

Commissioner of Income-Tax, Madhya Pradesh, Nagpur and Bhandara

Vs

Nandlal Bhandari Mills Ltd

Civil Appeals Nos. 629 to 632 of 1964

(K. Subba Rao, J. C. Shah, S. M. Sikri JJ)

07.12.1965

JUDGMENT

SUBBA RAO J. –

These appeals raise the question of construction of the provisions of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, hereinafter called "the Order", in the matter of computation of the aggregate depreciation allowances for the purpose of assessment to tax.

Nandlal Bhandari Mills Ltd. is a public company incorporated in Indore under the Indore Companies Act, 1914. It owns and runs a textile mill and some ginning factories. The Income-tax Officer assessed the company for the assessment years 1950-51, 1951-52, 1952-53 and 1953-54 on its income of the corresponding accounting years, being the calendar years 1949, 1950, 1951, and 1952. In the course of the assessments it became necessary to ascertain the written down value of the building, machinery, plant, etc. of the respondent-company as on January 1, 1949. On April 1, 1950, the Indian Income-tax Act, 1922, was extended to Part B States, including Madhya Bharat of which Indore became a part. Till the said date, the assessee was for many years assessed in the Companies Circle, Bombay, as a non-resident and for some years as a resident under the Indian Income-tax Act, 1922. It was also assessed to industrial tax under the Indore Industrial Tax Rules, 1927. For those years in which it was assessed as a non-resident u

"(1) Whether the computation of the written down value of the assets of the applicant in the light of the provisions of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, is legal and valid ?

(2) Whether the provisions of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, and the subsequent modifications thereof were valid in law in the light of the provisions of the Indian Income-tax Act, 1922, the Finance Act, 1950, and the Constitution of India ?

(3) Whether the Indore Industrial Tax Rules, 1927, could be regarded as rule of law of a Part B State for the purpose of the said Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, and if so, whether the same are valid in law ? and

(4) Whether the depreciation 'actually allowed' means the depreciation deducted in arriving at the taxable income or in arriving at the world income ?"

Before the High Court the third question was not pressed; and the second question was concluded

by the decision of this court in Commissioner of Income-tax v. Dewan Bahadur Ramgopal Mills Ltd. The correctness of the answers given by the High Court in respect of these two questions is not questioned before us and, therefore, nothing further need be said about them here.

Questions Nos. 1 and 4, in substance, form two parts of the same question. On question No. 1, the High Court held that the depreciation allowed for the years up to and including 1944 in the assessments made in the taxable territories would be the depreciation which was actually allowed against the taxable income and not the depreciation computed against the total world income. On the 4th question, it answered that the depreciation actually allowed meant the depreciation deducted in arriving at the taxable income. The present appeals filed by the revenue questions the correctness of the answer given by the High Court in regard to questions Nos. 1 and 4 referred to it.

Mr. A. V. Viswanatha Sastri, learned counsel for the revenue, argued that the assessee was only entitled to depreciation on the written down value calculated after deducting all the amounts of depreciation that had been taken into consideration in determining the world income. He argued that depreciation was allowed in respect of the user of the assets in the business, that the allowance did not depend on the assessable income and that the High Court, therefore, went wrong in striking a proportion on the basis of a part of the income actually assessed under the Indian Income-tax Act.

Mr. Desai, learned counsel for the assessee, contended that no depreciation as such having been allowed for the years up to and including 1944 is computed under the Indian Income-tax Act, the original cost itself should be taken as the written down value of the assets. Alternatively, he argued that in any event only that part of the depreciation which had entered into the computation of income liable to income-tax under the Indian Income-tax Act, which income was calculated on proportionate basis alone, should be deducted from the original cost in determining the written down value under section 10(5)(a) of the Indian Income-tax Act.

We shall deal with questions Nos. 1 and 4 together; as we have indicated earlier, they are really parts of the same question. The answer to the questions turns upon the interpretation of the provisions of the Order. It is, therefore, necessary to read the relevant provisions of the Order.

"Paragraph 2. Computation of aggregate depreciation allowance and the written down value. - In making any assessment under the Indian Income-tax Act, 1922, all depreciation actually allowed under any laws or rules of a Part B State relating to income-tax and super-tax, or any law relating to tax on profits of business, shall be taken into account in computing the aggregate depreciation allowance referred to in sub-clause (c) of the proviso to clause (vi) of sub-section (2) and the written down value under clause (b) of sub-section (5) of section 10 of the said Act :

Provided that where in respect of any assets, depreciation has been allowed for any year, both in the assessment made in the part B State and in the taxable territories, the greater of the two sums allowed shall only be taken into account.

Explanation. - For the purpose of this paragraph, the expression 'all depreciation actually allowed under any laws or rules of a Part B State' means and shall be deemed always to have meant the aggregate allowance for depreciation taken into account in computing the written down value under any laws or rules of a Part B State or carried forward under the said laws or rules."

After the Indian Income-tax Act, 1922, was extended to the Indore State, difficulties arose in the matter of fixing the allowances for depreciation. The rates of depreciation under the Act and under the Order were not the same. Paragraph 2 of the Order provides that in making an assessment under the Act all depreciation allowances actually allowed under the laws obtaining in the Part B State before the Act was extended to it shall be allowed. The proviso thereto says that when there is a conflict between the two rates, the greater of the two sums allowed shall be taken into account. The Explanation to the section defines the expression "all depreciation actually allowed under any laws or rules of a Part B State" to mean the aggregate allowances for depreciation taken into account in computing the written down value under the laws prevalent in the Part B State or carried forward under the said laws or rules. The argument turned upon the following expression in the said paragraph : "actually allowed" in the ma

Under section 10(2) of the Indian Income-tax Act, profits or gains of business shall be computed after making the allowances enumerated therein. Under clause (vi), in respect of depreciation of such buildings, machinery, plant or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed and in any other cases, to such percentage on the written down value thereof as may in any case or class of cases be prescribed is allowed. Under section 10(5)(b), "written down value" means in the case of assets acquired before the "previous year" the actual cost to the assessee less the depreciation actually allowed to him under the Act. Under the Indian Income-tax Act, income is to be charged to tax without reference to diminution in the value of capital or the wear and tear involved in the user of the assets; but in respect of specified assets like building, machinery, plant and furniture, etc., the Act come-tax Officer, who applied the formula laid down in rule 33 of the Income-tax Rules, 1922, in fixing the depreciation allowance, had actually allowed only a fraction of the amount towards depreciation allowable din assessing the world income of the assessee.

But the learned counsel for the revenue contended that the entire depreciation of the assets was taken into consideration in computing the taxable income and, therefore, the entire amount should have been taken into account by the Income-tax Officer in arriving at the written down value of the assets. It appears that the Income-tax Officer in assessing the non-resident up to 1944 had, in calculating the total world income of the assessee, allowed the entire amount of depreciation; thereafter, he arrived at the taxable income in India by the application of rule 33. As we have pointed out, the mere fact that in the matter of calculation the total amount of depreciation was first deducted from the world income and thereafter the proportion was struck in term of rule 33 does not amount to an actual allowance of the entire depreciation in ascertaining the taxable income accrued in India. The Income-tax Officer, as we have pointed out earlier, could have adopted a different method ny first ascertaining the gross i

Learned counsel for the assessee contended that under the method adopted in terms of rule 33 of the income-tax Rules, 1922, no depreciation was allowed at all in ascertaining the taxable income in India, for that was only taken into consideration in arriving at the total world income.

We cannot accept this argument - we may say that the learned counsel did not press this point seriously either. As we have indicated earlier, only a fraction of the amount of depreciation was actually allowed in the assessment of the income accrued in India. We do not propose to express any opinion on the question whether, if the other methods suggested in rule 33 of the Rules were adopted, it could be held that no depreciation was actually allowed in making the assessment.

Our conclusion finds support in the judgment of the Bombay High Court in *Hukumchand Mills Ltd.*

v. Commissioner of Income-tax. We endorse the view expressed therein.

In the result, we hold that the High Court has given correct answers to questions Nos. 1 and 4 referred to it. The appeals fail and are dismissed with costs.

Shah J. –

The respondent, a public limited company, was incorporated in the former Indian State of Indore. The company was being assessed to pay Income-tax in the Indore State under the Indore Industrial Tax Rules, 1927, on profits earned in its business of manufacturing cotton textiles. In assessing tax under the Industrial Tax Rules the Tax Officer of the Indore State allowed depreciation on the assets at rates prescribed by the Industrial Tax Rules. The company was also assessed to tax in British India under the Indian Income-tax Act, 1922, for some years as a resident and in others as a non-resident. The State of Indore became a part of the United State of Gwalior, Indore and Malwa in May, 1948, and the United State of Gwalior, Indore and Malwa became on January 26, 1950, a constituent State in the Indian Union as part of the Part B State of Madhya Bharat.

The Finance Act, 1950, by section 13 repealed the taxation laws in force in the territories of the Part B States. In proceedings for assessment under the Indian Income-tax Act for the assessment years 1950-51, 1951-52, 1952-53 and 1953-54, the Income-tax Officer worked out the written down value of the buildings, plant and machinery of the company on January 1, 1949, by taking into account the depreciation allowed under the Indian Income-tax Act, 1922, till January 1, 1945, and thereafter, the depreciation allowed under the Indore Industrial Tax Rules, and assessed tax on that footing. The order of the Income-tax Officer was confirmed by the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal.

The Tribunal referred under section 66(1) of the Indian Income-tax Act four questions to the High Court Madhya Pradesh at Jabalpur. The High Court did not answer questions Nos. 2 and 3, because one of the questions, in view of the judgment of this court (Commissioner of Income-tax v. Dewan Bahadur Ramgopal Mills²), did not require consideration, and the other was not canvassed. The two other questions are :

"(1) Whether the computation of the written down value of the assets of the applicant in the light of the provisions of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, is legal and valid ?

(4) Whether the depreciation 'actually allowed' means the depreciation deducted in arriving at the taxable income or in arriving at the world income ?"

The High Court recorded on the first question the answer that depreciation allowed in the years up to and inclusive of the year 1944 in the assessment made in the taxable territories would be the depreciation which was actually allowed against the total income, and not the depreciation computed against the total world income, and on the fourth question that depreciation "actually allowed" means depreciation deducted in arriving at the taxable income. With certificate granted by the High Court, this appeal has been preferred.

Under the Indore Industrial Tax Rules, 1927, depreciation was allowed at certain rates in respect of buildings, plant and machinery. By section 10(2)(iv) of the Indian Income-Tax Act, in computing profits or gains of a business, depreciation allowed in

respect of buildings, machinery, plant and furniture used for the purpose of business being the property of the assessee, is a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed, and, in any other case, at such percentage on the written down value thereof as may in any case or class of cases be prescribed. By sub-section (5) of section 10, written down value in sub-section (2) is defined. By virtue of section 4A(c) a company is regarded as resident in the taxable territories in any year (i) if the control and management of its affairs is situated wholly in the taxable territories in that year, or (ii) if its income arising in the taxable territories in the year.

Control and management of the affairs of the company was at all material times situated at Indore, but in the years in which its British Indian income exceeded the income without British India, the company was treated as resident for the purpose of the Indian Income-tax Act, and in the other years it was treated as non-resident. In assessing income of the company under the Indian Income-Tax Act in the years before 1950, the Income-tax Officer had, whether the company was assessed as resident or non-resident, to ascertain its world income, and for that purpose to take into account the depreciation allowable under section 10(2)(vi) read with section 10(5)(b). Depreciation allowance in respect of the profits of the company was therefore computed before the Indian Income-tax Act, 1922, was made applicable to the territory of the State of Indore by the Finance Act, 1950, under two different statutes - the Indian Income-tax Act, and the Indore Industrial Tax Rules, and in the assessment year 1950-51 there were two

TO remove anomalies arising from the application of the Income-tax Act in the computation of taxable income of assesses from the Part B States, the Central Government issued under section 12 of the Finance Act, 1950, the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950. Paragraph 2 of that Order as original promulgated read as follows :

"In making any assessment under the Indian Income-Tax Act, 1922, all depreciation actually allowed under any laws or of a Part B State relating to income-tax and super-tax, or any law relating to tax on profits of business, shall be taken into account in computing the aggregate depreciation allowance referred to in sub-clause (c) of the proviso to clause (vi) of sub-section (2) and the written down value under clause (b) of sub-section (5) of section 10 of said Act :

Provided that where in respect of any asset, depreciation has been allowed for any year both in assessment made in the Part B State and in the Taxable territories, the greater of the two sums allowed shall only be taken into account."

But the expression "all depreciation actually allowed under any laws or rules of a Part B State" in paragraph 2 was ambiguous. The Central Government purported to issue a notification under section 60A of the Indian Income-tax Act incorporating an Explanation to paragraph 2, but the notification was declared by the High Court of Hyderabad as invalid : *S. V. Naik v. Commissioner of Income-tax*¹. Thereafter, the Central Government Issued an amendment to the Order in exercise of the powers under section 12 of the Finance Act, 1950, and incorporated an Explanation with retrospective operation. The Explanation which became effective from May 8, 1956, provided :

"For the purpose of this paragraph, the expression 'all depreciation actually allowed under any laws or rules of a Part B State' means and shall be deemed always to have meant the aggregate allowance for depreciation taken into account in computing the written down value under any laws or rules of a Part B State or carried forward under the said laws or rules."

By the explanation it was sought to evolve a method of calculation of depreciation under the law or rules in force in a Part B State : it was in effect a definition clause. Therefore if before the application of the Income-tax Act, an assessee in a Part B State was being assessed to tax only under a State Law, depreciation actually allowed had to be taken into account for ascertaining the written down value of buildings, plant and machinery in the assessment year 1949-50 : if he was assessed under the Indian Income-tax Act as well as the State law, in determining the appropriate written down value, the proviso to paragraph 2 had to be applied, and depreciation actually allowed under the State law had to be compared with the depreciation actually allowed under the Indian Income-tax Act. The expressions "depreciation actually allowed under any law or rule of a Part B State" in the first clause, and the expressions "depreciation has been allowed... in the assessment in the Part B State" in the proviso have in r

In determining the written down value of the buildings, plant and machinery of the company, the Appellate Tribunal held that the expression "actually allowed" in paragraph 2 means depreciation which is availed of for the purpose of assessment of tax, and not merely a fraction of the total depreciation allowance taken into account in levying charge upon a part of the taxable income at a rate determined by the total world income. That is stated in paragraph 10 of the judgment of the Tribunal :

"The last contention of the assessee is that the Income-tax Officer should not have taken the full depreciation availed of in the preceding years, but that the depreciation should be apportioned in the same manner as the income brought to assessment. The deduction should only be made in respect of that depreciation which can reasonably be attributable to the Indian income. We think that the law does not make any distinction as to the part of income which was brought to assessment under the Indian Income-tax Act. If depreciation has in fact been availed of by the assessee either under the Indian Income-tax Act or under the Industrial Rules of the State deduction has to be made."

The High Court did not accept this view. They observed in paragraph 8 of their judgment :

"the depreciation in respect of an asset under the Indian Income-tax Act would clearly be the one actually allowed as laid down in section 10(5)(b) and the depreciation under the Part B State's law would also be the one actually allowed as provided in the substantive part of paragraph 2. It follows, therefore, that under the proviso it is the greater of the two depreciation allowances actually allowed that has to be taken into account in computing the written down value under section 10(5)(b). The word 'allowed' used in the proviso thus takes its colour from the expression 'all depreciation actually allowed to him under this Act' as used in section 10(5)(b) and the words 'all depreciation actually allowed under any laws or rules of a Part B State' in paragraph 2. The Appellate Assistant Commissioner and the Tribunal adopted this construction of the word 'allowed' as used in the proviso; but inconsistently with this they held that the words 'in the assessment made' used in the proviso indicated that it

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Under section 10 of the Income-tax Act taxable profits or gains earned by an assessee under the head "business" after making appropriate allowances under sub-section (2) have to be computed. One of such allowances is depreciation in respect of buildings, machinery, plant and furniture being the property of the assessee and used for the purpose of the business, at such percentage on the original cost thereof to the assessee or such percentage on the written down value thereof as may in any case or class of cases be prescribed. The view which has appealed to the High Court is that even though in determining the rate at which tax was to be charged in respect of the income of the company as resident (subject to the deductions permissible under section 14(2)(c)) or as a non-resident, the entire depreciation at rates applicable under the Indian Income-tax Act had to be taken into account, depreciation allowed in the taxable territories within the meaning of the proviso meant only the fraction of the total amount of that income would be chargeable. In determining the chargeable income from business, profession or vocation and the rate applicable thereto, the same rules apply, whether the company is taxed as resident or non-resident. Under the scheme of the Income-tax Act depreciation like any other allowance has to be allowed in computing the total profit : after the total profit is determined depreciation does not survive as a separate head of allowance. A part only of the total profit of a company determined in the manner prescribed by section 10 may, for reasons already mentioned, be taxable. But total profit being determined after depreciation is allowed, between the taxable profits which may be a fraction of the total profits and depreciation there is no definable relation. Therefore, it is wrong to presume that the depreciation allowed in the taxable territories, which is to be taken into account under the proviso to paragraph 2 of the Removal of Difficulties Order is only a fraction of the depreciation considered

The view which prevailed with the Tribunal that in determining the depreciation allowed within the meaning of the proviso, it is wholly immaterial that a part of the total income was chargeable to tax "if depreciation has in fact been availed of by the assessee", is in my judgment correct.

Reliance was sought to be placed upon rule 33 of the Indian Income-tax Rules by counsel for the company in support of his plea. The material part of the rule is : "In any case in which the Income-tax Officer is of opinion that the actual amount of the income, profits or gains accruing or arising to any person residing out of the taxable territories whether directly or indirectly..... in the taxable territories.... cannot be ascertained, the amount of such income, profits or gains of the purposes of assessment to income-tax may be calculated on such percentage of the turnover so accruing or arising as the Income-tax Officer may consider to be reasonable, or on an amount which bears the same proportion to the total profits of the business of such person (such profits being computed in accordance with the provisions of the Indian Income-tax Act), as the receipts so accruing or arising bear to the total receipts of the business, or in such other manner as the Income-tax Officer may deem suitable."

The rule in terms applies only when the Income-tax Officer cannot ascertain the actual income, profits or gains accruing or arising to any person residing outside the taxable territories. Where from the evidence actual income can be determined the rule has no application. Again the rule

contemplates the computation of income of a non- resident in three different ways : (1) on such percentage of the turnover so accruing or arising as the Income-tax Officer may consider to be reasonable; (2) on an amount which bears the same proportion to the total profits of the business of such person as the receipts so accruing or arising bear to the total receipts of the business (such profit being computed in accordance with the provisions of the Indian Income-tax Act); and (3) in such other manner as the Income-tax Officer may deem suitable.

In the computation of income of a non-resident by the second method it may be necessary to determine and allow depreciation. When the first or third method is resorted to, determination of depreciation would normally be out of place, because by the first method the income is taken as a percentage of the turnover accruing or arising, and by the third method taxable income may be determined in such other manner as the Income-tax Officer deems suitable. Paragraph 2 of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, applies only to cases in which in making an assessment under the Indian Income-tax Act depreciation allowed has to be taken into account in computing the total profits or income. Where the question of considering the depreciation allowed does not arise, because in the method adopted determination of depreciation does not enter, paragraph 2 of necessity would have no application. What must, however, be noticed is that in the ascertainment of total profits, either for the purpo

There is, therefore, no warrant either in section 10(2)(vi) or in paragraph 2 of the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950, or in rule 33 framed under the Indian Income-tax Act for the view that depreciation allowed is a fraction of the total depreciation of the business. I am unable to agree with the view taken by the High Court that in determining the appropriate written down value, by the application of the rule contained in the proviso to paragraph 2, only a fraction of the depreciation allowed in assessments made under the Indian Income-tax Act should be taken into account.

I record an answer on the first question in the affirmative, and on the fourth question that the depreciation actually allowed means the depreciation taken into account in arriving at the total or world income.

ORDER. –

In accordance with the opinion of the majority, the appeal are dismissed with costs.

Appeals dismissed.

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