CIT Karnataka, Bangalore

Vs

Shaan Finance (P) Ltd., Bangalore

(Sujata V. Manohar, D. P. Wadhwa JJ)

20.03.1998

JUDGMENT

MRS.SUJATA V.MANOHAR J

1.Delay condoned.

2.Leave granted.

3.These appeals raise a common question relating to the assessees' entitlement to investment allowance under Section 32A of Income-Tax Act, 1961.The assessee companies, as their names suggest, are financial companies which purchase machinery and hire out the machinery to manufacturers under agreements of hire.The common question in these appeals relates to the entitlement of the assessees to investment allowance under Section 32A of the Income-Tax Act, 1961.For the sake of convenience, we are setting out the question as framed in Civil Appeal Nos.7077-78 of 1993.The question is as follows:

> "Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that in respect of the machineries owned by the assessee, but leased to third parties and used by them for the manufacture of article or thing, investment allowance was allowable under sec.32A?"

4.The assessees are not themselves manufacturers of any article or thing.The machineries, however, which are owned by them are hired to different persons for the purpose of their business of manufacturing.In respect of these machineries, assessees claimed investment allowance under Section 32A.In all these proceedings, the concerned High Courts, being the High Courts of Karnataka and Madras, have held the assessees as entitled to investment allowance under Section 32A.Hence these appeals have been preferred before us.

5.The relevant provisions of Section 32A are as follows:

> "32A.(1) In respect of a ship or an aircraft or machinery or plant specified in sub-section (2), which is owned 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 this section, be allowed a deduction, in respect of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed or, if

the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, of a sum by way of investment allowance, equal to twenty-five per cent, of the actual cost of the ship, aircraft, machinery or plant to the assessee:

Provided that

(2) The ship or aircraft or machinery or plant referred to in sub-section (1) shall be the following, namely:-

(a) a new ship or new aircraft acquired after the 31st day of March, 1976, by an assessee engaged in the business of operation of ships or aircraft;

(b) any new machinery or plant installed after the 31st day of March, 1976-

(i) for the purposes of business of generation or distribution of electricity or any other form of power; or

(ii) in a small scale industrial undertaking for the purposes of business of manufacture or production of any article or thing; or

(iii) in any other industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing not being an article or thing specified in the list in the Eleventh Schedule."[underlining ours]

6.Therefore, in respect, inter alia, of plant and machinery for which an investment allowance is claimed in any relevant previous year, an assessee must satisfy the following conditions:

(1) The machinery should be owned by the assessee.

(2) It should be wholly used for the purposes of the business carried on by the assessee, and

(3) The machinery must come under any of the categories specified in sub-section (2) of Section 32A.

7.Sub-section (2) describes such machinery, plant as also ship or aircraft.Under sub-section (2)

(b) (iii) any new machinery or plant installed after 31st of March, 1976 in any industrial undertaking for the purpose of manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule is eligible for investment allowance.In the present case, the machinery satisfies this description under Section 32A (2) (b) (iii) The department, however, contends that investment allowance can be claimed by the assessee only in a case where the assessee is t he owner of the machinery and also uses the machinery himself.In other cases, investment allowance cannot be granted.We have to examine this contention.

8.We have already set out the three requirements of Section 32A(1) which entitle an assessee to claim investment allowance.One of the requirements is that the machinery must be wholly used for the purpose of such assessee's business.When the business of the assessee is leasing of such

machines, the machines so leased out are being used for the purpose of the assessee's business. The income by way of hire charges which the assessee receives is also taxed as business income of the assessee.

9.Sub-section (2) of section 32A, however, requires to be examined to see whether there is any provision in that sub-section which requires that the assessee should not merely use the machinery for the purposes of his business, but should himself use the machinery for the purpose of manufacture or for whatever other purpose the machinery is designed.Sub-section (2) covers all items in respect of which investment allowance can be granted.These items are, ship, aircraft or machinery or plant of certain kinds specified in that sub-section. In respect of a new ship or a new aircraft, section 32A(2) (a) expressly prescribes that the new ship or the new aircraft should be acquired by an assessee which is itself engaged in the business of operation of ships or aircraft.Under sub-section (2) (b), however, any such express requirement that the assessee must himself use the plant or machinery is absent. Section 32A (2) (b) merely describes the new plant or machinery which is covered by section 32A.The plant or machinery is described with reference to its purpose.For examples, sub-section (2) (b) (i) prescribes "the purposes of business of generation or distribution of electricity of any other form of power".Sub-section (2) (b) (ii) refers to small scale industrial undertakings which may use the machinery for the business of manufacture or production of any article, and sub-section (2) (b) (iii) refers to the business of construction, manufacture or production of any article or thing other than that specified in the Eleventh Schedule.Sub-section 2(b), therefore, refers to the uses to which the machinery can be put.It does not specify that the assessee himself should use the machinery for these purposes.In the present case, the person to whom the machinery is hired does use the machinery for specified purposes under section 32A (2) (b) (iii).That person, however, is not the owner of the machinery.The High Courts of Karnataka and Madras have held that looking to the requirements specified in Section 32A the Assessees, in the present case, fulfil all the requirements of that section, namely, (1) the machinery is owned by the assessee; (2) the machinery is used for the purpose of assessees' business and; (3) the machinery is as specified in sub-section (2).

10.We are inclined to agree with this reasoning of the High Courts of Karnataka and Madras.

11.The provisions relating to investment allowance are akin to the provisions under Section 33 of Income-Tax Act, 1961 relating to development rebate which was discontinued with effect from 1st of April, 1974 by a Notification issued by the Central Government.From 1st of April, 1976, however, section 32A was introduced in the Income-tax Act, 1961 granting investment allowance under Finance Act, 1976.A circular of the department being Circular No.202 dated 5th of July, 1976, which explained the provisions of the Finance Act, 1976, pertaining to direct taxes, refers to investment allowance in paragraph 23.1.It is stated that the new scheme of investment allowance is broadly on the lines of development rebate scheme that was discontinued earlier.(paragraph 23.2.) Whereas development rebate was allowed at varying rates, investment allowance will be admissible at the uniform rate of 25% only.Describing the provisions of Section 32A (2), the circular states that now ships and new aircraft acquired after 31st of March, 1976 by the tax payers engaged in the business of operation of ships or aircraft will be eligible.It says; "It should be noted that new ships and aircraft will qualify for investment allowance only in the hands of tax payers carrying on the business of operating ships or aircraft and the allowance will not be available in respect of ships or aircraft acquired by other tax payers." In respect of new machinery or plant installed after 31st of March, 1976, however, the circular does not prescribe any such condition of the assessee himself carrying on the business of manufacturing.The circular thus clearly brings out the difference between Section 32A(2) (a) and Section 32A (2) (b).

12.Since the provisions of Section 33 dealing with development rebate are similar to the provisions or Section 32A, it is necessary to look at cases dealing with the grant of development rebate under Section 33.In the case of Commissioner of Income-tax, Kerala-II Vs.Castlerock Fisheries (126 ITR 382), the Kerala High Court considered the case of an assessee which temporarily let out its cold storage plant to a sister concern.The income derived by such letting was assessed by the Income-tax Officer in the hands of the assessee as business income of the assessee for the relevant accounting years.The assessee claimed development repute in respect of the cold storage plant.The High Court said that it was accepted by the department that in letting out the plant and machinery, the assessee was still doing business and the hire charges which it had received, had been assessed as business income of the assessee.Hence the assessee had complied with all conditions for the grant of development rebate including the condition that the assessee had used the machinery for the purposes of its business.The High Court said that it must, therefore, necessarily be assumed that the conditions laid down in Section 33(1) (a) that the machinery or plant is wholly used for the purposes of the business carried on by the assessee, is duly satisfied and the assess is entitled to development rebate.In appeal before this Court, a Bench of three Judges of this Court upheld the decision of the Kerala High Court in the above case in Commissioner of Income-tax Vs.Castle Rock Fisheries ([1997] 10 SCC 770).This Court also held that since the department has proceeded on the explicit basis that despite the fact that the plant had been temporarily let out by the assessee to a sister concern, the plant and machinery was nevertheless being used by the assessee for its business purpose by treating the income derived by the assessee by such letting out as business income of the assessee, the development rebate must be considered as having been rightly granted.Therefore, where the business of the assessee consists of hiring out machinery and/or where the income derived by the assessee from the hiring of such machinery is business income, the assessee must be considered as having used the machinery for the purposes of its business.

13.A similar view has been taken by the Andhra Pradesh High Court in the case of Commissioner of Income-tax Vs. Vinod Bhargave (169 ITR 549) where Jeevan Reddy, J.(as he then was) held that there leasing of machinery is a mode of carrying on business by the assessee the assessee would be entitled to development rebate.The Court observed, (p.551): " Once it is held that leasing out of the machinery is one mode of doing business by the assessee and the income derived from leasing out is treated as business income it would be contradictory in terms to say that the machinery is not used wholly for the purposes of assessee's business."

14.The appellant-department, however, relies upon certain observations of this Court in Commissioner of Income-tax Vs.Narang Dairy Products (219 ITR 478) where a Bench of two judges of this court said in the context of development rebate in respect of new machinery and plant that not only should the ownership of the plant and machinery be with the assessee but also its user by the assessee for the purpose of his business.The assessee before the Court in that case carried on the business of manufacture of milk powder.The entire machinery for the purpose of his business was allowed development rebate in the assessment year 1965-66.However, in August 1969 some of the machinery was let out by the assessee for a period of three years with a provision for renewal or for outright purchase, to a third party.This Court said that the withdrawal of development rebate was justified since the transaction of letting out with a provision for outright purchase amounted to a transfer of the machinery as defined in Section 2 (47) of the Income-tax Act, 1961.

15.The ratio of this decision would not apply to the cases which are before us.In the case of Narang Dairy Products (supra) this Court has pointed out that when the machinery was let out by the assessee to Hindustan Lever Limited it cannot admit of any doubt that the machinery or plant could not and was not used by the assessee for the purpose of the business carried on by him, which was

the business of manufacture of milk powder.Therefore, the assessee could not be considered as having used the machines only for the purpose of his business. Secondly, in the case of Narang Dairy Products (supra) the transaction was a transaction of hire with the right of outright purchase.The Court was of the view that the words "otherwise transferred" may be wide enough to cover such a situation.

16.This Court also relied upon the decision of the Kerala High Court in Blue Bay Fisheries (P) Ltd.Vs.Commissioner of Income-tax (166 ITR 1) in the case of Narang Dairy Products (supra).In the case of Blue Bay Fisheries also, the assessee purchased a trawler for its business.The trawler was leased to the transferee.Under the agreement of lease, at the end of ten months, the trawler was to be sold to the transferee.In terms of the agreement, the assessee also took steps to obtain the approval of the concerned authority for the sale of the trawler.The trawler was to remain in the exclusive possession of the transferee and the transferee was allowed to suitably alter the trawler so as to make it a tug.The Kerala High Court said that the terms of the agreement showed that the right to exclusive possession and enjoyment of the trawler had been transferred.The transfer was permanent and preparatory to sale.Hence it amounted to transfer.

17.Neither of these cases deals with an agreement of hire of machinery in contradistinction to an agreement of hire purchase.When the machinery is given on hire by the owner to the hirer on payment of hire charges, the income derived by the owner is business income.The owner is also entitled to depreciation on the machinery so hired out.The hirer, on the other hand, who plays hire charges, is entitled to claim these as revenue expenditure.The hirer has not acquired any new asset.A transaction of hire is, therefore, of bailment of the machinery.There is no extinguishment of any right of the owner in the machinery.There is merely a licence given to the hirer to use, for a temporary period, the machinery so hired.In the case of M/s.Damodar Valley Corporation Vs.The State of Bihar (AIR 1961 SC 440), this Court examined the contract under which the machinery and equipment was supplied by the corporation to the contractors.The question was whether it was a mere contract of hiring or a sale or a hire purchase.The Court said (p.445): "It is well-settled that a mere contract of hiring, without more, is a species of the contract of bailment, which does not create a title in the bailment.But the law of hire purchase has undergone considerable development during the last half a century or more and has introduced a number of variations, thus leading to categories, and it becomes a question of some nicety as to which category a particular contract between the parties comes under." We need not dwell on the niceties of a hire purchase contract since we are concerned only with contracts of hire simpliciter.

18.In the case of hire purchase agreements, the department's Circular No.9 of 1943 dated 23rd or March, 1943 provides, inter alia, that where, under the terms of the agreement the equipment shall eventually become the property of the hirer or confer on the hirer an option to purchase the equipment, the transaction should be regarded as one of hire purchase.In such cases, the periodical payments made by the hirer should, for tax purposes, be regarded as made up of (1) consideration for hire to be allowed as a deduction in the assessment and; (2) payment on account of purchase to be treated as capital outlet, depreciation being allowed to the lessee on the initial value.In the case, however, of hire of machinery, the owner is entitled to depreciation.

19.In this connection, a reference may also be made to M/s.K.L.Johar and Co.Vs.The Deputy Commercial Tax Officer, Coimbators III (AIR 1965 SC 1082 at p. 1090) where this Court, while examining a hire purchase agreement, pointed out that such an agreement has two elements; (1) element of bailment, and (2) element of sale in the sense that it contemplates an eventual sale.In the absence of any element of sale in the present case, we do not see any reason for treating the

agreement as "transfer" or disallowing the grant of investment allowance, when the assessee complies with the requirements of Section 32A.Section 32A is a beneficial provision in a taxing statute.Full effect, therefore, requires to be given to the language used in Section 32A.As observed by this Court in C.A.Abraham Vs.Income-tax Officer, Kottayam & Anr.(AIR 1961 SC 609 at p.612), in interpreting a fiscal statute, the Court cannot proceed to make good the deficiencies if there be any.The court must interpret the statute as it stands and in case of doubt, in a manner favorable to the tax-payer.In the present case, the language of Section 32A covers leasing or finance companies which give the machinery on hire as in the present case.

20.In the premises, the appeals are dismissed with costs