(1980) 08 GUJ CK 0038

In the Gujarat High Court

Case No : IT Reference No. 174 of 1975

Monogram Mills Co. Ltd. APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 12-08-1980

Acts Referred:
Income Tax Act, 1922 — Section 24(2)
Income Tax Act, 1961 — Section 1(45), 14, 15, 2(45), 20

Citation : (1982) 8 TAXMAN 144

Hon'ble Judges : B.J. Divan, C.J;P.D. Desai, J

Bench : Division Bench

Advocate : K.C. Patel, for the Appellant; G.M. Desai and R.P. Bhatt, for the Respondent

Judgement

B.J. Divan, C.J.—In this case, at the instance of the assessee, the following questions have been referred to us for our opinion:

1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the carried forward development rebate of the earlier years cannot take precedence over the unabsorbed depreciation and business losses for the purpose of set off during the current year?

2. Whether the Tribunal has erred in interpreting section 2(45), read in context of sections 5, 33 and 72, etc., in determining the point at issue?

The facts leading to this reference are as follows: The assessment year under consideration is 1970-71, corresponding to the calendar year 1969. The assessee is a limited company carrying on the business of manufacture and sale of cotton cloth. The ITO computed the income of the assessee at Rs. 15,92,301. From this he made certain deductions on account of telephone deposit, depreciation, business losses carried forward from earlier years and unabsorbed carried forward depreciation at Rs. 5,73,136. The ITO also assessed share of profit from Monotes Sales Agency. The assessee on the other hand, claimed that the development rebate should have been given priority over the business losses of earlier years and unabsorbed depreciation. The ITO did not agree with the contention of the assessee and rejected those contentions. Thereafter, the matter was taken up in appeal to the AAC, who agreed with the ITO and confirmed his order. Thereafter, the assessee took the matter in further appeal before the Appellate Tribunal. Before that body the contention of the assessee was that the depreciation, development rebate and the losses should be set off in the following manner:

1. Current year''s depreciation.

2. Carried forward development rebate

3. Current year''s development rebate

4. Carried forward losses from earlier years

5. Unabsorbed depreciation.

The Tribunal found that the views expressed by the well known commentators on the income tax Act were against the contention urged on behalf of the assessee, but it was contended before the Tribunal, as it has also been contended before us, that none of these commentators has given any arguments and/or reasons in support of the view that first current year''s depreciation, carried forward losses from the earlier years and unabsorbed depreciation should be allowed and thereafter carried forward development rebate and current year''s development rebate should be allowed. The Tribunal held that when the plant or machinery was installed subsequent to 31-12-1957 the treatment of the development rebate is altogether different and it does not form part of the business loss. According to the Tribunal if in a particular year, development rebate is not sufficient to be adjusted against the profits the same can be carried forward. According to the Tribunal, under the scheme of section 24(2) of the Indian income tax Act, 1922 (hereinafter referred to as "the 1922 Act Act''), development rebate comes last for the purpose of setting off. It may be pointed out that under the Income tax Act, 1961 (hereinafter referred to as "the 1961 Act"), section 33(2) of the 1961 Act is equivalent to section 24(2) of the 1922 Act so far as the question of carrying forward and setting off of unabsorbed development rebate is concerned.

2. In order to appreciate the contentions which have been urged on behalf of the assessee, certain figures should be noted at this stage. In the assessment year under consideration, so far as the assessee is concerned, there was a total carried forward development rebate of Rs. 3,30,891. This unabsorbed development rebate was being carried forward from the year 1963-64. The assessee had carried for ward business loss for the assessment year 1964-65 at Rs. 4,49,663 and carried forward unabsorbed depreciation for various years at Rs. 21,91,060. As we have pointed out above, the figure of the total profit, before the provisions regarding the setting off carried for ward business losses,

unabsorbed depreciation and unabsorbed development rebate could be considered, was Rs. 15,91,801 because out of the amount of Rs. 500 on account of telephone deposit and Sukhary account was allowed to be deducted and the figure finally arrived at was Rs. 15,91,801.

3. In order to appreciate the controversy arising in this case, it is also necessary to refer to some of the relevant provisions of the 1961 Act. Section 1 (45) defines "total income" as the total amount of income referred to in section 5, computed in the manner laid down in this Act. Therefore, unless there is some thing inconsistent with this meaning in the subject or context or unless the context otherwise requires, the expression "total income" used'' in this Act would mean total income computed in the manner laid down in the Act. Section 4 is the charging section and it provides that where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of the total income of the previous year or years, as the case may be, of every person. Section 5 provides for the scope of total income and lays down that subject to the provisions of this Act, the total income of, any previous year of a person who is a resident includes all income from whatever source derived which (a) is received or is deemed to be received in India in such year by or on behalf of such person, or (b) accrues or arises or is deemed to accrue or arise to him in India during such year. We are not concerned with clause (c) of section 5(1) in this case.

4. Chapter IV of the 1961 Act deals with the computation of the total income and section 15 deals with the heads of income. It provides that save as otherwise provided by this Act, all income shall, for the purpose of charge of income tax and computation of total income be classified under the following heads of income:

A. Salaries.

B. Interest on securities.

C. Income from house property.

D. Profits and gains of business or profession.

E. Capital gains.

F. Income from other sources.

We are concerned in this case with the group of sections under which computation of income under the head "Profits and gains of business or profession" has to be carried out. Section 28 provides what income can be chargeable to income tax under the head "Profits and gains of business or profession". Clause (i) of section 28 provides that the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year shall be chargeable to income tax. We are not concerned with the other parts of this section. u/s 29 it has been provided that the income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43A. Therefore, before the income of the assessee is computed under the head ''Profits and gains of business or profession" all sections-from sections 32 to 43A will have to be borne in mind before arriving at the net figure of income under the head "Profits and gains of business or profession". Section 32 provides for depreciation. Under sub-section (1) of section 32, it has been provided that in respect of depreciation of buildings, machinery, plant or furniture owned by the assessee and used for the purposes of the business or profession, the following deductions shall, subject to the provisions of section 34, be allowed. Under clause (ii) of sub-section (1) of section 32, it has been provided that in the case of buildings, machinery, plant or furniture, other than ships covered by clause (i), such percentage on the written down value thereof as may in any case or class of cases be prescribed, is the depreciation allowance. Under sub-section (2) of section 32 provision is made for what can be called carrying forward of unabsorbed depreciation. It provides that where, in the assessment of the assessee (or, if the assessee is a registered firm or an unregistered firm assessed as a registered firm, in the assessment of its partners), full effect cannot be given to any allowance under clause (i) or clause (ii) of subsection (1) in any previous year, owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of sub-section (2) of section 72 and sub-section (3) of section 73, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years.

5. At this stage it may be pointed out that section 72 deals with carry forward and set off of business losses. At a later stage, we will deal with the concept of carry forward and set off of business losses, but, at this stage we may point out that section 72(2) provides that where any allowance or part thereof is under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of section 72. Therefore, before any depreciation allowance can be carried forward and set off against the profits of the subsequent years, the carried forward business loss has first to be set off and thereafter effect can be given to the unabsorbed depreciation allowance. u/s 33, provision has been made for the development rebate and clause (a) of sub-section (1) of section 33 provides that in respect of a new ship or new machinery or plant (other than office appliances or road transport vehicles) which is owned by the assessee and is wholly used for the purposes of the business carried on by him, there shall, in accordance with and subject to the provisions of section 33 and of section 34, be allowed a deduction, in respect of the previous year in which the ship was acquired or the machinery or plant was

installed or, it the ship, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, a sum by way of development rebate as specified in clause (b) of section 33. In this case there is no controversy regarding the percentage at which the development rebate has to be worked out. What is really material in this case is section 33(2) which provides that in the case of a ship acquired or machinery or plant installed after 31-12-1957, where the total income of the assessee assessable for the assessment year relevant to the previous year in which the ship was acquired or the machinery or plant installed or the immediately succeeding previous year, as the case may be (the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of section 33 or sub-section (1) of section 33A or any deduction under Chapter VIA or section 280-0) is nil or is less than the full amount of the development rebate calculated at the rate applicable thereto under sub-section (1) or sub-section (1A), as the case may be, the sum to be allowed by way of development rebate for that assessment year under sub-section (1) or sub-section (1A) shall be only such amount as is sufficient to reduce the said total income to nil, and the amount of the development rebate, to the extent to which it has not been allowed as aforesaid, shall be carried forward to the following assessment year, and the development rebate to be allowed for the following assessment year shall be such amount as is sufficient to reduce the total income of the assessee assessable for that assessment year, computed in the manner aforesaid, to nil, and the balance of the development rebate, if any, still outstanding shall be carried forward to the following assessment year and so on, so, however, that no portion of the development rebate shall be carried forward for more than eight assessment years immediately succeeding the assessment year relevant to the previous year in which the ship was acquired or the machinery or plant installed or the immediately succeeding previous year, as the case may be.

Explanation to, sub-section (2) of section 33 provides for a situation where for any assessment year development rebate is to be allowed in accordance with the provisions of sub-section (2) in respect of ships acquired or machinery or plant installed in more than one previous years, and the total income of the assessee assessable for that assessment year is less than the aggregate of the amounts due to be allowed in respect of the development rebate of that particular year. The situation envisaged by Explanation to sub-section (2) of section 33 does not arise in the present case.

6. Section 72 of the 1961 Act is in Chapter VI which deals with the aggregation of income and set off or carry forward of loss. Chapter VI consists of sections commencing from section 66 to section 80. Section 69D deals with the aggregation of income. Section 70 deals with set off or carry forward and set off. It deals with set off of loss from one source against income from another source under the same head of income. Thus, section 70 deals with the intra-head adjustment of loss. Though the sources under the same head may be different in arriving at the net result, loss from one source may be set off against the profits

and gains or income from another source and the net result has to be arrived at after this intra-head arrangement. Section 71, on the other hand, deals with the setting off of loss from one head against income from another. Thus, in the same year of assessment, loss from one head can be set off against the income from another head. The requirement of both section 70 and section 71 is that both intra-head adjustment and inter heads adjustment must be during the same year of assessment. Section 72 deals with carry forward and set off of business losses and it provides that where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the asses-see, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where the assessee has income only under the head "Capital gains" relating to capital assets other than short-term capital assets and has exercised the option under sub-section (2) of that section or where he has no income under any other head, the whole loss shall, subject to the other provisions of Chapter VI, be carried forward to the following assessment year and it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year, provided that the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant for that assessment year; and if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on. Under sub-section (2) of section 72 provides that where any allowance or part thereof is, under subsection (2) of section 32 or sub-section (4) of section 35 to be carried forward, effect shall first be given to the provisions of section 72.

7. Though there is no direct authority for the priority to be given as between carried forward business loss, unabsorbed depreciation and carried forward development rebate under the provisions of section 72(1), section 32(2) and section 33(2) there is a direct authority of the Supreme Court, relating to the priority to be given at the time of setting off of carried forward business loss and unabsorbed depreciation in Cambay Electric Supply Industrial Co. Ltd. Vs. The Commissioner of Income Tax, Gujarat-II, Ahmedabad, , in that case the Supreme Court was concerned with the provisions of section 80E of the 1961 Act, as it then stood. Under that section special deduction was to be given at the rate of 8 percent on profits and gains attributable to business of generation and distribution of electricity. The question was whether, in arriving at the figure on the basis of which 8 percent deduction was to be calculated, the unabsorbed depreciation and unabsorbed development rebate were to be deducted. There the Supreme Court pointed out that the important words in section 80E(1) are those that appear in parenthesis, viz., "was computed in accordance with the other provisions of the Act", and since it was income from business, the same, in view of section 29, had to be computed in accordance with sections 30 to 43A, which would include section 41(2) (providing for the balancing charge), section

32(2) (providing for carry forward of depreciation) and section 33(2) (providing for carry forward of development rebate), but what is really material is that in this decision the Supreme Court also pointed out that section 72(1) has a direct impact upon the computation under the head "Profits and gains of business or profession". Tulzapurkar, J. speaking for the Supreme Court, pointed out at page 97 of the report that it is not possible to accept the view that section 72 has no bearing on, or is unconnected with, the computation of the total income of an assessee under the head ''Profits and gains of business or profession". Actually, section 72(1) provides that where the net result of computation under the head "Profits and gains of business or profession" is a loss and such loss cannot be or is not wholly set off against the income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off, subject to the other provisions of the Chapter, shall be carried forward to the following assessment year and shall be set off against the profits and gains, if any, of any business or profession for that assessment year. Therefore, section 72(1) has a direct impact upon the computation under the head "Profits and gains of business or profession". In other words, the correct figure of total income, which is otherwise taxable under other provisions of the Act. cannot be arrived at without working out the net result of computation under the head ''Profits and gains of business or profession".

8. Mr. Patel, the learned counsel for the assessee has urged before us that the provisions of sections 20 to 71 should be first applied before the question of considering the carry forward and set off of business losses or unabsorbed depreciation from the previous year under the provisions of section 72(2) or section 32(2), is taken into consideration. His contention is that, under the scheme of section 33, development rebate is to be set off in lump sum in the earlier year relevant to the previous year in which the plant or machinery was installed or the ship was put into commission. He further stated that under the scheme of clauses (i) and (ii) of sub-section (2) of section 32 the current year''s development rebate is relinquished to the unabsorbed development rebate from the previous years and under that scheme development rebate for the current year must be given effect first before the provisions of carry forward and set off of business loss u/s 72(2) and section 32(2) can be applied. It is incumbent upon the income tax authorities to give development rebate of the current year and, therefore, carry forward and set off of the business loss and unabsorbed depreciation from the previous year will have to be relinquished to the lower order of priority as compared to the unabsorbed development rebate and development rebate of the current year.

9. In this connection the main burden of the argument of Mr. Patel was that the carry forward and set off of business loss, unabsorbed depreciation and unabsorbed development rebate must all be applied at the same stage, i.e., after the current year''s depreciation has been treated as a first charge against the receipts of the year under consideration and thereafter because of the provisions of section 72(2) and section 32(2) inter se carried forward business loss and

unabsorbed depreciation, priority has to be given to the carried forward business loss. He, however, contended that because of the specific provision of section 33(2) before current year''s development rebate can be given effect to and deducted by virtue of the scheme of clauses (i) and (ii) of subsection (2) of section 33, priority has to be given to the unabsorbed development rebate over the current year''s development rebate and hence by virtue of the specific provision of section 33(2) unabsorbed development rebate from the previous year and current year''s development rebate will both get priority over the carried forward business loss and unabsorbed depreciation from the previous year.

10. As has been held by this Court in Commissioner of Income Tax, Gujarat I Vs. Gujarat State Warehousing Corporation, and in Commissioner of Income Tax, Gujarat II Vs. Cambay Electric Supply Industrial Co. Ltd., as well as in Commissioner of Income Tax, Gujarat II Vs. Amul Transmission Line Hardware Pvt. Ltd., , under the provision of section 72(2) to which the provision of section 32(2) has been made subject, if there is a contest for priority as regards carried forward business loss and carried forward unabsorbed depreciation from the previous year, before the clubbing of the unabsorbed depreciation from the previous year with the current year''s depreciation and the deeming fiction of treating the unabsorbed depreciation of the previous year as the current year''s depreciation comes into operation, priority must be given to carried forward business loss. To that extent Mr. Patel is right but the question is as to what priority should be given to the carried forward unabsorbed development rebate. Because of the peculiar provisions of clauses (i) and (ii) of sub-section (2) of section 33, as between current year''s development rebate and unabsorbed development rebate from the previous year unlike in the case of carried for ward business loss and unabsorbed depreciation, priority is given to the unabsorbed development rebate from the previous year and thereafter the current year''s development rebate has to be set off.

11. However, in our opinion, this problem can be solved by closely analysing the provisions of sub-section (2) of section 33. In the body of that sub-section the material words, in our opinion, are "(the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of this section or sub-section (1) of section 33A or any deduction under Chapter VIA or section 280-0)". These words in the parenthesis make it clear that though u/s 2 (45) "total income" means the total amount of income referred to in section 5 computed in the manner laid down in this Act, for the specific purpose of sub-section (2) of section 33 when the total income is to be taken into consideration, no deduction is to be made in respect of the allowances under sub-section (1) or sub-section (1A) of section 33 or sub-section (1) of section 33A or any deduction under Chapter VI consisting of section 80A to section 80VV or section 280-0 for the annuity deposit. Therefore, a specially defined concept of total income has to be applied while working out the provisions of clauses (i) and (ii) of sub-section (2) of section 33. In order to give effect to the words in

parenthesis in sub-section (2) of section 33, one has first to compute the total income in the manner laid down in the Act and having thus computed it in the normal manner, the development rebate under sub-section (1) or sub-section (1A) of section 33, the development allowance under sub-section (1) of section 33A, the special deductions under Chapter VIA and the annuity deposits u/s 280-0, have all to be added back and it is only if the "total income" thus arrived after adding back at is nil, or is less than the full amount of the development rebate calculated at the rate applicable thereto under sub-section (1) or sub-section (1A), as the case may be the provisions of clauses (i) and (ii) of sub-section (2) of section 33 come into operation. Because of these words in the parenthesis no other meaning can be given to the concept of total income which has been made specially applicable to sub-section (2) of section 33.

12. As pointed out by the Supreme Court in Cambay Electric Supply Industries'' case (supra), section 72(1) has a direct impact upon the computation under the head "Profits and gains of business or profession". Therefore, before arriving at the figure of total income to which various amounts just now narrated have to be added back, carried forward business loss have to be set off and it is only after thus setting off of carried forward business losses from the previous years that the amount of profits and gains of business or profession, which is one of the heads of the total income in view of section 14, can be arrived at and it is only after arriving at the figure of total income in this manner that the additions have to be made in the light of the words in the parenthesis of sub-section (2) of section 33. If this setting off of carried forward business losses is not done before arriving at the total figure of income in the manner contemplated by subsection (2) of section 33, the direct impact of section 72(1) could not be given effect to. It is at this stage that by virtue of the provisions of section 72(2), after setting off of carried forward business loss, the unabsorbed depreciation will have to be set off and the unabsorbed depreciation and the deeming fiction of section 32(2) will come into play only after the carried forward business losses have been set off against the profits and gains from the business or profession u/s 72(1).

13. After giving effect to the carried forward business losses and setting them off, the deeming fiction would make the unabsorbed depreciation from the previous years the depreciation for the current year and under the scheme of section 32, while working out the profits and gains from business or profession, full effect must be given to the provisions of section 32(2). Section 32 is one of the sections in the group of sections from section 29 to section ''43A'' and the income under the head "Profits and gains of business or profession" can be worked out only after giving the full effect to the provisions of section 32 including sub-section (2) of section 32. Therefore, by virtue of the specific words in the parenthesis of sub-section (2) of section 33, the total income of the assessee for the year under consideration has to be worked out by giving effect to the provisions of section 32(1), thereafter to the provisions of section 32(2) and at that stage the development rebate (either current year''s development rebate or unabsorbed development rebate from the previous year) has to be

taken into consideration by virtue of the words occurring in the parenthesis in sub-section (2) of section 33.

14. Mr. Patel is right when he urges that like the carried forward business losses vide section 72(3), carried forward unabsorbed development rebate from the previous years can only be carried forward for a period of 8 years under the provisions of sub-section (2) of section 33. Under the provisions of clause (ii) of sub-section (2) of section 33, unabsorbed development rebate can only be carried forward to 8 assessment years immediately succeeding the assessment year relevant to the previous year in which the ship was acquired or machinery or plant was installed. It is possible, as Mr. Patel has argued, that if the interpretation that has been put to us (as set out above) were to be applied, the assessee may not be able to get anything out of unabsorbed development rebate of previous years and at the end of 8 years, by clause (ii) of sub-section (2), development rebate may lapse even when assessee concerned has fully satisfied section 34, which lays down the conditions for claiming the development rebate; but, in our opinion, there is a reason why the Legislature has preferred carried forward business losses and unabsorbed depreciation from the previous years to unabsorbed development rebate in the order of priority. As is well known, depreciation, which is provided for in section 32, is to protect the assessee against erosion of his capital. Current year''s depreciation is the first charge on the receipts of the particular year in the profit and loss account, but so far as the unabsorbed depreciation from the previous year is concerned, though it is allowed to be carried forward indefinitely, such unabsorbed depreciation may destroy the capital basis of the assessee. Similarly, carried forward business losses would also eat away the net capital, particularly working capital of the assessee concerned, and in order to protect the capital of the assessee which capital goes to earn income for the succeeding years, the Legislature had made special provision for carrying forward of business losses and unabsorbed depreciation and giving them priority over the development rebate. It is undoubtedly true, as Mr. Patel has emphasised by referring to the recommendations of the Taxation Enquiry Commission 1953-54, that development rebate is granted as an incentive to all assessees with business activities and industrial activities to install new plant and machinery and this incentive will not work if, at the end of 8 years, contemplated by clause (ii) of sub-section (2) of section 33, the development rebate for a particular year lapses, but the Legislature seems to have preferred to give protection to the capital of the business by providing for preference to the carried forward business losses and thereafter unabsorbed depreciation rather than to continue to give effect to the incentive in the shape of development rebate. Even if the development rebate is likely to be lost at the end of 8 years after the installation of the plant or machinery or acquisition of the ship, as the case may be, in our opinion, the Legislature has chosen the lesser evil between the two and has given preference to the carried forward business losses and then unabsorbed depreciation and thereafter unabsorbed development rebate.

15. It may be pointed out that there is no reference to sub-section (1) or sub-section (2) of section 72 in the provisions of sub-section (2) of section 33, where total income for the purpose of section 33(2) has to be specially worked out in the manner indicated in that sub-section, particularly in light of what is set out in the parenthesis of sub-section (2) of section 33. In the group of sections and subsections mentioned in that parenthesis, one does not find section 72(1) which provides for carry forward and set off of business losses from the previous years. It may be pointed out that when the Legislature wants to or does not want to exclude a particular section it says so and in absence of specific reference to section 72 in the parenthesis of section 33(2), it is not possible to exclude the business losses and carried forward business losses while giving effect to the provisions of section 33(2) regarding the unabsorbed development rebate from the previous years.

16. We may point out that u/s 72A of the 1961 Act, which came into effect from 1-4-1978 under the Finance (No. 2) Act, 1977, it has been provided that where there has been an amalgamation of a company owning an industrial undertaking or a ship with another company and the Central Government, on the recommendation of the specific authority, is satisfied that the conditions laid down therein, are fulfilled, then the Central Government may make a declaration to that effect and thereupon notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation was effected, but the unabsorbed development rebate of the amalgamated company is not to be deemed the unabsorbed development rebate of the amalgamating company. Thus, in section 72A, the Legislature has clearly laid down a distinction between the business losses which have been carried forward in the case of the amalgamating company and the unabsorbed depreciation allowances of the amalgamating company on the one hand and the unabsorbed development rebate of the amalgamated company on the other.

17. In a similar manner, the Legislature has also made a specific provision in the Explanation to section 44C of the 1961 Act. Section 44C, which came into effect from 1-6-1976 after being inserted by the Finance Act, 1976, has brought the concept of adjusted total income and the Explanation to section 44C provides that for the purpose of section 44C "adjusted total income" means the total income computed in accordance with the provisions of this Act, without giving effect to the allowance referred to in section 44C or in subsection (2) of section 32 or the deduction referred to in section 32A or section 33 or section 33A or the first proviso to clause (ix) of subsection (1) of section 36 or any loss carried forward under sub-section (1) of section 72 or sub-section (2) of section 73 or sub-section (I) of section 74 or sub-section (3) of section 74A or the deductions under Chapter VIA. Therefore, the legislative practice clearly is that, after computing the total income in accordance with the provisions of the Act, the total

income for the purpose of a particular section has to be modified or adjusted. The Legislature clearly provides as to how this is to be done. Clause (i) of Explanation to section 44C clearly shows that for the purpose of "adjusted total income" in the context of section 44C, the carried forward business losses, unabsorbed depreciation and development rebate u/s 33 are all to be brought back and are not to be excluded while considering the "adjusted total income".

18. Section 44A set out a special provision for deduction in case of trade, professional or similar associations. There also the Legislature has provided that certain expenditures are not to be considered as a part of the total income for the purpose of that section. At the end we have the provisions of section 80E which was under consideration before the Supreme Court in Cambay Electric Supply Industrial Co.''s case (supra). The Legislature has used the words "as computed in accordance with the other provisions of the Act" and, therefore, all the provisions of the Act, including section 72, were brought into play, as held by the Supreme Court, while considering the provision of section 80E [prior to its amendment by the Finance (No. 2) Act, 1967].

19. These different instances of the legislative practice, as occurring in different sections of the Act, clearly go to show that whenever the Legislature wants to define the "total income" in the context of particular provision of the Act, may it be section 80E or section 44A or section 44C, clear indications, as to how the total income for the purposes of that particular section or sub-section is to be computed, are given by the Legislature. Under these circumstances, the scheme of priority as between the carried forward business losses, unabsorbed depreciation and unabsorbed development rebate, which Mr. Patel has asked for in this case, cannot be said to be correct order of priority. In our opinion, the correct order of priority is as under:

1. Current year''s depreciation because that, is the first charge on the receipts in the profit and loss account.

2. Carried forward business losses u/s 72(2) read with section 72(1).

3. Unabsorbed depreciation by virtue of the provisions of section 32(2).

4. Unabsorbed development rebate because of the provisions of clauses (i) and (ii) of section 33(2).

5. Current year''s development rebate.

20. We find that all the commentators on the income tax Act have also mentioned in Their respective commentaries this very order of priority, but, barring one or two, none of the commentators have given any reason in support of their conclusion regarding this order of priority. In Kanga and Palkhivala''s The Law and Practice of income tax. 7th edition, Vol. I, at page 402, this very order of priority, that we have mentioned hereinabove, has been set out but no reasoning has been given in support of this conclusion. Similarly, in A.N. Aiyar''s income tax Act, 2nd edition, at page 824, the same order of priority as we have

mentioned, has been set out but barring the reference to me decision of this Court in CIT v. Gujarat Stale Warehousing Corporation''s case (supra), there is no reason advanced why this order of priority has been preferred by the learned commentator. In Iyengar on income tax, 6th edition, Vol. I, at page 837, the order of priority at which we have arrived at, has been mentioned but again no reasons has been given. Similar, is the position so far as the Chaturvedi and Pithisaria''s income tax Law, 2nd edition, at page 1128, is concerned. We may, however, point out that some of these commentators in their books do mention the relevant provisions like section 72(1) and section 33(2) against the different items mentioned in the order of priority. Jindal''s income tax Past and Present, 3rd edition, and page 437, while mentioning this order of priority says that development rebates are notional losses and can be set off against an) other head of income in future years. Section: 32(2) and 33(2) are exceptions to section 71 which allows inter-head set off only in year (sic): occurrence of loss. In V.S. Sundaram''s The Law of income tax in India, 9th edition, at page 465 the question of priority has been considered and it has been pointed out that there can be no question of priority as between current year''s depreciation allowance and development rebate. Total income has first to be arrived at before considering development rebate. Unabsorbed depreciation of earlier years is treated as additional depreciation of later years u/s 32(2). Therefore, when section 33(2) talks of the total income being computed without making any allowance under sub-section (1) (i.e., for the deduction of the rebate), but after making all other deductions, it follows that unabsorbed depreciation of earlier years will have first to be deducted before development rebate is deducted. The absence of a provision, as in sections 72(2) and 73(3), may, therefore, deprive the assessees of a part of the rebate owing to 8 years limit. But cases art unlikely to occur in practice, having regard to business conditions of these days.

21. Mr. Patel is right when he says that the view that such cases of development rebate of earlier years being not available to the assessee concerned owing to the lapse of 8 years are unlikely to occur in practice, is unfortunately not correct income of the cases (sic) now coming up before the income tax authorities, the case before us being an instance of one of such cases.

22. In Depreciation, Investment Allowance, Development rebate and Balancing Charge in income tax by Ramesh C. Sharma at page 223, the question of priority has been dealt with and there also the learned author, like V.S. Sundaram, has relied upon the specific language of section 33(2). In Chopra''s income tax Law and Practice, 2nd edition, at page 860, the learned author has set out the order of priority as we have mentioned earlier, and explains that the expression "total income" in section 33(2) means the total income computed without making any allowance under sections 33(1), 33(1A) and 33A, Chapter VI and section 280-0. We note that in the 11th edition of the Law of income tax in India by V.S. Sundaram, at page 1622, whatever has been stated in the earlier edition has been reiterated without any change.

23. Under these circumstances, the conclusion that we have arrived at is the conclusion which has appealed to all the learned commentators on the law of income tax and at least two of them have relied upon the specific wordings in the parenthesis of sub-section (2) of section 33 for the purpose of fixing this order of priority. Both, by way of process of interpretation and looking to the rationale, viz., preventing erosion of capital basis of the assessee''s business, the order of priority that we have mentioned earlier is the correct order of priority as between carried forward business losses, unabsorbed depreciation and unabsorbed development rebate of the previous years.

24. In P.K. Badiani Vs. The Commissioner of Income Tax, Bombay, , the Supreme Court has held that the allowance of initial depreciation or development rebate, unlike normal depreciation, is in no sense a deductible item of cost or expenditure in the process of settlement of the commercial profits; although it does not form part of the assessable profits, undoubtedly it does form part of the commercial profits, and thus, as we have pointed out above in the order of priority, current year''s depreciation is the first charge on the property from the commercial point of view is the view upheld by the Supreme Court in P.K. Badiani''s case (supra).

25. Under these circumstances, we answer the questions referred to us as follows:

Question No. 1 : In the affirmative, i.e., in favour of the revenue and against the assessee.

Question No. 2 : In the negative, i.e., in favour of the revenue and against the assessee.

The assessee will pay the costs of this reference to the Commissioner. After pronouncement of the above judgment, Mr Patel for the assessee has orally applied u/s 261 of the 1961 Act for a certificate for appeal to the Supreme Court. In our opinion, the question of law involved in this case is a substantial question of law. There is no direct authority on the interpretation of section 32(2) in the manner in which we have interpreted it. It is no doubt true that all the commentators have taken the same view that we have taken in this case, but there is no direct decision of the Supreme Court on this point and hence the certificate is granted.

