SUPREME COURT OF INDIA

Nectar Beverages Pvt. Ltd.

Vs.

Deputy Commnr. of Income Tax

C.A.No.5291 of 2004

(S.H. Kapadia and Aftab Alam JJ.)

06.07.2009

JUDGMENT

S.H. Kapadia, J.

1. Leave granted.

2. In this batch of Civil Appeals, pertaining to assessment years 1990-91 to 1998-99, the question which arises for determination is: whether the concept of balancing charge in Section 41(2) could be read into Section 41(1) of the *Income Tax Act, 1961*?

3. In this batch of civil appeals the lead matter is the case of Nectar Beverages Pvt. Ltd. v. Dy. CIT (Civil Appeal No. 5291/04) in which the facts are as follows.

4. In the Lead Matter, the assessee who is the manufacturer of soft drinks, purchased bottles and crates, each item of which costed less than Rs. 5,000/- and, therefore, was entitled to and allowed 100% depreciation on the cost of the said bottles and crates, in the year in which they were acquired, under the proviso to Section 32(1)(ii) of the *Income Tax Act, 1961* (1961 Act for short). When bottles and crates got worn out, they were sold by the assessee and proceeds therefrom were shown as miscellaneous income in the subsequent years. If these sales had taken place in the previous years relating to the assessment years prior to 1988-89, the same would, without doubt, would have been included in the business income of the assessee under Section 41(2). This was because prior to the assessment year 1988-89, Section 41(2) inter alia provided for balancing charge which was chargeable as income taxable under the 1961 Act. However, with effect from assessment year 1988-89, Section 41(2), which inter alia dealt with profit on sale of depreciable asset (balancing charge), stood deleted. Notwithstanding such deletion, the Department sought to tax Rs. 50,850/- holding that the sale proceeds of the 100% depreciated and written off assets can still be treated as the business income of the assessee under Section 41(1) of the 1961 Act.

5. Was the Department entitled to tax the aforestated sum under Section 41(1) is the question which we have to decide in these civil appeals?

6. For that purpose, we quote hereinbelow Section 32(1)(ii), which reads as follows:

> "Depreciation.
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> 32.(1) 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-
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> (i) [Omitted];
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> (ii) in the case of any block of assets, such percentage on the written down value thereof as may be prescribed:
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> Provided that where the actual cost of any machinery or plant does not exceed five thousand rupees, the actual cost thereof shall be allowed as a deduction in respect of the previous year in which such machinery or plant is first put to use by the assessee for the purposes of his business or profession:
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> We also quote hereinbelow Section 41(1), which reads as follows: Profits chargeable to tax.
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> 41.(1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee, and subsequently during any previous year the assessee has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him, shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.
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> We also quote hereinbelow Section 41(2) [*Omitted by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986*, w.e.f. 1.4.1988], which reads as follows:
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> 41.(2) Where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value if any, exceed the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business or profession of the previous year in which the moneys payable for the building, machinery, plant or furniture became due :

Provided that where the building sold, discarded, demolished or destroyed is a building to which

Explanation 5 to section 43 applies, and the moneys payable in respect of such building, together with the amount of scrap value, if any, exceed the actual cost as determined under that Explanation, so much of the excess as does not exceed the difference between the actual cost so determined and the written down value shall be chargeable to income-tax as income of the business or profession of such previous year :

Provided further that where an asset representing expenditure of a capital nature on scientific research within the meaning of clause (c) of sub-section (2B) of section 35, read with clause (4) of section 43 owned by the assessee which was or has been used for the purposes of business after it ceased to be used for the purpose of scientific research related to the business is sold, discarded, demolished or destroyed, the provisions of this sub-section shall apply as if for the words actual cost, at the first place where they occur, the words actual cost as increased by twenty-five per cent thereof had been substituted.

Explanation: Where the moneys payable in respect of the building, machinery, plant or furniture referred to in this sub-section become due in a previous year in which the business or profession for the purpose of which the building, machinery, plant or furniture was being used is no longer in existence, the provisions of this sub-section shall apply as if the business or profession is in existence in that previous year."

7. According to the Department, depreciation stood allowed in the earlier years when the said bottles and crates were bought; that such depreciation constituted expenditure under Section 41(1) and, therefore, when the assessee sold such bottles and crates as an asset there was recoupment of that expenditure which recoupment was taxable as deemed income under Section 41(1). On the other hand, the case of the assessee before us was that the word expenditure in Section 41(1) did not include depreciation. According to the assessee, each bottle and crate constituted 100% depreciable asset and since each bottle and crate costed less than Rs. 5,000/- the actual cost stood allowed as 100% deduction in respect of the previous year in which such plant was put to use by the assessee for its business. In short, the W.D.V. stood reduced to nil in the year in which the item was put to use. According to the assessee, bottles and crates bought before 1.4.1995 were sold in the previous year relevant to the assessment year in question, however, on account of deletion of Section 41(2) profits on sale of such bottles and crates were not taxable under that sub-section.

8. In the light of the above arguments, we need to analyse Section 41(1) and Section 41(2). Section 41 falls under Chapter IV which deals with computation of business income. Section 41 has a Head Note which says Profits chargeable to tax. Section 41(1) has remained unchanged, both, before 1.4.1988 and even after 1.4.1998. As stated above, Section 41(2), however, stood deleted between assessment years 1988-89 and 1998-99 for about ten years.

Under Section 41(1), where any allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee, and subsequently during any previous year the assessee had obtained, such loss or expenditure in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him, shall be deemed to be income of that previous year in which the recoupment takes place. According to the Department, notwithstanding, the deletion of Section 41(2), since the assessee had obtained the benefit of depreciation in the earlier years as allowance or deduction in respect of expenditure incurred by it when it bought bottles and crates, on recoupment in the assessment years in question, such recoupment was liable to be taxed as deemed income under Section 41(1). We do not find merit in the argument of the Department. Prior to 1.4.1988, Section 41(1) and Section 41(2), both, existed on the statute book. Section 41(2) specifically brought to tax the balancing charge as a deemed income under the 1961 Act. It stated that where any plant owned by the assessee and used for business purposes was sold, discarded or destroyed and the moneys payable in respect of such plant exceeded the written down value, then, so much of the surplus which did not exceed the difference between the actual and the written down value was made chargeable to tax as business income of the previous year in which moneys payable for the plant became due. In other words, as stated above, Section 41(2) made the balancing charge taxable as business income. In our view, if the argument of the Department herein of reading the balancing charge under Section 41(2) into Section 41(1) was to be accepted then it was not necessary for Parliament to enact Section 41(2) in the first instance. In that event, Section 41(1) alone would have sufficed. In our view, Section 41(1), Section 41(2), Section 41(3) and Section 41(4) operated in different spheres. One more aspect needs to be highlighted. Each of the sub-sections to Section 41 deal with different and distinct circumstances. For example, Section 41(1) deals with recoupment of trading liability. Section 41(2) dealt with the balancing charge. Section 41(3) specifically deals with balancing charge in respect of assets relating to scientific research whereas Section 41(4) deals with recovery of bad debts earlier allowed. Therefore, each of the sub-sections deal with different and distinct topics and one cannot read recoupment under one sub-section into another.

9. The entire controversy, therefore, stands resolved if one understands the meaning of balancing charge. Where any allowance or deduction had earlier been made in respect of any loss, expenditure or trading liability and subsequently the assessee has obtained or realized any amount towards such loss, expenditure or trading liability, Section 41(1) deems such realization/recoupment as assessee's income for the year in which it is realized. Section 41(2) as it stood at the material time stated that if in respect of any plant and machinery, any depreciation had been allowed and subsequently such plant and machinery was sold, discarded or destroyed, the assessee might get some value either as a result of sale or insurance or from salvage or compensation thereabout. The necessity to keep Section 41(2) as a provision in addition to Section 41(1) arose from the fact that, in its very nature, depreciation is neither a loss, nor an expenditure, nor a trading liability, referred to in Section 41(1). The depreciation recovered on sale of the capital asset was includible in the total income as balancing charge only under Section 41(2). That concept was foreign to the scheme of Section 41(1). The balancing charge under Section 41(2) arose only where any depreciable asset (building, machinery, plant or furniture) was sold. In fact, when the concept

of block of assets stood introduced w.e.f. 1.4.1988, Section 41(2) stood deleted. However, even after 1.4.1988, the proviso to Section 32(1)(ii) continued till 1.4.1996 when by the Finance (No. 2) Act, 1995 the bottles and crates even below Rs. 5,000/- came within the block of assets as defined under Section 2(11) of the 1961 Act. As stated, this judgment is confined to depreciable assets costing less than Rs. 5,000/- which did not enter the block of assets during the assessment years in question (when Section 41(2) stood deleted).

Effect of introducing *Finance (No. 2) Act, 1995* w.e.f. 1.4.1996:

10. At the outset, it may be noted that, by the above Finance Act, the first proviso to Section 32(1)(ii) stood deleted w.e.f. 1.4.1996. Consequently, bottles, crates and cylinders whose individual cost did not exceed Rs. 5,000/- also came to be included in the block of assets.

11. Before us, in this batch of civil appeals, we have four Civil Appeals (Civil Appeals arising out of S.L.P. (C) Nos. 8002/09 and 3064/09, Civil Appeal Nos. 356-357/06 and 5858/06) which fall in the period after 1.4.1996. The Lead Matter in this category is M/s Goa Bottling Company Pvt. Ltd. v. Asstt. Commissioner of Income Tax (Civil Appeal Nos. 356-357/06). That lead matter is for assessment year 1998-99. M/s Goa Bottling Company Pvt. Ltd. is a company registered under the Companies Act, 1956 and is in the business of manufacture and sale of soft drinks. For the purposes of its business, it bought bottles and crates whose cost per unit did not exceed Rs. 5,000/-. During the year ending 31.3.1998, the company received a sum of Rs. 6,89,91,901 on sale of scrap bottles and crates. The sale proceeds were segregated in two parts:

> "(a) in respect of bottles and crates purchased prior to 31.3.1995; and
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> (b) those purchased after 1.4.1995.
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> In the Return of income filed, the sale proceeds relating to bottles and crates purchased after 1.4.1995 were taken into consideration for the purpose of computation of short term capital gains under Section 50 whereas the sale proceeds relating to bottles and crates purchased prior to 31.3.1995 was not offered for short term capital gains on the ground that the assets stood depreciated at 100% under the proviso to Section 32(1)(ii) and hence did not form part of the block of assets."

12. For reasons given hereinabove, we are of the view that bottles and crates purchased prior to 31.3.1995 did not form part of the block of assets, hence, profits on sale of such assets were not taxable as a balancing charge, neither under Section 41(1) nor under Section 50. In respect of bottles and crates purchased after 1.4.1995, on account of deletion of proviso to Section 31(1)(ii) (vide Finance Act, 1995) such bottles and crates formed part of block of assets and consequently such assets purchased after 1.4.1995, in this case, became exigible to capital gains tax under Section 50.

13. Before concluding, it may be pointed out that, in the case of Nector Beverages Pvt. Ltd., assessee has earmarked the sale proceeds from bottles and crates as miscellaneous income

and not as profit on sale of assets whereas, in the case of other assessees, including Industrial Oxygen Co. Ltd. (now known as Inox Air Products Ltd.), the said sale proceeds have been earmarked specifically under the Heading Profits from sale of assets. To this limited extent only, we remit the case(s) of Nectar Beverages Pvt. Ltd. [Civil Appeal Nos. 5291/04, 5293/04 and 359-360/06] to the A.O. to go through the computation submitted by Nectar Beverages Pvt. Ltd. and find out whether earmarking profits from sale of assets as miscellaneous income has resulted in the understatement of net profits at the pre-Section 28 stage and taxable profits at post-Section 28 stage. In all other cases, sale proceeds have been earmarked as profits on sale of assets and in those cases, therefore, there is no question of verification by the A.O..

14. Subject to above, the Civil Appeals filed by the assessees succeed with no order as to costs.