreciations. The contention of the revenue that, while working out the trading result of the new unit, any other activity carried on by the assessee should not be taken into consideration, was not accepted by the Supreme Court. The Supreme Court pointed out that where the assessee carries on several businesses is entitled u/s 10 to set off loss in one business against profits in another. If there is any loss in a business carried on by the assessee by reason of the profits of such business not being sufficient to absorb the depreciation allowance, such loss can be set off against the profits of another business carried on by the assessee. If, however, there are no profits chargeable under the head "Business or profession" or if the profits chargeable under that head are insufficient to cover the depreciation allowance, the amount of the allowance to the extent to which it is not absorbed, can be set off against profits chargeable under any other head for that assessment year. The approach to be adopted while interpreting a provision like section 15C was pointed out:

The law of income tax in a modern society is intended to achieve various social and economic objectives. It is often used as an instrument for accelerating economic growth and development. Section 15C is a provision introduced in the Indian IT Act, 1922, with a view to carrying out this objective and it is calculated to encourage setting up of new industrial undertakings in the country....." (p. 783)

As to section 15C(3) the Supreme Court pointed out:

... There is nothing in sub-section (3) of section 15C or in any other provision of the Act which requires that in computing the profits or gains of a new industrial undertaking u/s 10, depreciation allowance or development rebate in respect of the new industrial undertaking for the past assessment years should be taken into account, even if it has been set off fully against the profits or gains of any other business carried on by the assessee or against income under any other head and there is no unabsorbed depreciation allowance or development rebate to be carried forward. It is indeed difficult to see how effect can be given to depreciation allowance and development rebate twice over, once in the past assessment years and again in the assessment year in question. To give effect to depreciation allowance or development rebate for the past assessment years, even though it has been set off and absorbed completely against the total Income of the assessee for those assessment years would be to allow a deduction not warranted by any provision of the Act and indeed it would be going contrary to the express provision of proviso (b) to clause (vi) and Explanation 1 to clause (vib). Sub-section (3) of section 15C clearly does not have any such effect. What it does is no more than provide as to how "the profits or gains

derived from new industrial undertaking 1 referred to in sub-section (1) of section 15C shall be computed. If sub-section (3) of section 15C had not been enacted, it might have been a matter of some controversy as to what is meant by the expression "the profits or gains derived from new industrial undertaking". Does it mean commercial profits or gains or profits or gains chargeable to tax or does it have any other connotation? It was to set this controversy at rest that sub-section (3) of section 15C enacted that the profits or gains of the new industrial undertaking shall be computed in accordance with the provisions of section 10. It may be noted that sub-section (3) of section 15C does not enact any legal fiction providing that the profits or gains of the new industrial undertaking shall be computed as if the new industrial undertaking were the only business of the assessee from the date of its establishment or the past years, depreciation or development rebate had not been set off against other income of the assessee.... (p. 788)

The above decision also indicates that the new industrial unit is not to be treated as a compartment by itself while computing its profits and gains for the purpose of section 80J. Section 80J is a beneficial provision intended to encourage establishment of new industrial undertakings as a means of accelerating economic growth and development. There is no reason as to why we should interpret this beneficial provision restrictively which would affect the purpose behind the enactment of the said provision. The above decision in no way advances the case of the revenue as contended by its learned counsel. The Punjab and Haryana High Court pointed out that the deduction u/s 80J for the current year has to be allowed before any deficiency of earlier years could be considered. Mr. Kumar, the learned counsel for the assessee, relied strongly on the observations of the Calcutta High Court in *Commissioner of Income Tax Vs. Orient Paper Mills Ltd.*, The question arose u/s 80-I of the Act before it was deleted by the Finance Act, 1972. The said section reads thus:

Deduction in respect of profits and gains from priority industries in the case of certain companies. -(1) In the case of a company to which this section applies, where the gross total income includes any profits and gains attributable to any priority industry, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such profits and gains of an amount equal to 8 per cent thereof, in computing the total income of the company.

The question arises as to how to compute the profits and gains attributable to a priority industry. The real question was whether the profits of priority industry could be set off against the unabsorbed development rebate of priority industry itself. While considering the question, speaking for the Division Bench, Sabyasachi Mukharji, J. (as he then was) observed:

... The allowance of initial depreciation or development rebate unlike normal depreciation was in no sense a deductible item of cost or an expenditure in the process of settlement of commercial profits; although it did not form part of the assessable profits undoubtedly it did form part of the commercial profits....(p.

Further, the Bench observed that it was a well known concept in the taxation law that the term "profits" in the various sections of the Act had not got the same meaning; some time it meant the assessable profits and some times it meant commercial profits and, therefore, the meaning attributable to a particular section in the Act depends upon the purpose with which it is enacted. Section 80-I therein was enacted as a kind of an incentive for the growth of priority industries. The Court proceeded to hold the profits and gains attributable to priority industry must be computed in the commercial sense and not in accordance with which provisions of the Act.

12. We do not find anything in any of the decisions cited before us as above which supports the contention of the revenue. Section 80J nowhere compells the computation of the profits and gains, apart from an industrial undertaking, by treating it as a separate entity for all purposes without reference to commercial expediency and practice.

13. In these circumstances, we are of the view that the Tribunal was justified in upholding the claim of the assessee. Consequently, the fourth question referred above is answered in the affirmative and against the revenue.