
(1981) 04 BOM CK 0024

In the Bombay High Court

Case No : Income-tax Reference No. 120 of 1971

Commissioner of Income Tax

APPELLANT

Vs

International Computers Ltd.

RESPONDENT

Date of Decision : 10-04-1981

Acts Referred:

Income Tax Act, 1961 — Section 155(5), 33(1), 34(3)

Citation : (1981) 131 ITR 1 : (1981) 7 TAXMAN 128

Hon'ble Judges : Sawant, J; Chandurkar, J

Bench : Division Bench

Advocate : R.J. Joshi and V.C. Kotwal, for the Appellant; S.E. Dastur and R.P. Makhija, instructed by Crawford Bayley and Co., for the Respondent

Judgement

Chandurkar, J.—The assessee is admittedly not an Indian company and iff a company registered under the United Kingdom Companies Act. It manufactures data processing equipments and these machines are sent overseas on hire. The assessee had a wholly owned subsidiary company in India by the name of M/s. International Computers and Tabulators (India) Private Ltd. The data processing machines are let out by the assessee-company to its Indian subsidiary and rental is charged by the assessee-company. The Indian subsidiary company hires out the equipments and the machines to other customers in India on rental basis. Out of the hire amount earned by the Indian subsidiary, from each customer in India, 45% of the rental charges are paid by the subsidiary company in India to the company in U.K. for obtaining from them the machines on hire.

2. In the relevant assessment years, i. e., from 1963-64, the entire hire charges payable by the Indian subsidiary to the assessee-company have been remitted to U. K. in full every year.

3. The assessee-company does not draw up a separate profit and loss account and balance-sheet for its Indian business but keeps a consolidated profit and loss account of its entire global activity in the U. K. Thus, the rental received by the assessee-company from its Indian subsidiary company forms part of the total

rentals shown in its consolidated profit and loss account maintained in the U.K. However, in the consolidated balance-sheet in the U.K., the assessee-company created a separate development rebate reserve in regard to its Indian business under the head "Appropriation to Reserves" with a sub-head "Development Rebate Reserve (India)" from year to year.

4. In respect of the five assessment years in question, the assessee-company's claim for grant of development rebate was rejected by the ITO on four grounds, one of the grounds being that the Indian company had remitted the rentals as profits to the assessee-company. The ITO also held that the data processing machines were office appliances which were excluded from the benefit of development rebate from the year 1960-61 onwards.

5. On appeal by the assessee, the AAC accepted the assessee-company's contention that the machines were its capital assets and not its stock-in-trade and that the machines were not office appliances. However, the claim for development rebate was rejected on the ground that there was a shortfall in the reserves and that profits were remitted outside India for all the years.

6. When the matter was taken in appeal to the Income Tax Appellate Tribunal, the Tribunal considered the provisions of Section 10(2)(vi) of Indian I.T. Act, 1922, and Section 34(3)(a) of the I.T. Act, 1961. The Tribunal found that it was not the revenue's case that any amount was specifically utilised for the creation of any asset outside India. With regard to the remittance of profits relied upon and the circumstances which disabled the company from claiming development rebate, the Tribunal found that there was no indication in the accounts anywhere that the reserves of ₹76,000, as they stood at the end of September, 1962, were at any time utilised for remittance outside India as profits. The Tribunal found that since all the hire charges paid by the Indian subsidiary were remitted to the assessee company in U.K., and these hire charges had an element of profit in them, such remittances went into the general pool of revenue of the assessee-company out of which amounts were appropriated to various reserves and, thus, though it may be that the reserves might have, in part, come out of the remittances, it could not be said that reserves, having once been created, were utilised as remittance of profits. The Tribunal, therefore, held that Clause (b) of the first proviso to Section 10(2)(vi) of the Indian I.T. Act, 1922, or Section 34(3)(a)(ii) of the I.T. Act, 1961, was not attracted. The Tribunal, therefore, held that the AAC was not right in sustaining the disallowance of the assessee's claim for grant of development rebate.

7. With regard to the finding recorded by the AAC that the machines were not office appliances, the Tribunal referred to the functioning of the data processing units and held that these machines were not treated as office appliances such as tabulators or adding machines. Accordingly, the Tribunal directed the ITO to grant the benefit of development rebate in full for the assessment years 1962-63 and 1963-64, and to recompute the development rebate admissible for the years 1959-60, 1960-61 and 1961-62, in regard to such number of machines for which

the reserves created did not fall short of the 75% of the rebate admissible. Arising out of this order of the Tribunal, the following two questions have been referred to this court u/s 66(1) of the Indian I.T. Act, 1922, and Section 256(1) of the I.T. Act, 1961?

" 1. Whether, on the facts and in the circumstances of the case, the data processing equipment could be regarded as " office appliances" for the purpose of granting development rebate for the assessment years 1960-61, 1961-62, 1962-63 and 1963-64?

2. Whether, on the facts and in the circumstances of the case, the amount equal to 75% of the development rebate, credited to reserve could be said to have been utilised by the assessee-company for remittance outside India as profits ? "

8. The controversy which is put in issue in the first question, viz., whether the data processing machines are office appliances for the purposes of development rebate u/s 33(I) of the I.T. Act, 1961, has been considered in sufficient detail in the earlier decision of this court in Commissioner of Income Tax, Bombay City-I Vs. I.B.M. World Trade Corporation, . It was held in that case that the data processing machines were not office appliances and were eligible for allowance of development rebate u/s 33(1) of the I.T. Act, 1961. It is not in dispute that, in view of this decision, question No. 1 has to be answered in the negative and against the revenue.

9. So far as the second question is concerned, before we refer to the argument of the learned counsel for the revenue, it is necessary to refer to the relevant part of the provisions of Section 34(3)(a) on the construction of which the answer to the second question will depend. The relevant part of Section 34(3)(a) reads as follows ;

" 34. (3)(a) The deduction referred to in Section 33 shall not be allowed unless an amount equal to seventy-five per cent. of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking, other than-

(i) for distribution by way of dividends or profits; or

(ii) for remittance outside India as profits or for the creation of any asset outside India:....,"

10. Rest of the section is not material for our purpose. Sub-section (3), Clause (a) of Section 34 refers to conditions under which the deduction by way of development rebate permissible u/s 33 will be allowed. The first condition is that an amount equal to 75% of the development rebate to be actually allowed must be debited to the profit and loss account of the relevant previous year and that amount should be credited to the reserve account. The second condition is that the amount which is credited to the reserve account, though can be utilised by

the assessee during a period of eight years next following in the business of the undertaking, these purposes do not include, (i) distribution by way of dividends or profits, and (ii) remittance outside India as profits or for the creation of any asset outside India. Admittedly, so far as the condition of crediting the reserve account is concerned, there is no dispute in this case that such an account has been credited. There is also no dispute that the amount in the reserve account has not been utilised for distribution by way of dividends or profits.

11. Now, the learned counsel for the revenue has contended that the entire amount of rental earned by the Indian subsidiary has been remitted by it to the assessee-company and, therefore, the assessee-company is disentitled from claiming development rebate in view of the second condition in Clause (a) of Section 34(3) of the I.T. Act, 1961. What is argued is that the entire amount which was remitted, included profits and, therefore, the entire profits earned by the Indian company had been remitted outside India.

12. The Tribunal has positively observed in its order that it was not the case of the revenue that any part of the reserve account had been remitted outside India for the creation of any asset outside India. The only question, therefore, is whether, when the entire rental income of the Indian subsidiary has been remitted to the assessee-company in U.K., it constitutes an amount out of the reserve account remitted outside India as profits.

13. The scheme of Section 34(3)(a) shows that it was not intended to give benefit of development rebate to an assessee, who having credited the reserve account for the purposes of earning development rebate, then utilised that reserve account either for distribution by way of dividends or profits, or remittance outside India as profits. The words "remittance outside India as profits" are extremely significant inasmuch as they indicate that the nature of the remittance must be as profits. A careful reading of the provisions of Section 34(3)(a) will show that, in order that any one of the two conditions mentioned in Clause (i) and (ii) can be invoked to disentitle the assessee from claiming development rebate, the first essential requirement is that there must be a reserve account and the second one is that the reserve account is utilised for remittance outside India as profits. Unless, therefore, it can be said that the assessee has drawn on the reserve account in order to enable him to remit certain amounts as profits outside India, the disabling Clause (ii) in Sub-section (3)(a) of Section 34 cannot come into operation.. It can hardly be disputed that when at the end of the accounting year a part of the profits are appropriated towards a reserve account, the amount so appropriated loses its character as profits and they assume the character of a reserve. As long as the amounts in the reserve account continue to have the character of a reserve and are not drawn upon to be remitted as profits, there is no occasion for Clause (ii) of Sub-section (3)(a) to come into operation .

14. The whole foundation of the argument on behalf of the revenue is that in each accounting year, the entire amount of remittance has been remitted and,

therefore, the assessee has disentitled itself from claiming development rebate. This contention is based on a misapprehension of the scope of Section 34(3)(a). When the rental income, as and when earned, is remitted these remittances are not out of any reserve account for that year because the reserve account will come into being only at the end of the accounting year when the balance-sheet is finalised and approved by the shareholders. As already pointed out, unless there is a reserve account in existence, there is no occasion for Clause (i) or (ii) to come into operation. The mere fact that as and when the rental income was earned it has been remitted, will not result in any one of the two clauses in Section 34(3)(a) being attracted.

15. There is another ground on which the argument of the learned counsel for the revenue must be rejected. What is required by Section 34(3)(a) is that the reserve account should not be drawn "upon during a period of eight years next following the year in which the reserve is credited.

16. The prohibition in Section 34(3)(a) against the amount credited to reserve account being utilised in the manner indicated by Clauses (i) and (ii) thus operates in respect of the eight years next following the year in which the amount has been credited to the reserve account. The argument before us is that each of the years of account is concerned, all the monies earned have been remitted to the U.K. This overlooks the fact that the stipulation in Section 34(3)(a) is in respect of the period of eight years following the year in which the reserve is created. Any remittances in the year in which the amount has been later credited to the reserve account will not at all attract the prohibition u/s 34(3)(a), Clause (i) and (ii). Therefore, on the mere fact that all the amounts earned have been remitted in the respective accounting years, the assessee was not entitled to the benefit of development rebate cannot be sustained on the wording of Section 34(3)(a).

17. Though we have already pointed out that on the terms of Section 34(3)(a) the prohibition operates in the years subsequent to the year in which any amount is credited to a reserve account, it may be instructive to refer to the provisions of Section 155(5) of the I.T. Act, 1961, which provides for the consequence of utilising the amounts set apart as reserve for the purposes which are impermissible u/s 34(3)(a). The material part of Section 155(5) reads as follows ;

"155. (5) Where an allowance by way of development rebate has been made wholly or partly to an assessee in respect of a ship, machinery or plant installed after the 31st day of December, 1957, in any assessment year u/s 33 or under the corresponding provisions of the Indian Income Tax Act, 1922 (11 of 1922), and subsequently--...

(ii) at any time before the expiry of the eight years referred to in Sub-section (3) of Section 34, the assessee utilises the amount credited to " the reserve account under Clause (a) of that sub-section-

(a) for distribution by way of dividends or profits ; or

(b) for remittance outside India as profits or for the creation of any asset outside India ; or

(c) for any other purpose which is not a purpose of the business of the undertaking,

the development rebate originally allowed shall be deemed to have been wrongly allowed, and the Income Tax Officer may, notwithstanding anything contained in this Act, recompute the total income of the assessee for the relevant previous year and make the necessary amendment..."

18. Section 155(5) thus enables the ITO to recompute the total income of the assessee for the relevant previous year in which the allowance by way of development rebate has been granted to the assessee but that at any time during the period or before the expiry of eight years next to the relevant year, the assessee has utilised the amount credited to the reserve account for purposes which are impermissible u/s 34(3)(a). There can, therefore, be no manner of doubt that before the provisions of Section 34(3)(a) are to be invoked and action u/s 155(5) is intended to be taken by the ITO, it has to be established that in any year, within a period of eight years next following the year in which the amount is credited to the reserve account, that amount has been utilised for the purposes of remittance outside India as profits so far as the Indian company in this case is concerned. On the facts relied upon on behalf of the revenue, it cannot be said that in any of the assessment years following the assessment year in respect of which the sum was credited to the reserve account, any remittances were made outside India as profits out of the amount so credited to the reserve account.

19. In the view which we have taken, we need not consider the correctness of the observations made by the Tribunal in para. 10 of the order that the provisions of Section 34(3)(a)(ii) are inapplicable in the case of a foreign company selling goods or services directly to India.

20. So far as the present reference is concerned, the assessment years 1959-60, 1960-61 and 1961-62 are governed by the Indian I.T. Act, 1922, and the provisions of Section 34(3)(a)(ii) are analogous to Clause (b)(ii) of the proviso which occurs in Section 10(2)(vib) of the Indian I.T. Act, 1922. The provisions of Section 155(5) of the I.T. Act, 1961, corresponds to Section 35(11) of the Indian I.T. Act, 1922. It is, therefore, not necessary for us to consider independently the relevant provisions of the I.T. Act, 1922.

21. In the view which we have taken, the questions are answered as follows :

Question No. 1--In the negative and against the revenue.

Question No. 2--In the negative and against the revenue.

22. Revenue to pay costs of this reference.