**ANDHRA PRADESH HIGH COURT**

Veerabhadra Iron Foundry

Vs

Commissioner of Income-Tax

(Krishnarao J.)

25.04.1967

**JUDGMENT**

**Krishnarao J.**

1. This is a reference under section 66(1) of the Indian Income-tax Act of 1922 by the Income-tax Appellate Tribunal framing the following question for our decision : R.C. No. 8/1964

> "Whether the assessee is entitled to the allowance of development rebate under section 10(2)(vib) of the Act ?"

The assessee is a registered firm carrying on business in the manufacture and sale of sugarcane crushers, tobacco furnaces, etc. During the year of account ending March 31, 1960, relevant to the assessment year 1960-61, the assessee also started the business of exhibiting cinema films on December 4, 1959, when he installed new machinery costing about Rs. 1,00,233. In the return submitted by the assessee a claim was made towards development rebate on the value of this machinery basing the claim under the provisions of section 10(2)(vib) of the Income-tax Act of 1922. The assessee had not credited to a reserve fund as required by the provisions of the Act and did not make the relevant entries in respect of the reserve fund before the close of the accounting year. It is stated by the assessee that this omission was due to a misapprehension on the part of the assessee that such entries should be made only by companies. During the assessment proceedings this omission was pointed out by the Income-tax Officer and, on the request of the assessee, the proceedings were adjourned for a few days, so as to enable the assessee to make the relevant entries. Accordingly, the assessee made the relevant entries on August 9, 1961, debiting the profit and loss account relating to the accounting year with a sum of Rs. 18,784 and crediting the development rebate reserve account likewise and the assessee made the consequential entries in the accounts of the two partners. On the basis of these entries, the assessee made the claim towards development rebate. It may be recalled that though the entries were not made initially, the assessee in fact did make a claim towards development rebate. But though the Income-tax

Officer himself pointed out the mistake and was even inclined to grant sufficient time to the assessee for making the entries, nevertheless, he disallowed the claim on the ground that the assessee ought not to have made the relevant entries nearly one year and four months after the closing of the accounting year and the statutory requirement was not complied with by the assessee. The Appellate Assistant Commissioner agreed with the conclusion of the Income-tax Officer and dismissed the appeal. On appeal by the assessee before the Appellate Tribunal, the same view was taken and the appeal was accordingly dismissed. Thereafter, the assessee applied to the Tribunal for a reference under section 66(1) of the Act and accordingly the Tribunal referred the above question for our decision.In order to appreciate the question arising for decision, it is necessary to refer to the relevant sections in the Indian Income-tax Act, 1922 (omitting particulars which are not applicable) :

"10. Business. - (1) The tax shall be payable by an assessee under the head Profits and gains of business, profession or vocation, in respect of the profits and gains of any business, profession or vocation carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely :- ...

(vib) in respect of a new ship acquired or new machinery or plant installed after the 31st day of March, 1954, which is wholly used for the purposes of the business carried on by the assessee, a sum by way of development rebate in respect of the year of acquisition of the ship or of the installation of the machinery or plant, equivalent to,....

(ii) in the case of machinery or plant installed before the 1st day of April, 1961, twenty-five per cent....

Provided that no allowance under this clause shall be made unless - ...

(b) except where the assessee is a company being a licensee within the meaning of the Electricity (Supply) Act, 1948 (54 of 1948), or where the ship has been acquired or the machinery or the plant has been installed before the 1st day of January, 1958, an amount equal to seventy-five 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 a reserve account to be utilised by him during a period of ten years next following for the purposes of the business of the undertaking, except -..."The assessees claim for development rebate was dissallowed on the ground that the mandatory provisions of proviso (b) had not been complied with. The first part of the proviso (b) refers to certain exceptions and the present case does not fall within those exceptions because the machinery was installed after January 1, 1958. Hence, omitting exceptions to the proviso, it reads as follows :

> "No allowance under this clause shall be made unless...an amount equal to seventy five 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 a reserve account to be utilised by him.."

This provision of law is significantly silent as to what point of time when the debit and credit entries should be made. According to the department, the entries have to be made before the close of the accounting year. But it is pointed out by Sri Venkatappayya Sastry, the learned counsel for the assessee, that it is not obligatory to make the relevant entries before the close of the accounting year and that the question of creating a reserve fund and making a credit entry does not arise until a profit and loss account is drawn up and the business actually results in profit and that though it may not be necessary for him to establish the ultimate date before which the entries could be lawfully made, it is sufficient for the purposes of this case to note that he has made the requisite entries as required by the proviso, before the assessment in question was finalised in the hands of the Income-tax Officer. In fact, the omission was discovered by the Income-tax Officer and, at the request of the assessee, time was granted to him to enable him to make the necessary entries. But for some reason or the other, the Income-tax Officer was not inclined to give the entries placed before him the assessment is finalised.The learned counsel for the assessee argued that the department failed to appreciate the significance of a profit and loss account. By the very nature of the said account, it is only drawn up by way of analysis from the primary accounts which are maintained by the assessee from day to day. In fact, the profit and loss account is not a book of account in the sense that it is maintained from day to day in the regular course of business, and, being only an abstract of the results of the business, it can be drawn up at any time and not necessarily before the close of the accounting year and in fact it is not possible to draw up such an account before the closing of accounting year. The learned counsel relies upon a ruling in P. Appavu Pillai v. Commissioner of Income-tax where it is observed as follows :

> "Nor are we able to agree with the learned counsel for the department that the profit and loss account is an account which can be said to be book of account. It is only a statement representing the state of business as at the end of the accounting year and the details contained in the statement are culled out from such other books of account which may be called primary books which a businessman generally maintains."

The learned counsel has invited our attention to certain passages from a book on Accountancy by William Pickles (3rd edition 1960). At page 65 it is observed :

> "When preparing final accounts it will be necessary to consider the question of the period in respect of which an expense has been incurred. It is easy to realise that at any given

date, an expense may have been paid, or charged if an expenses day book is used, in respect of a period which is not co-extensive with the period of accounts, either falling short of, or stretching beyond such period, and as it is essential that the period for which accounts are prepared should bear the true expenditure - no more, no less - an adjustment is usually called for to give effect to this principle."

At page 74, referring to depreciation, it is stated as follows :

"In normal circumstances, the question of providing for depreciation is deferred until the trial balance is extracted and, hence, will not have been dealt with prior to the preparation of the final accounts...Depriciation is the inherent decline in the value of an assest from any cause whatever. The wearing out of a machine is a simple and obvious example, but it must be emphasized that this is but one of many causes. As with all other entries, there must be complete double-entry for the depreciation adjustment. The required entry is : debit trading and profit and loss account and credit the asset, in respect of which depreciation is being recorded. This entry conforms with the principles already enunciated in that the debit to trading and profit and loss account is necessary because the amount written off represents an expense and the credit to the asset is required as the asset has, pro tanto, been reduced in value."

At page 967, referring to profit and loss account, it is stated as follows :

"Only a short account is required giving the information laid down in the Act. Thus, there will usually be no detailed trading or profit and loss account; the published account will commence with profit on trading for the year to which will be added dividends, interest and other non-trading receipts and against which will be debited depreciation, etc..."

The learned counsel takes objection to the observation of the Appellate Tribunal stating that "when once profit and loss has been ascertained, subsequent manipulations in the accounts even for rectification for any obvious mistakes can only be carried out and corrected in the subsequent years account". It is stated that the entries made by him are not in the nature of any manipulations in the sense that he was making any alterations in an account which has been maintained day to day. Even the final assessment proceedings involved a certain amount of adjustments and it is therefore submitted that when those entries have been placed before the Income-tax Officers before the assessment is finalized, there can be no real objection.The learned counsel next referred us to a ruling of the Madras High Court in Commissioner of Income-tax v. Veeraswami Nainar in which Ramchandra Iyer C.J., who delivered the judgment on behalf of the Division Bench, while holding that it was not open to the Tribunal during the pendency of the appeal before it, to give a direction to an assessee that he should be allow to rewrite the necessary entries

in his books of entries in his book of account by making the requisite entries, in order to enable him to claim the benefit of the development rebate, however, indicated by implication, that such a benefit can be given to an assessee who had made the necessary book entries by the time he produced his accounts before the Income-tax Officer. The learned counsel states that so far as the present case is concerned, he had placed the books of account containing all the relevant entries before the Income-tax Officer by the time the assessment was finalised and that he is therefore entitled to the relief. Though we are reclined to rely on the observations of the learned judge in support of the assessees claim in the present case, the learned counsel for the assessee contended that the basis of the actual decision of the Madras High court requires reconsideration and is open to various objections. In the said decision of the Madras High Court, it was observed as follows :

> "It will be apparent from the terms of the proviso that the object of the legislature is allowing a development of the assessees business from out of the reserve fund. The entries in the account books required by the proviso are not an idle formality. The assessee being obliged to credit the reserve fund for a specific purpose, he cannot draw upon the same for purposes other than those of the business, and if the assessee were a company, for example, that amount could not be disturbed by way of dividend. It is also clear from the terms of the proviso that the reserve should be made at the time of making up the profit and loss account. The Tribunal was clearly in error when it held that it would be open to the assessee to readjust the account by making the reserve at a later of period of time. Any account maintained by a business should reflect its financial transactions correctly. If at the time of the closing of the accounts for a year, a particular appropriation had not been made, but the moneys had been spent otherwise, it would indeed be futile to direct the assessee to readjust the account. For, then, it will not be a true account. The Tribunal has stated that the requirement as to creation of a reverse fund is of a highly theoretical nature, which need not complied with to the letter of the statute."

It is pointed out by the learned counsel that what is essential is only that the assessee should claim the rebate for the relevant accounting year, that the question of the necessity for the creation of reverse fund will arise only when the allowance for development rebate is to be actually allowed and that this really postulates the existence of a profit. The decision seems to proceed as if there is a statutory duty to create the reverse fund whether the trade results in a profit or loss. When there is only loss, the question or utilisation of any of its funds does not arise and therefore it can arise only when there is profit. It is however not necessary for us to canvass the correctness of the reasoning of the decision of the Madras High Court. It is sufficient for our purpose to say that there is an indication in the judgment that if the requisite entries are made by the time the accounts are produced before the Income-tax Officer, meaning thereby, before the assessment is finalized, the assessee would be entitled to the benefit of development rebate.To

sum up our conclusions : We are not inclined to agree with the view taken by the department that the reverse fund should be credited and consequential entries effected before the close of the accounting year. Though it is not necessary for us to decide which is the ultimate point of time beyond which the said entries cannot be made, it is sufficient for the purpose of this case to hold that as the assessee made the necessary entries before the assessment was finalised by the Income-tax Officers, he is entitled to the benefit of the rebate. As already pointed out, the necessity for the creation of a reserve fund arises only when the trade results in profit and this can be ascertained only after drawing up the profit and loss account. It has to be remembered that the profit and loss account is not a primary account which is maintained from day to day but it is only an abstract of the results of the entire business prepared out of the regular accounts of the assessee. The finalisation of the assessment itself in the hands of the Income-tax Officer involves various incidental adjustments of the account submitted by the assessee. Under these circumstances, there is nothing wrong if the assessee credits a reserve fund and makes the necessary entries before the matter is finalised by the Income-tax Officers. As this has been done in the present case, we answer the question in the affirmative and in favor of the assessee. The assessee will be entitled to costs of this reference. Advocates fee Rs. 250.R.C. No. 15 of 1964 This is also a reference made to us by the Income-tax Appellate Tribunal on the application of the assessee. The question for decision is identical as that arising in the above R.C. No. 8 of 1964. In this case, also, the assessee made the necessary entries before the completion of the assessment by the Income-tax Officer but subsequent to the last day of the accounting year. The claim for rebate was disallowed by the authorities on the ground that the relevant entries were not made during the accounting year. But as the entries have been made before the completion of the assessment of the assessment, following our decision in the above R.C. No. 8 of 1964, we hold that the assessee is entitled to relief towards development rebate claimed by him. We accordingly answer this question in the affirmative and in favor of the assessee. The assessee is entitled to costs of this reference. Advocates fee Rs. 150.