

(1978) 08 KAR CK 0001

In the Karnataka High Court

Case No : IT Ref. No"s. 124 and 125 of 1977

International Instruments Private Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 03-08-1978

Acts Referred:

Citation : (1979) 1 TAXMAN 91

Hon'ble Judges : M.K. Srinivasa Iyenger, J;E.S. Venkataramiah, J

Bench : Division Bench

Advocate : G. Sarangan, for the Appellant; S.R. Rajashekara Murthy, for the Respondent

Judgement

E.S. Venkataramiah, J.—The assessee in these two cases is International Instruments Private Limited, Bangalore, and the assessment years are 1967-68 and 1968-69. The assessee owned a factory in Bangalore where it was manufacturing dash-board instruments used in automobile industry, under a licence which it had obtained under an agreement dated September 30, 1959, with a Germa Company known as VDO TACHOMETER WERKE Adolf Schindling GmbH. Till the assessment year 1966-67 the assessee had been claiming relief u/s 84 of the income tax Act, 1961 (hereinafter referred to as "the Act") as it stood then on the basis that the entire unit was One new industrial undertaking. In the course of the assessment year 1967-68 the assessee was advised that having regard to the provisions of section 84 of the Act and the development of the industry of the assessee over several years, it should claim relief that it was entitled to in law by putting forward before the income tax authorities the real state of affairs. Accordingly, in the assessment year 1967-68, the assessee claimed relief u/s 84 of the Act in respect of the following seven units which commenced operation subsequent to the year 1961:

Name of the unit

Year of commencement

Nature of work

1. Press Shop

1962

Manufactures metal cases to mount the instrument technically known as "pressed components".

2. Machine Shop

1963

In this section, iron brass and aluminium rods are fed into machine to make gears, axles, special type bolts, screws and other tiny articles technically called "turned components".

3. Dial Printing Shop

1964

Prints dials on metal sheets to be used in the instruments.

4. Plastic Moulding Shop

1965

Manufactures plastic components like figure wheel, digit wheel, traffic wheels, etc.

5. Cable Shop

1962

Manufactures steel wires used as cables for speedometers.

6. Others (assembling, plating and all other remaining odd works)

1961

All the remaining items of assembling, plating, etc, undertaken in this section.

7. Dye-casting Shop

1966

Manufactures of dyes used in other sections.

The assessee stated that at the commencement, it used to import all the components of the dash-board instruments from abroad and was merely assembling them. Gradually it commenced to manufacture the components required for the manufacture of dash-board instruments one after another in the manner indicated above. In order to establish each one of the units referred to above, it had to invest fresh capital, install fresh machinery and engage fresh labour. The products that were being manufactured in each one of the above units were marketable commodities which the assessee had either to import or

buy earlier for the purpose of manufacturing finished dashboard instruments. On the setting up of each of the units, the assessee manufactured or produced the relative articles in each of them and used them in the manufacture of dashboard instruments. It contended that each one of them should therefore be treated as a new industrial undertaking established in the year mentioned against it and relief granted in respect of it u/s 84 of the Act. In the following assessment year 1968-69, a deduction was claimed by the assessee u/s 80J of the Act which was introduced in the place of section 84 of the Act in respect of the said units. The assessee also claimed in the assessment year 1967-68 development rebate u/s 33 of the Act on assets of the value of Rs. 68,393 in addition to other assets. In the assessment year 1968-69 the assessee claimed development rebate in respect of the assets of the value of Rs. 1,60,066 in addition to the value of other assets. The income tax Officer rejected the claim of relief u/s 84 of the Act in the assessment year 1967-68 and deduction u/s 80J of the Act in the assessment year 1968-69 on the ground that the units in question were not new industrial undertakings eligible to any relief thereunder. In respect of the development rebate, he held that the assets of the value of Rs. 1,658 were not eligible for development rebate in the year 1967-68 and assets of the value of Rs. 4,720 were not eligible for development rebate in the year 1968-69. He, however, denied development rebate even in regard to the rest of the items on the ground that the required reserve had not been created by the assessee. On the basis of the above findings, he concluded the assessments. Aggrieved by the orders of assessment, the assessee filed appeals before the Appellate Assistant Commissioner of income tax. The Appellate Assistant Commissioner upheld the decision of the income tax Officer in so far as the claim of the assessee for relief u/s 84 and deduction u/s 80J were concerned. But in view of the submission made on behalf of the assessee before him that the Central Board of Direct Taxes had issued instructions in regard to the assessee to grant development rebate u/s 33 of the Act in respect of the assets in question during the assessment years "1967-68 and 1968-69, he directed the income tax Officer to consider the said question afresh and grant the permissible relief. Against the orders of the Appellate Assistant Commissioner, the assessee as well as the Department filed appeals before the income tax Appellate Tribunal. The Tribunal allowed the appeal of the Department and set aside the direction of the Appellate Assistant Commissioner in regard to development rebate. It dismissed the appeal of the assessee and confirmed the order in so far as the relief claimed u/s 84 and deduction u/s 80J were concerned. Thereupon, at the instance of the assessee the Tribunal has referred to this Court u/s 256(1) of the Act, the following questions:

Re. 1967-68:

- (i) Whether, on the facts and in the circumstances of the case, the assessee was entitled to any deduction u/s 84 in the assessment for 1967-68?
- (ii) Whether, on the facts and in the circumstances of the case, the Tribunal was

right in law in holding that the assessee was not entitled to the allowance of development rebate on the assets of the value of Rs. 66,735?

Re. 1968-69:

(i) Whether, on the facts and in the circumstances of the case, the assessee was entitled to any deduction u/s 80J in the assessment for 1968-69?

(ii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was not entitled to the allowance of development rebate on the assets of the value of Rs. 1,55,346?

2. The Tribunal refused to grant the relief u/s 84 and deduction u/s 80J of the Act for the following reasons:

6. The only other contention in this appeal is that the lower authorities erred in not allowing the relief u/s 80J of the income tax Act. In disallowing the assessee's claim in this regard the Appellate Assistant Commissioner has referred to his order for earlier years. The facts are set out in the Appellate Assistant Commissioner's order for the assessment year 1967-68. Briefly the facts are; according to the assessee its undertaking consists of different shops or units which operate at different stages of production and each such unit should be taken as a separate and independent industrial undertaking within the meaning of section 80J of the Act. These units are as follows:

Name of the unit

Year of commencement

1. Press Shop

1962

2. Machine Shop

1963

3. Dial Printing Shop

1965

4. Plastic Moulding Shop

1965

5. Cables Shop

1962

6. Others

1961

7. Die Casting Shop

1966

The income tax Officer held that the entire plant and machinery constituted a single industrial undertaking which commenced operation even as early as assessment year 1962-63 when they started production of dash-board instruments by mainly assembling imported parts. For this purpose he relied on a finding in the assessment order for 1962-63. According to the assessee, however, each of the above so called shops should be taken as separate and independent industrial undertaking and the profits of the same should be given the relief u/s 80J up to the limits prescribed in sub-section (2) of that section.

7. It was as a result of a collaboration agreement entered by the assessee on 30-9-1959 with a German concern, viz., VDO TACHOMETER WE RKE that the assessee undertook the manufacture of dash-board instruments under licence from the German company. The agreement shows that it is a composite and indivisible agreement and it does not make any distinction between the so called units which are now claimed to be distinct and separate from each other. The manner of functioning by the assessee and its method of accounting also show that there are no separate independent units at all. No separate account is kept for each unit. There are no interdepartmental sales noted and the cost of production in each stages is not separately ascertained. Even with regard to the capital equipment like plant and machinery, the balance sheets from the beginning do not make any distinction between plants and machinery of the various units which are said to be distinct and separate. The assessee itself has not ascertained the profit of each unit and, on the facts and in the circumstances of the case, in our opinion, it would be practically impossible to do so. The facts of the case are, therefore, very similar to the facts in the case of Commissioner of Income Tax Vs. Textile Machinery Corporation, decided by the Calcutta High Court. In the case of Commissioner of Income Tax Vs. Indian Aluminium Co. Ltd., which is a later judgment of the Calcutta High Court, it was held that substantial expansion brings into existence a new industrial undertaking. In that case there were factories at different places and it was found, as a fact, that there was substantial expansion which could be taken as bringing into existence a new industrial undertaking. There is no such thing in the present case. The decisions in the case of Rajeswari Mills Ltd. Vs. Commissioner of Income Tax, and in the case of Anil Starch Products Ltd. v. Commissioner of income tax [1969] 59 ITR 514 are clearly distinguishable and have been rightly distinguished by the Appellate Assistant Commissioner in his order for the Assessment year 1967-68.

8. In the above circumstances, we are unable to accept the claim of the assessee that the various units aforementioned constitute different industrial undertakings. The contention is accordingly rejected." - vide orders of the Tribunal in I.T.A. 818/Bang/1972-73 dated 8-2-1974 in respect of assessment year 1969-70.

3. From the portion of the order of the Tribunal extracted above, it is clear that the principal grounds on which the relief was denied were:

- i. that all the new undertakings in respect of which relief was claimed, had come into existence as a result of a single collaboration agreement;
- ii. that the manner of functioning by the assessee and its method of accounting showed that there was no independent units at all because no separate accounts had been Kept for each unit;
- iii. that there were no inter-departmental sales noted and the cost of production in each stage had not been separately ascertained; and
- iv. that in similar circumstances, the High Court of Calcutta had denied relief in Commissioner of Income Tax Vs. Textile Machinery Corporation,

The Tribunal, however, did not hold that each of the seven units referred to above had not been established in the respective years as claimed by the assessee and that some articles were being manufactured there. It also did not disbelieve the case of the assessee that formerly it was securing from abroad the articles, which were later on manufactured in the several units, for the purpose of using them in the manufacture of dash-board instruments. In the circumstances, it is reasonable to hold that it was possible for the assessee to manufacture dash-board instruments even without the several units which came into existence subsequently. It follows that each one of the units has to be treated as a new industrial undertaking in which new articles came to be manufactured as and when it was established. It is no doubt true that in similar circumstances the Calcutta High Court had denied relief to the assessee in the case of Commissioner of Income Tax Vs. Textile Machinery Corporation, That decision has subsequently been reversed by the Supreme Court in Textile Machinery Corporation Limited, Calcutta Vs. The Commissioner of Income Tax, West Bengal, In that case section 15C of the Indian income tax Act, 1922, corresponding to sections 84 and 80J of the Act, came up for consideration. The Supreme Court held that the assessee was entitled to relief u/s 150 of the 1922 Act in respect of two new units, namely, a steel foundry division, and a jute mill division which were established as adjuncts to its existing factory. In doing so, the Supreme Court observed as follows:-

The assessee continues to be the same for the purpose of assessment. It has its existing business already liable to tax. It produces in the two concerned undertakings commodities different from those which it has been manufacturing or producing in its existing business. Manufacture or production of articles yielding additional profit attributable to the new outlay of capital in a separate and distinct unit is the heart of the matter, to earn benefit from the exemption of tax liability u/s 15C. Sub-section (6) of the section also points to the same effect, namely, production of articles. The answer, in every particular case, depends upon the peculiar facts and conditions of the new industrial undertaking on account of which the assessee claims exemption u/s 15C. No hard and fast rule can be laid down. Trade and industry do not run in earmarked channels and particularly so in view of manifold scientific and technological developments.

There is great scope for expansion of trade and industry. The fact that an assessee by establishment of a new industrial undertaking expands his existing business, which he certainly does, would not, on that score, deprive him of the benefit u/s 15C. Every new creation in business is some kind of expansion and advancement. 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 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. This has not happened here in the case of the two undertakings which are separate and distinct.

It is clear that the principal business of the assessee is heavy engineering in the course of which it manufactures boilers, wagons, etc. If an industrial undertaking produces certain machines or parts which are, by themselves, identifiable units being marketable commodities and the undertaking can exist even after the cessation of the principal business of the assessee, it cannot be anything but a new and separate industrial undertaking to qualify for appropriate exemption u/s 15C. The principal business of the assessee can be carried on even if the said two additional undertakings cease to function. Again, the converse is also true. The fact that the articles produced by the two undertakings are used by the boiler division of the assessee will not weigh against holding that these are new and separate undertakings. On the other hand, the fact that a portion of the articles produced in these two new industrial undertakings had been sold in the open market to other is a circumstance in favour of the assessee that the new industrial units can function on their own. Use of the articles by the assessee is not decisive to deny the benefit of section 15C.

Section 15C partially exempts from tax a new industrial unit which is separate physically from the old one, the capital of which and the profits thereon are ascertainable. There is no difficulty to hold that section 15C is applicable to an absolutely new undertaking for the first time started by an assessee. The cases which give rise to controversy are those where the old business is being carried on by the assessee and a new activity is launched by him by establishing new plants and machinery by investing substantial funds. The new activity may produce the same commodities of the old business or it may produce some other distinct marketable products, even commodities which may feed the old business. These products may be consumed by the assessee in his old business or may be sold in the open market. One thing is certain that the new undertaking must be an integrated unit by itself wherein articles are produced and at least a minimum of ten persons within the aid of power and a minimum of twenty persons without the aid of power have been employed. Such a new industrially

recognisable unit of an assessee cannot be said to be reconstruction of his old - business since there is no transfer of any assets of the old business to the new undertaking which takes place when there is reconstruction of the old business. For the purpose of section 15C, the industrial units set up must be new in the sense that new plants and machinery are erected for producing either the same commodities or some distinct commodities. In order to deny the benefit of section 15C, the new undertaking must be formed by reconstruction of the old business. Now, in the instant case, there is to formation of any industrial undertaking out of the existing business since that can take place only when the assets of the old business are transferred" substantially to the new undertaking. There is no such transfer of assets in the two cases with which we are concerned.

It is seen from the decision of the Supreme Court that the grounds on which the Tribunal denied relief to the assessee are irrelevant. Merely because pursuant to a single collaboration agreement the units in question came into existence, it cannot be said that they are not new industrial undertakings or separate units. The fact that the assessee was getting articles produced from the new undertakings from abroad for manufacturing dash-board instruments earlier, shows that they were marketable commodities and they answered one of the tests adopted by the Supreme Court in determining whether an undertaking is a new industrial undertaking or not. The fact that there was common management or the fact that separate accounts had not been maintained, would not also lead to the conclusion that they were not separate undertakings. Even if separate account is not maintained the investment on each of the units can be reasonably determined with the material which the assessee may make available to the department. We are, therefore, of the view that the finding of the Tribunal that the assessee was not entitled to relief u/s 84 and deduction u/s 80J of the Act during the assessment years in question, is erroneous.

4. The next question relates to the claim of development rebate made by the assessee u/s 33 of the Act. It is well known that development rebate is granted by way of an incentive to encourage entrepreneurs to modernise the plant and machinery of their industrial undertakings, in order to see that the rebate so granted is used in business and is not otherwise frittered away, section 34 provides that at least 75 percent of such allowance should be debited to the profit and loss account of the assessee of the relevant previous year and credited to a reserve account as development rebate reserve to be utilised over a period of eight years next following for the business and not distributed either by way of dividends or profits or remitted outside India as profits or for the creation of any asset outside India. In the instant cases, it is no doubt true that the assessee had not created a fresh development rebate reserve during the assessment years in relation to the assets in respect of which the development rebate was claimed. But its case was that in the year 1965-66 a development rebate reserve to the extent of Rs. 6,35,505 had been created though in law, having regard to the value of the assets in respect of which development rebate had been claimed during that assessment year it had to create development rebate reserve only in

a sum of Rs. 4,63,971 and as there was an excess of Rs. 1,71,534 by way of reserve was available, which would cover the claim made in these two assessment years 1967-68 and 1968-69, it was not necessary for the assessee to create a separate reserve. In fact, it could have before preparing the profit and loss account and the balance sheet withdrawn the excess reserve referred to above and treated it as fresh reserve created during the relevant assessment years. But as the balance sheet and the profit and loss account had been sent to the Registrar of Companies, the assessee thought it would not be proper to reconstruct the balance-sheet and the profit and loss account treating the said excess amount as fresh reserve. It, however, made a representation to the Central Board of Direct Taxes explaining the circumstances of the case and requesting it to issue necessary instructions to the assessing authorities to allow development rebate on the basis of the reserve already available. It is seen from the order of the Tribunal that the Central Board of Direct Taxes had issued instructions to the Department in favour of the assessee. It is on the basis of such instructions, the Appellate Assistant Commissioner issued directions to the income tax Officer to grant the allowance prayed for u/s 33 of the Act. The Tribunal did not act upon the instructions of the Board thinking that the said instructions had been withdrawn as could be seen from the relevant portion of its order:

In so far as the Board's instructions are concerned it appears from the paper book furnished by the counsel that although previously the Board had given instructions for allowance of the assessee's claim, these instructions were subsequently withdrawn by the Board's circular letter dated 27th October 1972 based on the judgment of the Supreme Court in the Indian Overseas Bank Ltd.'s case [1970] 17 ITR 512 and of the Gujarat High Court in the case of Surat Textile Mills Ltd. Vs. Commissioner of Income Tax, Gujarat II, Therefore, the assessee's claim that the development rebate should be allowed on the additional items on the basis of Board's instructions is untenable as the Board's earlier instructions were later withdrawn." - Vide para 11 of the order of the Tribunal in ITA Nos. 816, 817, 841 and 842/Bang/72-73, dated 9-5-1974.

The conclusion of the Tribunal is the result of a misconception. What had been actually withdrawn by the Board was a part of a Circular No. F 10/49/65-IT(A-I), dated 14th October, 1965 which contained certain general instructions. The remaining parts of that circular which did not conflict with the decision of the Supreme Court in The Indian Overseas Bank Ltd. Vs. The Commissioner of Income Tax, Madras, remained intact. That it was so is clear from Circular No. 189 dated 30th January 1976 which is found in 102 ITR 90 (St.), the relevant part of which reads as follows:

Reference is invited to Board's Circular. F. No. 10/49/65-IT (A-1), dated 14th October, 1965, which, inter alia, explained the position regarding the creation of statutory reserve for allowance of development rebate as follows:

(a) In the case of certain industrial undertakings, particularly those in which

there is Government participation either by way of capital, loan or guarantee, and where there are certain obligations by law or agreement about the maintenance of reserve for development purposes, the development rebate reserve may be treated as included in the said reserve though not specifically created as a development rebate reserve.

(b) In a case where the total income computed before allowing the development rebate is a loss, there was no legal obligation to create any statutory reserve in that year, as no development rebate would actually be allowed in that year.

(c) Where there was no deliberate contravention of the provisions, the income tax Officer may condone genuine deficiencies subject to the same being made good by the assessee through creation of adequate additional reserve in the current year's books in which the assessment is framed.

2. The Supreme Court, in the case of *The Indian Overseas Bank Ltd. Vs. The Commissioner of Income Tax, Madras*, had occasion to consider the validity of the position as explained at (a) above. In that case, the Bank had not created any development rebate as such, although the books of accounts disclosed a substantial reserve u/s 17 of the Banking Companies Act of 1949. On the claim of the bank that reserve had been created for purposes of claiming development rebate, the Supreme Court held that the reserve contemplated under the income tax Act was altogether an independent reserve and since the taxpayer had not complied with the requirements for the creation of special development rebate reserve, it was not entitled to claim the allowance in question. The Supreme Court also observed that the entries in the account books were not idle formalities. Thus, the instructions of the Board set out above in as far as part (a) is concerned became inoperative. However, the position explained in parts (b) and (c) above were not specifically considered by the Supreme Court in that decision. Taking note of the decision of the Supreme Court in *The Indian Overseas Bank Ltd. Vs. The Commissioner of Income Tax, Madras*, as well as a subsequent pronouncement of the Gujarat High Court in the case of *Surat Textile Mills Ltd. Vs. Commissioner of Income Tax, Gujarat II*, the Board had withdrawn in 1972 the aforesaid circular dated 14th October, 1965, to the extent it was superseded by the aforesaid Supreme Court decision and the judgment of the Gujarat High Court in *Surat Textile Mills Ltd.*

3. It was also directed that past assessments be reviewed and suitable action be taken to retrieve loss of revenue including securing of necessary disallowances by way of enhancement, etc., in appeals relying on the aforesaid judicial pronouncements. It would appear that this has been interpreted by the field officers as having withdrawn not only part (a), but parts (b) and (c) of para 1 above also, and rectificatory/revisionary action has been initiated in a number of cases.

4. It has been represented to the Board that their earlier instruction dated 14th October, 1965, represented the correct position in law and that its withdrawal to

the extent it was presumed to be overruled by the Supreme Court in the *The Indian Overseas Bank Ltd. Vs. The Commissioner of Income Tax, Madras*, created unnecessary hardship to assessees. Some of the rectificatory action taken had also reached High Court for decisions and in two separate decisions the Bombay High. Court struck down the "rectificatory order" u/s 154 in the case of *TATA IRON and STEEL CO. LTD. Vs. N. C. UPADHYAYA AND ANOTHER.* *TATA IRON and STEEL CO. LTD. v. KUM. D. V. BAPAT and ANOTHER.,* and in a more detailed discussion on merits in the writ petition of the *Indian Oil Corporation Ltd. Vs. S. Rajagopalan, Income Tax Officer, Companies Circle II(1), Bombay and Others,*

5. The Board have re-examined the issues involved and are of the view that except the clarification given in part (a) of para 1 above, which stands superseded by the aforesaid decision of the Supreme Court, the clarifications given in parts (b) and (c) of para 1 above hold good,

The case of the assessee came under para 1 (c) of the above circular which provided that where there was no deliberate contravention of the provisions, the income tax Officer may condone genuine deficiencies subject to the same being made good by the assessee through creation of adequate additional reserve in the current year's books in which the assessment is framed. In addition to the foregoing general instructions, the Board issued specific instructions in exercise of its power u/s 119 of the Act which empowered it to issue instructions wherever it considered it desirable or expedient so to do. Unfortunately the Tribunal committed an error in thinking that the specific instructions issued in the case of the assessee in the year 1969 had been withdrawn. The Tribunal should not have, therefore, interfered with the order of the Appellate Assistant Commissioner in this behalf. In the result, in each of the cases question No. 1 is answered in the affirmative and question No. 2 in the negative. Both the questions are answered in favour of the assessee.