
(1977) 04 CAL CK 0023

In the Calcutta High Court

Case No : Income-tax Reference No. 318 of 1973

Commissioner of Income Tax

APPELLANT

Vs

Indian Oxygen Ltd.

RESPONDENT

Date of Decision : 22-04-1977

Acts Referred:

Income Tax Act, 1961 — Section 35(1), 37(1), 80J, 80J(1), 84
Income Tax Rules, 1962 — Rule 19, 19(1)

Citation : (1978) 113 ITR 109

Hon'ble Judges : S.C. Deb, J;Dipak Kumar Sen, J

Bench : Division Bench

Advocate : B.L. Pal and B.K. Naha, for the Appellant;Debi Pal, M. Seal and J.C. Shaw, for the Respondent

Judgement

Dipak Kumar Sen, J.—This consolidated reference u/s 256(1) of the Income Tax Act, 1961, is at the instance of both the revenue as also the assessee. The facts found and/or admitted may be shortly noted as" follows :

2. Messrs. Indian Oxygen Ltd., the assessee, is a public limited company manufacturing and selling gases. It also manufactures electrodes. For the assessment year 1965-66, the assessee claimed deduction on account of expenses aggregating to Rs. 3,40,053 incurred for research. This was disallowed by the Income Tax Officer on the grounds that as such expenses constituted capital expenditure and the research was not conducted by the assessee itself, the provisions of Section 35(1) of the Income Tax Act, 1961, were not applicable. The Appellate Assistant Commissioner, however, allowed such expenses and set aside the order of the Income Tax Officer. The decision of the Appellate Assistant Commissioner was affirmed by the Tribunal.

3. For the same assessment year the assessee had also claimed the relief u/s 84 of the Income Tax Act, 1961, in respect of its wire mill factory on the ground it was a new industrial unit, the products whereof were being used by the assessee in its electrode factory. The Income Tax Officer held that the assessee was not

entitled to the relief claimed inasmuch as the products of this mill had not been sold in the market. On appeal, the Appellate Assistant Commissioner, following the decision in the case of Anil Starch Products Ltd. Vs. Commissioner of Income Tax, Gujarat, , allowed the appeal and held that for the purpose of allowing relief u/s 84 of the Income Tax Act, 1961, the profits of the new industrial undertaking would have to be computed on ordinary commercial principles. The Tribunal, on further appeal, however, reversed the finding of the Appellate Assistant Commissioner following its earlier decision based on a judgment of this court in the case of Commissioner of Income Tax Vs. Textile Machinery Corporation, .

4. A further controversy arose in respect of computation of the capital of the said wire mill unit as also the gas plant belonging to the assessee at Bombay. In respect of the gas plant at Bombay the assessee claimed that for computation of the capital in this unit, u/s 84 of the Act, capital under the item " work-in-progress" should be included. The Income Tax Officer disallowed the claim of the assessee and excluded the amount of such capital from the computation on the ground that the assets representing the; said capital had not been brought into use during the computation period. In the appeal, the Appellate Assistant Commissioner rejected the contentions of the assessee and held that in the case of assets not acquired or purchased during the relevant accounting period their value should be included as and when they became assets of the business and used therein. The Appellate Assistant Commissioner construed the proviso to Rule 19(1) of the Income Tax Rules, 1962, and held that the capital included in the item " work-in-progress " represented assets which were not brought into use and could not be considered for the purpose of computation of capital. On further appeal the Tribunal accepted the contentions of the assessee and held that the proviso to Rule 19(1) applied only to an asset which was acquired within the computation period. Only in respect of such an asset average cost had to be computed and in the computation of such average cost the actual user of the asset became relevant. If any asset was in existence throughout the computation period, it formed part of the capital within the meaning of the said Rule and the said section and should be included in the computation.

5. The following questions have been referred for determination by this court :

" 1. Whether, on the facts and in the circumstances of the case, the Tribunal is right in holding that the sum of Rs. 3,40,053 paid by the assessee to M/s. British Oxygen Ltd. was a permissible deduction u/s 37(1) of the Income Tax Act, 1961 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 2,96,259 representing the value of the capital work-in-progress at the beginning of the previous year should be included in the computation of the capital employed for the purpose of working out the relief u/s 84(1) of the income tax Act, 1961 ?

3. Whether, on the facts and in the circumstances of the case, -and also having regard to the fact that the products of the wire mill unit were used as raw

material in the manufacture of electrodes at the electrode factory, Khardah, the Tribunal was justified in holding that the assessee was not entitled to relief u/s 84 of the Income Tax Act, 1961, in respect of profits from the wire mill unit ? "

6. So far as question No. 1 is concerned, the same is now covered by a decision of this court in Income Tax Reference No. 78 of 1970 in the case of the same assessee Commissioner of Income Tax Vs. Indian Oxygen Ltd., , Following that decision we answer the question in the affirmative and in favour of the assessee.

7. Similarly, question No. 3 is now covered by a decision of the Supreme Court in the case of Textile Machinery Corporation Limited, Calcutta Vs. The Commissioner of Income Tax, West Bengal, . Following the said judgment we answer the question in the negative and also in favour of the assessee.

8. So far as question No. 2 is concerned to appreciate the controversy between the parties it is necessary to consider the section and the rule involved. Section 84 of the Income Tax Act, 1961, inter alia, reads as follows:

" 84. (1) Save as otherwise hereinafter provided, Income Tax shall not be payable by an assessee on so much of the profits or gains derived from any industrial undertaking or hotel to which this section applies as do not exceed six per cent. per annum on the capital employed in the undertaking or hotel, computed in the prescribed manner.....

Rule 19 of the Income Tax Rules, 1962, provides as follows :

"19. Computation of capital employed in an industrial undertaking or a hotel.--(1) For the purposes of Section 84, the capital employed in an undertaking or a hotel to which the said section applies shall be taken to be(a) in the case of assets acquired by purchase and entitled to depreciation-

(i) if they have been acquired before the computation period, their written down value on the commencing date of the said period;

(ii) if they have been acquired on or after the commencing date of the computation period, their average cost during the said period ;

(b) in the case of assets acquired by purchase and not entitled to depreciation-

(i) if they have been acquired before the computation period, their actual cost to the assessee ;

(ii) if they have been acquired on or after the commencing date of the computation period, their average cost during the said period ;

(c) in the case of assets being debts due to the person carrying on the business, the nominal amounts of those debts;

(d) in the case of any other assets, the value of the assets when they became assets of the business:

Provided that if any such asset has been acquired within the computation period, only the average of such value shall be taken in the same manner as average cost is to be computed.....

(6) In this rule,--

(i) " average cost " in relation to any asset means such proportion of the actual cost thereof as the number of days of the computation period during which such asset is used in the business bears to the total number of the days comprised in the said period ;

(ii) " computation period-" means the period for which the profits and gains of the undertaking or hotel are computed under Sections 28 to 43A....."

9. Mr. B.L., Pal, learned counsel for the revenue, contended before us that the relief allowed u/s 84 of the Act is based on profits derived from capital employed in the undertaking and for the purpose of granting such relief it is necessary to compute the capital employed in the undertaking in terms of Rule 19. The said Rule 19 lays down all categories of capita] employed in the business which includes assets of the business. Therefore, in order to compute capital, it is also necessary to compute the value of the assets of the business as laid down by the said rule, Mr. Pal submitted that if the said section and the rule were read together an item could not be an asset of the business under Clause (d) of the rule unless it was used and employed in the business during the relevant period and contributed to the earning of the profit. Section 84 contemplated employment of capital in the business and Clause (vi) of Rule 19 also envisaged that assets should be used in the business.

10. In support of his submissions Mr. Pal cited two decisions. The first was a decision of the House of Lords in the case of Birmingham Small Arms Co. Ltd. v. Inland Revenue Commissioners [1951] 2 All ER 296. Here, the House of Lords considered and construed the expression " capital employed " in relation to the excess profits tax imposed by the Finance Act, 1939. This tax was charged upon the excess of profits and in the computation of excess profit it was necessary to compute the average amount of capital employed in the trade or business. It was laid down by the said statute as follows :

" Subject to the provisions of this Part of this Schedule, the amount of the capital employed in a trade or business (so far as it does not consist of money) shall be taken to be--(a) so far as it consists of assets acquired by purchase on or after the commencement of the trade or business, the price at which those assets were acquired, subject to the deductions hereafter specified ; (b) so far as it consists of assets being debts due to the person carrying on the trade or business, the nominal amount of those debts, subject to the said deductions ; (c) so far as it consists of any other assets which have been acquired otherwise than by purchase as aforesaid, the value of the assets when they became assets of the trade or business, subject: to the said deductions. "

11. The factory of the assessee in that case had been severely damaged by aerial bombing in or about November, 1940. It was agreed between the assessee and the Board of Trade that November, 1940, should be taken as the date from which interest should accrue in respect of any claim established under the War Damage Act of 1941. The assessee subsequently lodged a formal claim. On the 12th November, 1943, the assessee's claim was admitted at ₹ 647.012 which was paid in March, 1947.

12. In the assessment of excess profits tax for the accounting period, from the 1st August, 1940, till the 31st July, 1941, the assessee contended that in the computation of the capital employed in his business the amount awarded under the War Damage Act should be included. Contentions of the assessee having been rejected by the Special Commissioners, the King's Bench Division and the Court of Appeal, the matter finally came up to the House of Lords.

13. Lord Simonds, construing the statute, held that the expression " capital employed " meant " assets employed ". He stated in his judgment at page 299 of the report as follows :

" My Lords, it is plain on the face of this sub-para. (1) that " capital employed " means assets employed. For the capital is something which " consists" of money or " consists " of assets of various kinds. Then by a slight twist the " value " of the assets becomes the " amount" of the capital. It is necessary then to determine what are the assets employed in the trade or business of the person, firm or corporation which carries it on. The case of the appellants, as I understand it, rests mainly, if not entirely, on the contention that in the case of a company carrying on a business all its assets are " employed " in that business unless expressly excluded by the Act --a contention succinctly stated by saying that the capital employed in a business is the same thing as the assets of a business. It was, I think, essential to the appellants' case to maintain this argument, for the Special Commissioners had found that the right (or " claim " as they called it) regarded as an asset was not employed in the trade. It had, therefore, to be shown either that they were wrong in law because they had misinterpreted the word " employed ", or that there were no facts to support their finding. Thus, it was that the appellants formulated the second reason in their formal case in these words :

" Because every asset of a trade or business is part of the capital employed in the trade or business unless expressly excepted by statute."

My Lords, I see no valid reason for disregarding and giving no meaning to the word " employed ". It was suggested that, inasmuch as the section had to cover the case of an individual or firm as well as that of an incorporated company, it was necessary to use language which would distinguish between the property of the individual or the partners in the firm which was embarked on the trade and that which remained their private concern. This contention appears to me farfetched and unconvincing. There is no more difficulty in ascertaining what are

the capital or assets " of " a trade carried on by an individual or a partnership than " of "a trade carried on by a company ; there is just the same difficulty in ascertaining what for the purpose of the excess profits tax is the capital or are the assets " employed " in it. In either case some meaning must be given to the word " employed." That at least is a cardinal rule of construction. It falls then to the commissioners to determine as a fact whether a right, which I will assume to be an asset belonging to a limited company, is an asset employed in its trade. It cannot be capital employed in its trade unless it is an asset so employed. In the present case, they have held that the right in question was not so employed, and I see no reason for disturbing their landings."

14. In an earlier decision of the House of Lords in the case of *Inland Revenue Commissioners v. Terence Byron Ltd.* [1945] 1 All ER 636, Lord Simonds had observed that an asset might be still employed in trade though at any moment it might not be actively or productively employed. Lord Simonds sought to construe this observation as meaning that different considerations might arise on facts, e.g., if the company decided to abandon the use of the site instead of re-building the theatre on it, then the property could not be an asset employed in the trade.

15. The aforesaid observations of Lord Simonds were not accepted or adopted by the other law Lords. In his judgment Lord Normand expressly stated that in deciding that appeal it was not necessary to enquire whether an asset was " actively employed " in the company's trade or business in the relevant year. Lord Normand construed the earlier decision of the House in the case of *Terence Byron Ltd.* [1945] 1 All ER 636 as to have settled this point finally. He further observed in his judgment as follows [1951] 2 All ER 296 :

" The words " employed in " are not otiose, for it might be necessary to determine what capital was employed in one of two trades or businesses carried on by the company, or what part of the capita) of a partner was employed in the partnership business, or what part of the individual's capital was employed in his trade or business. The provisions of the paragraph deal with the assets of which the capital employed in the trade or business consists, and it deals with them exhaustively. Apart from money, these assets are divided into (a) assets acquired by purchase, (b) assets being debts due to the person carrying on the trade or business, and (c) any other assets acquired otherwise than by purchase. The appellants' contention is that " assets " include every item of property of every kind which may be made available to satisfy the debts of the owner of the assets, and that (apart from money) every item of property, including every chose-in-action belonging to the company, which does not fall under heads (a) or (b) of the sub-paragraph, necessarily falls under head (c). In this case we are asked to treat as capital employed in the trade or business an asset consisting of a claim to money which is not a debt and which, therefore, docs not fall within head (b). It is a claim that might and later did ripen into a debt, and it is capable of being valued, though the amount which would become payable and the date at which it would become payable were in the accounting year unknown and

uncertain. It is also a very unusual sort of asset because it is not a money claim arising from the business activities of the company or from the employment of its other assets, hut a claim created by the gratuitous grant of Parliament. I think it is not an asset of the kind contemplated by the provisions under consideration."

16. Lord Radcliffe in his judgment observed as follows (page 303) :

" The test in computing capital is not whether an asset belonging to the proprietor of a business is employed in his business or not, but whether there is capital employed in his business consisting of this or that asset. In many cases, there is no difference at all between the two questions : in a few cases the difference may be important. But to treat them as the same question does tend to lead to a confusion that has not been absent from the arguments in this case, for, whereas once capital has been introduced into a business it may naturally be regarded as still employed in it until such capital is lost or withdrawn. I have not been able to bring to my mind any clear conception of what is meant by an asset being employed in a business if it means something different from merely belonging to it. Your Lordships have been, in effect, invited to say that there is some pregnant meaning that should be attached to the word " employed " in this connection. I do not think that I am being unfair to the argument of the respondents if I say that we were not presented with any set of words which were capable o(defining what that pregnant meaning might be, apart from the suggested interpretation of the word " employed " as meaning " actively or productively employed during the accounting period " which has already been rejected by this House in Terence Byron's case [1945] 1 All ER 636.....

My Lords, % do not think that the words " capital employed in a trade or business " bear any significant difference of meaning from the words " capital of a trade or business ". I stress; of course, that we are dealing with the capital of a trade or business and not the capital of its proprietor. He, or, in the case of a company, it, may, obviously, own capital or assets that are not the capital or assets of his or its trade or business. But, with that out of the way, I do not see what other distinction remains."

17. Radcliffc concurred with the conclusion and dismissed the appeal "with the following observation (page 306) :

" But lest I go too far, I will content myself with saying that no part of the capital employed in this business in the accounting period consisted of this claim, which was at that date uncertain as to the amount that it would produce or the year in which it would be paid. A case of this sort is quite exceptional. The asset is, as it were, voted by Parliament, but it remains a vote until the claim is recognised and paid. We treat it as a chose-in-action for the purposes of this case, but I would think it very unsafe to suppose that every chose-in-action which belongs to the proprietor of a business in connection with it is a for in of capital employed in his business."

18. Lord Tucker observed as follows (page 306) :

" My Lords, I agree with those of your Lordships who consider that authority, as well as the legislative history of the words " capital employed % point to the conclusion that in their present context they do not refer to the actual use made of a particular asset in the relevant accounting period once it is shown to have been a form of capital put into the business and still there."

19. The next decision cited was Jayaram Mills Ltd., Rajapalayam Vs. The Commissioner of Excess Profits Tax, Madras, . Here the Madras High Court had to consider the Excess Profits Tax Act of 1940. The assessee in that case was a limited company carrying on the business of spinning. With the object of extension the assessee decided to open a weaving section and for that purpose started purchasing assets from the year 1944. In 1944, looms and connected machines were purchased and removed to the assessee's mill site. Factory buildings were constructed at the site and weaving machineries were erected by June, 1946. But the weaving mills started functioning only from July, 1947. The question arose whether in computing the excess profits tax for the accounting period between the 1st July, 1945, and the 31st March, 1946, the capital employed by the assessee in its business should include the value of the building, plant, machinery and fittings of the weaving department. The Excess Profits Tax Act, 1940, levied charge on the excess profits for the computation of which the average amount of capital employed in the business during the chargeable accounting period had to be determined. Sub-rule (1) of Rule 1 of Schedule II of the said Act provided as follows :

"1. (1) Subject to the provisions of this Schedule, the average amount of the capital employed in a business (so far as it does not consist of money) shall be taken to be-

(a) so far as it consists of assets acquired by purchase on or after the commencement of the business, the price at which those assets were acquired, subject to the deductions hereafter specified ;

(b) so far as it consists of assets being debts due to the person carrying on the business, the nominal amount of those debts, subject to the said deductions;

(c) so far as it consists of any other assets which have been acquired otherwise than by purchase as aforesaid, the value of the assets when they became assets of the business, subject to the said deductions."

20. In assessing the excess profits tax, the officer concerned excluded the value of the building, plant and machinery of the weaving department. The Appellate Assistant Commissioner reversed the decision of the Excess Profits Tax Officer. On further appeal, the Appellate Tribunal held that, as the weaving department of the assessee did not go into production during the chargeable accounting period, the assets of the said department did not become business assets and, therefore, did not form part of capital employed for the purpose of earning profits during the said period. The value of such assets, therefore, could not be taken into account for computation of average capital. On a reference, the Madras High

Court held that once the assets had been acquired for the purpose of business, whether the same were used or not, they would still be assets of the business and available for the use of the business. It held further, that the fact that the weaving department did not go into actual production will not disentitle the assessee from claiming that the money spent on it should be considered as capital employed in the business. The High Court construed the section and observed that the word " employed " in the sub-rule related to the capital and not to the assets. The rule did not lay down that the assets should be employed in the business. The decision of the House of Lords in the case of Birmingham Small Arms Co. Ltd.. [1951] 2 All ER 296 was cited and was considered by the Madras High Court which noted that the observation of Lord Simonds had not been followed by the other law Lords.

21. In the facts and circumstances of the present reference it appears to us that the decisions cited by Mr. B. L. Pal do not support the contentions of the revenue but, on the contrary, support the contentions of the assessee.

22. Section 84 of the Income Tax Act, 1961, refers to "capital employed " and not to " assets used ". Rule 19 is even more specific. It clarifies the expression "capital employed" and lays down that capital employed consists of the following classes of assets. These are :

- (a) assets acquired by purchase and entitled to depreciation ;
- (b) assets acquired by purchase not entitled to depreciation;
- (c) nominal amount of debts due to the person carrying on the business ; and
- (d) any other type of assets.

Only in the computation of the value of the assets, acquired at or after the commencing date of the computation period, it is necessary to determine their average cost during the entire accounting period and for that purpose only the actual user of the assets in the business becomes relevant. It is quite clear from the rule that if an asset is acquired prior to the commencement of the accounting period the question of its user or non-user is entirely immaterial. Whether such an asset is used or not, it will still be included in the capital employed in the business.

23. Looking fit the position from another point of view it appears to us that the moment capital is utilised for the purposes of acquiring any asset for a business, such capital becomes employed in the business. Whether the asset itself is actually used in the business or not, so far as the capital is concerned, it continues to be employed in the business.

24. Our view as aforesaid finds support from the observations of the majority of the law Lords in the case of Birmingham Small Arms Co. Ltd. [1951] 2 All ER 296. The Madras High Court has taken the same view in the case of Jayaram Mills Ltd., Rajapalayam Vs. The Commissioner of Excess Profits Tax, Madras, .

25. For the reasons given above we answer question No. 2 in the affirmative and in favour of the assessee.

26. In the facts and circumstances, there will be no order as to costs.

Deb, J.

27. I agree.