Shri Shubhalaxmi Mills Ltd.

Vs

Additional Commissioner of Income-Tax, Gujarat.

Civil Appeal No. 47 of 1975

(R. S. Pathak, Rangath Misra JJ)

28.03.1989

JUDGMENT

PATHAK C.J.I. –

1. This appeal by certificate granted by the High Court of Gujarat is directed against the judgment of the High Court on the following questions referred to it by the Appellate Tribunal:

> "(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the assessee cannot be denied the benefit of carry forward of development rebate ?
>
> (2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in directing that the Income-tax Officer should determine the development rebate and such development rebate should be allowed to be carried forward and set off when profits are available and if, in that year, the assessee fulfills the necessary requirements for such allowance like creation of adequate reserve ?"

The assessee is limited company. It has a textile mill at Cambay in the State of Gujarat, for the assessment year 1962-63, the previous year being the calendar year 1961, the assessee claimed that a sum of Rs. 1,26,233 should be allowed as development rebate under section 33 of the Income-tax Act, 1961, the Income-tax Officer rejected the claim on the ground that the assessee had not created a reserve as contemplated by sub-section (3) of section 34 of the Income-tax Act, 1961, the Appellate Assistant Commissioner of Income-tax dismissed the appeal filed by the assessee. In second appeal, the claim of the assessee found favour with the Income-tax Appellate Tribunal. At the instance of the Revenue, the questions set forth earlier were referred to the High Court for its opinion. The High Court has answered the question in favour of the Revenue and against the assessee. It has held that the assessee had failed to comply with the conditions of sub-section (3) of section 34 of the Act.

In this appeal by the assessee, it is urged that the view taken by the High Court is erroneous that it is not necessary that a reserve should be created in the previous year during which the machinery or plant was installed.

Sub-section (1) of section 33 provides that development rebate may be claimed as a deduction in respect of new machinery or plant installed after March 31, 1954, which is owned by the assessee and is wholly used for the purposes of the business carried on by him, and that the allowance of the deduction is subject to the provisions of section 34. Clause (a) of sub-section (3) of section 34

provides that the deduction referred to in section 33 shall not be allowed unless an amount equal to 75 per cent. of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to reserve account to be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking, other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset out side India. The Finance Act, 1966, added an Explanation to this clause. The Explanation declared that the deduction referred to in section 33 could not be denied by reason only that the amount debited to the profit and loss account of the relevant previous year and credited to the aforesaid reserve account exceeded the amount of the profit of such previous year (as arrived at without making the deposit aforesaid) in accordance with the profit and loss account. The Explanation was inserted with retrospective effect from the commencement of the Act. Before the Explanation was enacted, difference of opinion had existed between the High Courts on the question whether the statute required the creation of the reserve in the previous year in which the new machinery or plant was installed when the amount of the profit of that previous year was either nil or insufficient for the purposes of enabling the creation of such reserve. It is not necessary to refer to these cases, for it seems clear to us that the Explanation, which applies to the assessment year under consideration before us, removes the doubt altogether. What is contemplated is the creation of a reserve fund in the relevant previous year irrespective of the result of the profit and loss account disclosed by the books of the assessee. Mere book entries will suffice for creating such a reserve fund. The debit entries and the entries relating to the reserve fund have to be made before the profit and loss account is finally drawn up. That is a condition for securing the benefit of development rebate and if that condition is not satisfied, we fail to see how the deduction on account of development rebate can be claimed at all.

Learned counsel for the assessee relies on West Laikdihi Coal Co. Ltd. v. CIT [1973] 87 ITR 501 (Cal) and CIT v. Modi Spinning and Weaving Mills Co. Ltd. [1973] 89 ITR 304 (All). Those were cases decided under the provisions of the Indian Income-tax Act, 1922, and there was no Explanation such as the one we have before us. Reference was made to the decision of this court in Indian Overseas Bank Ltd. v. CIT [1971] 77 ITR 512. In that case, however, the question was whether the creation of a reserve in compliance with section 17 of the Banking Companies Act constituted sufficient compliance with the requirements of proviso (b) to section 10(2)(vib) of the Indian Income-tax Act, 1922. Reference has also been made to Addl. CIT. v. Vishnu Industrial Enterprises [1980] 122 ITR 919 (All). We do not find it possible to agree with the view taken by the Allahabad High Court in that case that the development rebate reserve need not be created in the relevant previous year during which the new machinery or plant is installed and that a profit must have been earned during the previous year to permit the creation of a reserve fund. We think that the Explanation is clear. And that there can be no doubt that it envisages the creation of a reserve fund notwithstanding that there is no profit or insufficient profit from which such reserve may bed provided. To contemplate otherwise would be to negate the entire scheme incorporated in section 33 read with section 34 of the Act. For the same reason, we are unable to affirm the view taken by the Allahabad High Court in CIT v. U.P. Hotel and Restaurants Ltd. [1984] 145 ITR 598. Out attention has been drawn by learned counsel for the assessee to Dodballapur Spinning Mills Ltd. v. CIT [1980] 121 ITR 94 (Kar), where reference has been made to a circular issued by the Central Board of Direct Taxes dated October 14, 1965, and to subsequent circular dated January 30, 1976. We have carefully considered the matter and we do not think that the circulars effect the true position in law.

On behalf of the assessee, reliance was placed on Indian Oil Corporation Ltd. v. S. Rajagopalan, ITO [1973] 92 ITR 241, where the Bombay High Court has held that there was no obligation on the assessee to create a reserve in the year of installation if there was no taxable income in the relevant

year. Some of the submission addressed in that case may be set forth in detail. A powerful argument was addressed by learned counsel for the assessee and it was pointed out that the expression "shall be allowed" in clause (a) of sub- section (1) of section 33 indicated that the development rebate is to be assessed and thereupon it becomes allowable, and that sub-section (2) of section 33 which provides for the allowance of development rebate mentions that the sum "to be allowed" by way of development rebate for the assessment year shall be only such amount as shall be sufficient to reduce the total assessable income to nil and the amount of development rebate to the extent to which it has not been allowed shall be carried forward to the following assessment years for eight subsequent years, reference was also made to the distinction between the expressions "to be allowed" and "actually allowed" used in the relevant provisions. It was also argued that the utilisation by the assessee of the development rebate reserve for the purposes of the business of the undertaking contemplated the existence of an actual fund which could be utilised for the purposes of the business, and that an illusory debit entry in the profit and loss account and an illusory credit entry in the development rebate reserve account were not contemplated. The High Court accepted the submission and concluded that it was not mandatory that the necessary debit and credit entries must be made in the assessment year following the year of installation in which the development rebate is determined under section 33. Having considered the matter at some length in the present case, it seems to us clear that in order to claim the deduction on account of development rebate under sub-section (1) of section 33, it is obligatory that the debit entries in the profit and loss account and the credit entry in a reserve account should be made in the relevant previous year in which the machinery or plant is installed or first put to use. The development rebate contemplated by sub-section (1) of section 33 cannot be allowed as a deduction unless a reserve account has been created in the previous year in which the installation or first use occurs. Any doubt in so reading the provisions because of want, or insufficiency, of profit in such previous year has been ren=moved by the Explanation to clause (a) of sub-section (3) of section 34. The significance of the words "actually allowed" in clause (a) of sub-section (3) of section 34 has been considered by the High Court in the judgment under appeal and we are in entire agreement with the view taken by the High Court in that regard.

A number of other cases have also been placed before us by learned counsel for the assessee, but as they deal with the point on the basis of considerations substantially the same as have been referred to in the cases mentioned earlier, we think it unnecessary to deal with them specifically.

Upon the aforesaid considerations, we hold that the High Court is right in answering the question in favour of the Revenue and against the assessee.

In the result, the appeal is dismissed but there is no order as to costs.

Appeal dismissed.

</html