CALCUTTA HIGH COURT

West Laikdihi Coal Co. Ltd

Vs

Commissioner of Income-Tax

(Sankar Prasad Mitra and Sen, JJ.)

09.08.1971

JUDGMENT

Sankar Prasad Mitra, J.

1. This is a reference under Section 66(1) of the Indian Income-tax Act, 1922. The question is whether the assessee, had to create a reserve fund out of its profits to be eligible for development rebate, under Section 10(2)(vib) of the Indian Income-tax Act, 1922.

2. Let us, therefore, at the outset, set out the relevant provisions of the Act. These provisions are :

> " 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 or 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. .... 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 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. and in the case of machinery or plant ins'talled after the 31st day of March, 1961, twenty per cent. of the actual cost of the machinery or plant to the assessee ;
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> Explanation 1.--In the case of ..... machinery or plant installed after the 31st day of December, 1957, where the total income of the assessee for the year of .... installation (the total income for this purpose being computed without making any allowance under this

clause) is nil or is less than the full amount of the development rebate calculated at the rate applicable thereto under this clause,--

(i) the sum to be allowed by way of development rebate for that year under this clause shall be only such amount as is sufficient to reduce the said total income to nil; and

(ii) the amount of the development rebate, to the extent to which it has not been allowed as aforesaid, shall be carried forward to the following year, and the development rebate to be allowed for the following year shall be such amount as is sufficient to reduce the total income of the assessee for that year, computed in the manner aforesaid, to nil, and the balance of the development rebate, if any, still outstanding shall be carried forward to the following year and so on, so however, that no portion of the development rebate shall be carried forward for more than eight years.

Explanation 2.-- Where in any year development rebate is to be allowed in accordance with the provisions of Explanation) in respect of .....machinery or plant installed in more than one year, and the total income of the assessee for that year (the total income for this purpose being computed without making any allowance under this clause) is less than the aggregate of the amounts due to be allowed in respect of the assets aforesaid for that year, the following procedure shall be followed, namely :--

(i) the allowance under paragraph (ii) of Explanation 1 shall be made before any allowance under paragraph (i) of that Explanation is made ; and

(ii) where an allowance has to be made under paragraph (ii) of Explanation 1 in respect of amounts carried forward for more than one year, the amount carried forward from an earlier year shall be allowed before any amount carried forward from a later year :

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

(a) the particulars prescribed for the purpose of Clause (vi) have been furnished by the assessee in respect of the .... machinery or plant; and

(b) except where the assessee is a company, being a licensee within the meaning of the Electricity (Supply) Act, 1948. ... or the machinery or 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 10 years next following for the purposes of the business of the undertaking, except-

(i) for distribution by way of dividends or profits, or

(ii) for remittance outside India as profits or for the creation of any asset outside India, and if any such .... machinery or plant is sold or otherwise transferred by the assessee to any person other than the Government or for any consideration not connected with any amalgamation or succession referred to in Clause (vic) at any time before the expiry of ten years from the end of the year in which it was acquired or installed, any allowance made under this clause shall be deemed to have been wrongly allowed for the purposes of this Act:

Provided further that no allowance under this clause shall be made in respect of any machinery or plant which consists of office appliances or road transport vehicles."

The assessee in the instant reference derives income from coal mining. During the calendar years 1959 and 1960 (assessment years 1960-61 and 1961-62), the assessee had installed additional machinery and plant on which it claimed development rebate of Rs. 9,468 and Rs. 2,440, respectively. Profits shown in the profit and loss accounts for the respective years came to Rs. 41,663 and Rs. 76,476.75, respectively. In order to be eligible for the rebate, the assessee should have, under the above provisions of the Act, created a reserve of seventy-five per cent. of the amounts claimed as development rebate, that is, Rs. 7,101 and Rs. 1,830, respectively. No such reserve, however, was created. But the assessments for the relevant years ended in a loss. These assessments were as follows:

Assessment year Assessed income of the year (without allowance of development rebate) Brought forward unabsorbed depreciation of the earlier years Balance of unabsorbed depreciation carried forward Rs.

Rs.

Rs.

1960-61 27,070 19,725 87,955 1961-62 80,018 87,955 7,957 The Income-tax Officer held that no development rebate could be allowed " as the assessee did not create any reserve as per provisions of law."

The Appellate Assistant Commissioner agreed with the Income-tax Officer's order.

3. Before the Tribunal, the assessee contended that there was no taxable income for the assessment years 1960-61 and 1961-62. There could, according to the assessee, be no debit to the profit and loss account for the purpose of creating the reserve in these years. The assessee further

pointed out that as it was permissible to carry forward an unabsorbed development rebate under similar circumstances, it should be presumed that the creation of the reserve was not called for when the total income was nil or was a minus figure. The contention of the department before the Tribunal was that the assessed figure had nothing to do with the required reserve being created because the terms of the provisions of Section 10(2)(vib) required the department to see whether there were sufficient net profits as per audited accounts of the years to justify the creation of reserve. The departmental representative submitted to the Tribunal that, having regard to the book profits of Rs. 14,663 and Rs. 76,476 for the relevant years, the assessee could have provided for the necessary reserves.

4. The Tribunal has held as follows :

> "We agree with the departmental representative that the condition precedent to the appellant's claim being not fulfilled, the benefit claimed under Explanation 2 to Section 10(2)(vib) would not come into play and as such the claims appear to have been rightly rejected by the department. We, therefore, confirm the consolidated order of the Appellate Assistant Commissioner, dated 16th March, 1944, and dismiss both the appeals."

The following question of law has been referred to this court:

> " Whether, on the facts and in the circumstances of the case, and on a proper interpretation of proviso (b) to Section 10(2)(vib), the assessee had to create a reserve in order to be eligible for allowance of development rebate though there was no taxable income in the relevant years as per the assessment ? "

Mr. D. K, Sen, learned counsel appearing for the department, slightly deviated from the stand taken by the departmental representative who had argued this case before the Income-tax Appellate Tribunal. The departmental representative's contention, as we have pointed out, was that the assessee should have created the reserve in the year of installation as its audited accounts showed a net profit before the unabsorbed depreciation was taken into account. But, Mr. Sen's contention is that, irrespective of any question of profit, the assessee, as a condition precedent, must create the reserve in the year of installation of the plant or machinery in order to be eligible for a development rebate.

5. Counsel for the parties drew our attention to the cases reported in *Commissioner of Income-tax v. Veeraswami Nainar*[1], *(Mad.), Indian Overseas Bank Ltd. v. Commissioner of Income-tax*[2], *Veerabhadra Iron Foundry v. Commissioner of Income-tax*[3], , *Metal Box Company of India Ltd. v. Their Workmen*[4], *Commissioner of Income-tax v. Mazdoori Kisan Sahkari Samiti*[5],, *Indian Overseas Bank Ltd. v. Commissioner of Income-tax*[6], *Surat Textile Mills Ltd. v. Commissioner of*

Income-tax[7]*Radhika Mills Ltd. v. Commissioner of Income-tax*[8]*, Transport Co. (Private) Ltd. v. Second Income-tax Officer*[9]*,* and Commissioner of Income-tax v. Saurashtra Wire-healds Mfg. Co. It would not be necessary for us to refer to all the decisions to decide the point of law in issue in this reference. We shall rely on such of them as we consider to be relevant.

6. The principal argument of Mr. D. K. Sen, learned counsel for the revenue, is that an assessee derives his right to get the development rebate under the first proviso to Section 10(2)(vib) read with the first part of this clause. In other words, an assessee would not be entitled to development rebate unless he fulfils the conditions stated in this proviso. Mr. Sen submits that once the development rebate is granted (and it is granted when the conditions prescribed by this proviso are fulfilled) it constitutes an allowance. And the way the allowance is to be worked out, that is the method and manner in which the allowance is to be determined, have been provided for in the two Explanations to this clause. Explanation 1, says Mr. Sen, provides for the manner and method in the year of installation and Explanation 2 prescribes the manner and method for subsequent years. But it has to be remembered, urges counsel for the revenue, that development rebate is allowed once and for all in the year of installation and the reserve which the first proviso requires as a condition precedent must be created in the year of installation. Mr. Sen has especially relied on the Gujarat High Court's decision in the case of *Commissioner of Income-tax v. Saurashtra Wire-healds Manufacturing Co. Private Ltd.*[10]*,* In this case the Gujarat High Court observes at page 536 that:

"The development rebate has to be paid once and for all, and that too in the year of installation. The development rebate is not to be spread over and cannot be spread over a number of years as in the case of additional depreciation under Section 10(2)(via),", Mr. Sen's other argument is that, under the scheme of the Indian Income-tax Act, "development rebate " is an item of business expenditure. Under Section 10 of the Act expenditures actually incurred in the business are allowed by way of deduction. These expenditures relate to the expenses incurred in the financial year. And only expenses incurred in the financial year can be claimed by way of deduction particularly in view of expression "relevant previous year" in Clause (b) of the first proviso. If it be held, argues Mr. Sen, that " relevant previous year " in this proviso refers to the year or years when profits are made so that the assessee's accounts can be adjusted by allowing the appropriate deduction, the entire scheme of these provisions would fail. In fact, according to Mr. Sen, there is no scope under the Income-tax Act, for purposes of deduction, to look to any other year except the year when an expense is actually incurred. Learned counsel contends that unless the provisions of Section 10(2)(vib) are approached from this point of view it would not be possible to maintain their consistency with the various other deductions that are claimed under Section 10(2). In other words, in all cases of deductions under Section 10(2) the assessee must show that the expenses were actually incurred in the year for which they are claimed and which for income-

tax purposes is " the relevant previous year ".Bearing this principle in mind learned dounsel for the department wanted us to construe the expression " actually allowed " under Clause (b) of the first proviso aforesaid. According to him the words "actually allowed" in Clause (b) mean " actually allowable " or " actually claimable ". He relies on the judgment of the Madras High Court in Commissioner of Income-tax v. Veeraswamy Nainar. In this case an assessee claimed the development rebate under Section 10(2)(vib). At the time the assessee's profit and loss account was drawn up the necessary reserve had not been created and shown in the account. The Income-tax Appellate Tribunal held that it would be open to the assessee to readjust the account by making the reserve at a later period of time. The Madras High Court did not accept this view and said that in order that an assessee could claim an allowance by way of development rebate under Section 10(2)(vib) he should comply with the conditions contained in the first proviso thereto as otherwise, under the express terms of that proviso, he would not be entitled to the allowance. Where the assessee, said the Madras High Court, failed to satisfy the conditions requisite for obtaining the allowance, it would not be for the court to embark upon what the general object of the exemption was, and whether the conditions imposed were of a theoretical or technical nature, which, in the interest of justice, should be dispensed with. The Madras High Court was of opinion that the assessee, not having set apart in his accounts 75 per cent. of the amount claimable as development rebate, could not claim the benefit of Section 10(2)(vib) of the Act.

7. This judgment of the Madras High Court, therefore, supports the view that the expression " actually allowed " in proviso (b) means actually allowable or claimable. The view expressed in this judgment was followed by the same High Court in the case of Indian Overseas Bank Ltd. v. Commissioner of Income-tax and received the approval of the Supreme Court in Indian Overseas Bank Ltd. v. Commissioner of Income-tax. We would have occasion to advert to this decision of the Supreme Court later in this judgment as well.

8. Mr. Sen for the department submits that, in the light of the above judgment of the Madras High Court, and the Supreme Court, it is apparent that in the year of installation of the machinery an assessee knows what is the quantum of development rebate allowable to him. And on the basis of the sum allowable he has to create a reserve account which has to be appropriately shown in his profit and loss account for the year of installation. Learned counsel says that unless these conditions precedent are fulfilled an assessee is not entitled to claim development rebate at all. Our attention has been drawn to the relevant sections of the Companies Act to show that a profit and loss account is a statutory requirement in a balance sheet and there is no scope for making alterations or modifications thereto at a later or subsequent stage.

9. There is no dispute as to the propositions laid down by the Madras High Court. As we shall

point out later even if the expression " actually allowed " be understood to mean " actually allowable " or " actually claimable " the requirements of the first proviso would not be materially affected. With regard to the judgment of the Gujarat High Court in Commissioner of Income-tax v. Saurashtra, Wire-healds Mfg. Co., however, we have to point out that the observation we have referred to was made before Clause (vib) was drastically amended by the Finance Act of 1958.

10. The provisions relating to development rebate in Clause (vib) of Section 10(2), it appears, were introduced for giving incentives to businessmen to develop their business. It is not, strictly speaking, an expenditure which is allowed as a deduction for purposes of assessment of income-tax. The development rebate cannot be treated by the assessee as part of its income or profit for all purposes. Restrictions have been imposed on an assessee's right to deal with or dispose of the development rebate. For a period of ten years the assessee cannot utilise the reserve account that has to be created either for distribution by way of dividends or profits or for remittances outside India as profits or for the creation of any asset outside India. Against this background we have to examine the provisions of Clause (vib) to see whether the reserve account must be created in the year of installation of the plant or machinery irrespective of whether the assessee has an assessable income in that year. If an assessee has to create a reserve account in the year of installation, though in that year the assessee does not earn any profit, the assessee may have to resort to borrowings for creation of the reserve in order to be entitled to development rebate at some future date. That obviously could not have been the intention of the legislature. The whole object of Clause (vib) would fail if creation of the reserve account were insisted on in the year of installation of the plant or machinery whether or not the assessee had the funds to create such an account. Section 10(2)(vib) does not intend to impose a burden on the assessee, but tries to give him relief or to confer benefits on him to encourage him to build up his business. The first part of Section 10(2)(vib) provides for the circumstances in which an assessee would be entitled to a development rebate as well as the maximum amount of development rebate that would be granted to him. This part is not concerned with how in the cape of a particular assessee the development rebate is to be allowed. The second part of Section 10(2)(vib) consists of two Explanations. These Explanations deal with the methods that are to be adopted in granting development rebate to assessees. For instance, if the total income of the assessee in the year of installation's less than the full amount of the development rebate that he is entitled to, the sum to be allowed by way of development rebate for that year shall be only such amount as is sufficient to reduce the said total income to nil. And the amount of development rebate, to the extent to which it has not been allowed in the year of installation, shall be carried forward to the following year. The word " allowed " has been used both in Clauses (i) and (ii) of Explanation 1.

11. In the third part of the section, we have two provisos. The first proviso is the one we are concerned with in this reference. It has two clauses, namely, Clause (a) and Clause (b). The first

proviso opens with the words " no allowance under this clause shall be made ". Here the expression " no allowance " refers to the entire amount of development rebate claimable by an assessee under Clause (vib). Clause (a) of the proviso has to be complied with in the year of installation. But Clause (b) of the proviso prescribes the condition precedent for fulfilment in the year or years the development rebate or portions thereof are actually allowed. As we have seen in Explanation 1 it has been clearly laid down that if the whole of the amount of development rebate cannot be allowed in a particular year, it would be carried forward to the following year. Therefore, the words " actually allowed " in Clause (b) of the first proviso have to be restricted to the quantum of development rebate in fact allowed in a particular year of assessment and not carried forward to the following year. And the reserve account that has to be created and debited " to the profit and loss account of the relevant previous year " is directly related to the quantum of development rebate actually allowed to an assessee in a particular year of assessment. In otter words, by Clause (b) of the first proviso, the assessee is required to set apart an amount equal to seventy-five per cent. of the development rebate that would be allowed to him in a particular year of assessment as a reserve which has to be shown in the profit and loss account of the assessee before that account is finally drawn up or closed. In this third part of the section the use of two expressions " no allowance " and " actually allowed " bring out clearly, in our opinion, what the legislature intended to convey.

12. The position, therefore, is that Clause (b) of the first proviso to Section 10(2)(vib) imposes two conditions. The first condition is that the assessee must debit his profit and loss account of the relevant year by an amount equivalent to seventy-five per cent. of the development rebate to be actually allowed in that year and credit the same to a reserve account. The second condition is that the assessee can utilise this reserve account only for the purpose specified in the statute. The expression " actually allowed " has to be construed in the context of the provisions made in Explanation 1 to Section 10(2)(vib). That Explanation envisages allowance of the development rebate in instalments over a number of years, depending on the assessable income of an assessee. Naturally, the words " relevant previous year " in Clause (b) of the first proviso refers not to the year of installation but also to the year or years in which either the whole or a part of the development rebate is " actually allowed ". If we construe " relevant previous year " as the year of installation, the main object of Section 10(2)(vib), in our opinion, would fail. The purpose of Clause (b) of the first proviso seems to be that the assessee would create a reserve fund out of the development rebate to be actually allowed to him in any particular year and not by incurring loans or otherwise and utilise the reserve account for a period of ten years for the purpose of the business of the assessee's undertakings only, except the purposes indicated in the said clause.

13. We may usefully quote the comments in Kanga's Law and Practice of Income-tax, 6th edition, volume 1, at page 367, on the relevant proviso in the Income-tax Act, 1961,

corresponding to Clause (b) of the first proviso, we are now considering. The comments are as follows :

> "..... .The clause requires the assessee to create a reserve of an amount equal to seventy-five per cent. of the development rebate actually allowed, that is, not of that part of the rebate which, being unabsorbed, is carried forward to a subsequent year....."

We are inclined to agree with these comments.

14. The Madras High Court in Radhika Mills Ltd. v. Commissioner of Income-tax has, it appears, taken a similar view. At page 667 it is observed :

> " It follows, therefore, in our opinion that although the books may show profits, if the assessment results in nil income or loss, there will then be no obligation on the part of the assessee to create a reserve as a condition for carrying over the development rebate."

We are, therefore, of opinion that the assessee in the instant case was not obliged to create a reserve account if there was no taxable income in the relevant years for the purpose of enabling the assessee to carry forward the development rebate to the following years as it could not be actually allowed in the years in question. The answer to the question referred to us is in the negative and in favour of the assesses. Each party will pay and bear its own costs.

A.N. Sen, J.

15. I agree.

Cases Referred.

1[1965] 55 I.T.R. 35 (mad)
2[1967] 63 I.T.R. 733 (Mad.)
3[1968] 69 I.T.R. 425
4[1969] 73 I.T.R. 53 (S.C.)
5[1970) 75 I.T.R. 253
6[1970] 77 I.T.R. 512 (S.C.)
7[1971] 80 I.T.R. 1(Guj.)
8[1969] 74 I.T.R. 661 (Mad.)
9[1964] 51 I.T.R. 82 (Mad.)
10[1968] 67 I.T.R. 524 (Guj)