

CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs

Kishanlal and Sons (Udyog) Pvt

(Dipak Kumar Sen and S.C Sen, JJ.)

23.07.1984

JUDGMENT

Dipak Kumar Sen, J.

1. This reference arises out of income-tax assessment of Kishanlal & Sons (Udyog) Pvt. Ltd., the assessee in the assessment years 1970-71 and 1971-72, the relevant accounting years ending on the 30th April of 1969 and 1970.
2. The facts found on record are, inter alia, that the assessee had been carrying on business in loading and unloading iron ores in the past assessment years and owned a jetty and trolley lines which were used in the said business.
3. In the assessment year 1970-71, the assessee discontinued its business in iron ore.
4. In the said assessment year, an agreement was entered into by the assessee with one New Era Fabrics Private Ltd. under which the assessee obtained the use of the knitting machines and godown of the said New Era Fabric Private Ltd. in consideration of payment of rent and compensation. The assessee utilised the machinery for sewing laminated bags, the running expenses of which, the wages of the labourers and other expenses being agreed to be paid by the assessee.
5. For the jetty and trolley lines, the assessee had been allowed depreciation and development rebate in the earlier assessment year which had remained unabsorbed. In the assessment years involved, the assessee claimed that such unabsorbed depreciation and development rebate should be allowed to be carried forward and set off against its business income for the said years. The ITO disallowed the assessee's claim for set off of unabsorbed depreciation on the ground that the assessee did not carry on its earlier business in the relevant years. The claim for set off of unabsorbed development rebate was also disallowed on the same ground as also on the ground that a reserve had not been created in respect of the same.

6. In the assessment year 1970-71, the assessee had borrowed money on interest from one Utkal Properties & Finance Private Ltd. Money was also advanced by the assessee to the said New Era Fabrics Private Ltd. The assessee paid Rs. 79,169 in the same year as interest to the said Utkal Properties & Finance Private Ltd. and in turn received Rs. 62,767 as interest from New Era Fabrics Private Ltd. in the said assessment year. In its assessment, the assessee claimed deduction of the said Rs. 79,169 paid as interest. The ITO allowed it to the extent of Rs. 62,767 and disallowed the balance Rs. 16,582.

7. On appeal, the AAC held that the unabsorbed depreciation and development rebate could be allowed only when the assets involved were used for the purpose of business.

8. On the disallowance of the balance interest of Rs. 16,382, it was held that payment of interest at a higher rate to the said Utkal Properties & Finance Private Ltd. would not be considered as an expenditure incurred for making or earning any income under the head "Other sources" and as such the same was not admissible under Section 57 of the I.T. Act, 1961.

9. Being aggrieved, the assessee went up on further appeal before the Income-tax Appellate Tribunal. The assessee contended before the Tribunal that to claim set off of unabsorbed depreciation and development rebate, it was not necessary that the business in which such depreciation and development rebate was initially allowed should be carried on in the subsequent years.

10. On the disallowance of deduction of part of the interest paid to New Era Fabrics Private Ltd., the assessee submitted that as it was obliged for business purposes to advance funds to New Era Fabrics Private Limited at a lower rate of interest, the interest paid to Utkal Properties & Finance Private Ltd. at a higher rate should not have been disallowed.

11. The Tribunal accepted the submissions of the assessee and allowed the assessee's claim for set off of unabsorbed depreciation and development rebate.

12. The Tribunal also found that the assessee was obliged to advance funds to New Era Fabrics Private Ltd. at a rate of interest lower than that it had agreed to pay to the said Utkal Properties & Finance Private Limited and directed that the difference should also be allowed as deduction. The appeals of the assessee were disposed of accordingly.

13. On an application by the Revenue under Section 256(1) of the I.T. Act, 1961, the following questions have been referred to this court for determination as questions of law arising out of the order of the Tribunal :

For the assessment years 1970-71 and 1971-72 :

"Whether, on the facts and in the circumstances of the case, the assessee was entitled to carry forward and set off the unabsorbed depreciation and development rebate of the assessment years 1968-69 and 1969-70, against the business income of the years under reference ?"

For the assessment year 1970-71 :

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 16,582 is allowable as admissible expenditure under Section 57 of the Income-tax Act, 1961 ?"

14. At the hearing, learned advocate for the Revenue drew our attention to Sections 32 and 33 of the I.T. Act, 1961, the material points of which are as follows :

Section 32(1) :

"In respect of depreciation of.....machinery, plant..... owned by the assessee and used for the purposes of the business.....the following deductions shall, subject to the provisions of Section 34, be allowed--...

(ii) in the case of...machinery, plant or furniture, other than ships covered by Clause (i), such percentage on the written down value thereof as may in any case or class of cases be prescribed."

Section 32(2) :

"Where, in the assessment of the assessee...full effect cannot be given to any allowance under.....clause (ii).....of Sub-section (1).....in any previous year, owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of Sub-section (2) of Section 72 and Sub-section (3) of Section 73, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years."

Section 33(1)(a) :

" In respect of... new machinery or plant (other than office appliances or road transport vehicles) which is owned by 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 and of Section 34, be allowed a deduction, in respect of the previous year in whichthe machinery or plant was installed or, if.....machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, a sum by way of development rebate as specified in Clause (b).

(2) In the case of..... machinery or plant installed after the 31st day December, 1957, where the total income of the assessee assessable for the assessment year relevant to the previous year in which.....the machinery or plant installed or the immediately succeeding previous year, as the case may be, [the total income for this purpose being computed without making any allowance under Sub-section (1) or Sub-section (1 A) of this section or subsection (1) of Section 33A or any deduction under Chapter VI-A or Section 280-0] is nil or is less than the full amount of the development rebate calculated at the rate applicable thereto under Sub-section (1) or Sub-section 1A, as the case may be,--

(i) the sum to be allowed by way of development for that assessment year under Sub-section (1) or Sub-section (1A) 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 assessment year, and the development rebate to be allowed for the following assessment year shall be such amount as is sufficient to reduce the total income of the assessee assessable for that assessment 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 assessment year and so on, so however, that no portion of the development rebate shall be carried forward for more than eight assessment years immediately succeeding the assessment year relevant to the previous year in which.....the machinery or plant installed or the immediately succeeding previous year, as the case may be."

15. Construing the said sections, learned advocate for the Revenue submitted that to claim unabsorbed depreciation or development rebate, the assessee must show that the assets in respect of which such depreciation and development rebate have arisen and had remained unabsorbed, continued to be owned and used by the assessee in his business. The sections and in particular Section 32, it was submitted, must be read as a whole.

16. In support of his contentions, learned advocate for the Revenue cited the following decisions :

(a) *Sahu Rubbers Private Ltd, v. CIT*¹ Here, a Division Bench of the Bombay High Court

construed Section 10 of the Indian I.T. Act, 1922, and proviso (b) thereof. The said section of the earlier Act is more or less in pari materia with Section 32 of the Act of 1961. It was held as follows (pp. 470) :

"This provision as to the manner in which the unabsorbed depreciation allowance is to be adjusted leads to the only inference that, for its adjustment in the subsequent year, the business of the assessee must continue. It postulates continuance of that business. If the business does not continue, then no question arises of ascertaining the depreciation allowance allowable for that year in respect of those depreciable assets. Now, when no question arises about the computation of depreciation allowance, the unabsorbed depreciation cannot be added to any depreciation, nor can it be substituted in its place. In our opinion, in order to claim adjustment of unabsorbed depreciation of the previous year in the assessment year, the assessee must establish that his business is continuing. If the business is no more in existence, unabsorbed depreciation cannot thereafter be adjusted in the assessments of future years. Had the intention of the Legislature been to adjust the unabsorbed depreciation allowance against the profits and gains chargeable to tax of the following year or years, irrespective of whether that business continues or not, it would have said so. But it has not said so and the reason appears to be obvious. If unabsorbed depreciation in respect of assets of a defunct business is added to the depreciation allowance in respect of a running business of an assessee, it would adversely affect the written down value of those assets without there being any depreciation thereof..... On the language of the proviso (b), in our opinion, it relates to the computation of the profits and gains of business of an assessee and deals with the same subject-matter as is dealt with in Clause (vi) of subsection (2) of Section 10 and, therefore, is within the ambit and scope of Clause (vi), and is not an independent substantive provision of law."

(b) *Madeva UpendraSinai v. Union of India* . In this case, the Supreme Court considered Section 32 of the I.T. Act, and observed as follows (p. 223) :

"Sub-section (2) of Section 32 allows the carry forward of unabsorbed depreciation allowance to any subsequent year, without any time-limit, where such non-absorption is 'owing to there being no profits or gains chargeable for the previous year or owing to the profits or gains being less than the allowance'. Depreciation loss under Section 32(2) thus, to a large extent, stands on the same footing as other business losses. An assessee claiming depreciation of assets has to show that such assets are owned by him and were used by him in the account year for the purpose of his business, the profits of which are being charged [Section 32(1)(i)]."

17. On question No. 2, learned advocate for the Revenue submitted that, in the facts and

circumstances, the said amount of Rs. 16,582 was not allowable as admissible expenditure under Section 57 of the I.T. Act, 1961.

18. Learned advocate for the assessee contended, on the other hand, that the issue in question No. 1 has since been answered categorically in favour of the assessee by the Allahabad High Court as also by the Bombay High Court in a subsequent decision where its earlier decision in Sahu Rubbers Private Ltd.'s case [1963] 48 ITR 464 was distinguished. The learned advocate submitted that both unabsorbed depreciation and development rebate could be carried forward. The unabsorbed depreciation could be set off against the business income of the assessee in the subsequent years, even if the particular business in which the depreciation was originally claimed and allowed did not exist. The unabsorbed development rebate could be set off against the total income of the assessee irrespective of the business carried on by him.

19. Learned advocate for the assessee cited the following decisions in support of his contentions.

(a) CIT v. Rampur Timber and Turnery Co. Ltd. . In this case, the facts were that no business had been carried on by the assessee in the relevant previous years and the assets and machinery which the assessee continued to possess were not used for the purpose of business. Construing Section 32 of the I.T. Act, 1961, a Division Bench of the Allahabad High Court held that though there was no depreciation allowance available for that year, unabsorbed depreciation for the previous year would still be available for adjustment by virtue of the clear provisions of Section 32(2) as it had to be deemed to be an allowance for that previous year.

(b) CIT v. Virmani Industries (P.) Ltd. . Here, it was reiterated by the Allahabad High Court that for the purposes of Section 32(2) of the Act, it was not necessary either that the same business should be carried on by the assessee in the succeeding years or that the depreciable assets of the original business should be utilised in the new business. So long as the assessee carried on some business in the year, subsequent unabsorbed depreciation carried forward would have to be allowed in that year, even if the business had no depreciable assets. The legal fiction brought about by the deeming provision in the said section had to be carried to its logical conclusion. The decision in Sahu Rubbers Private Ltd.'s case [1963] 48 ITR 464 (Bom)(supra) was expressly dissented from.

(c) CIT v. Estate & Finance Ltd².. Here, another Division Bench of the Bombay High Court held that the decision in Sahu Rubbers Private Ltd.'s case [1963] 48 ITR 464 (Bom), did not constitute a binding authority on the interpretation of Section 32(2) of the I.T. Act, 1961. The difference between the proviso to Section 10(2)(vi) of the Act of 1922 and Section 32(2) of the Act of 1961 was noted and. it was held that though there was no difference in phraseology, the provision in Section 32(2) was not intended to be applied only for computing depreciation. The said section

contained an independent provision and for setting off unabsorbed depreciation carried forward from a preceding year, it was not necessary that the business in respect of which the depreciation was originally allowed and carried forward should remain in existence in the succeeding year.

(d) *Hyderabad Construction Co. Ltd. v. CIT* . In this case, a Division Bench of the Andhra Pradesh High Court held that unlike Section 32(1) of the Act, Section 32(2) did not impose any condition for set off of unabsorbed depreciation against the income of the succeeding assessment year which required continuation of the business and user of the assets and machinery in such business. It was held that such unabsorbed depreciation could be set off against other income of the assessee in the relevant assessment year. The decision of the Bombay High Court in *Sahu Rubbers Private Ltd.'s case* [1963] 48 ITR 464 was expressly dissented from.

(e) *Addl. CIT v. Kapila Textiles (P.) Ltd.*³. In this case, a Division Bench of the Karnataka High Court followed and applied *Rampur Timber and Turnery Co. Ltd.'s case* , and held that carry forward and set off of unabsorbed depreciation under Section 32(2) of the Act was not subject to the condition that the original business must have been carried on by the assessee in the subsequent year.

(f) *Eastern Coal Storage (P.) Ltd. v. CIT* . The facts in this case were that the assessee had been allowed depreciation on machinery and assets up to December 31, 1970. No depreciation was allowed for the next assessment year 1972-73 as there was no claim for the same. In the assessment year 1973-74, the ITO found that the plant and machinery had been sold at a profit which was brought to tax. The AAC directed that the amount of profit should be recomputed taking into account that Rs. 52,405 had been brought forward from the year 1965-66 as unabsorbed depreciation.

20. The Tribunal set aside the order of the AAC in an appeal by the Revenue from which there was a reference to this court. The question referred was whether the Tribunal was right in holding that the unabsorbed depreciation should not be deducted in computing the profits under Section 41(1) of the Act. This court followed *Rampur Timber and Turnery Co. Ltd.'s case* , *Virmani Industries (P.) Ltd.'s case* and *Estate & Finance Ltd.'s case* [1978] 111 ITR 119 (Bom), and held that carried forward unabsorbed depreciation by fiction became the depreciation allowance in a subsequent year, even if the business did not have depreciable assets in that year. It was held that the fiction in Section 32(2) should be given full effect and even for the purpose of Section 41(2), the business should be deemed to have been carried on in the year in question.

21. On question No. 2, learned advocate for the assessee cited *D. & H. Secheron Electrodes (P.) Ltd. v. CIT* . In this case, a Division Bench of the Madhya Pradesh High Court held that where it was established that capital has been borrowed by the assessee for the purpose of its business or

profession and that the assessee has paid interest thereon it was not open to the Revenue to disallow a part of the interest paid on the capital borrowed on the ground that no interest had been charged by the assessee on advances made by it to its sister concerns and in particular where it was not found that the capital borrowed was not for the purpose of business.

22. There is no dispute in the instant case that in the relevant assessment years, the assessee continued to own the machinery and assets of its earlier business, and that in such earlier business, depreciation had been allowed and had remained unabsorbed. That the assessee is entitled to carry forward such unabsorbed depreciation is also not in dispute.

23. Sub-s. (2) of Section 32 of the I.T. Act, 1961, provides that once depreciation has been duly allowed in a particular year but could not be given effect to by reason of the chargeable profits or gains being less than the allowance, the same has to be added to the amount of allowance for depreciation for the following previous year or alternatively if there is no allowance in that year be deemed to be the allowance for that previous year. This continues in the succeeding previous years. The deeming provision comes into operation if there is no allowance in any succeeding previous year. It has been held by this court in *Eastern Cold Storage (P) Ltd.* [1983] 139 ITR 664, that the deeming provision has to be given full effect for all purposes of the Act. The Allahabad High Court, the Andhra Pradesh High Court, the Karnata High Court as also the Bombay High Court in its subsequent decision in *Estate and Finance Ltd.* [1978] 111 ITR 119 (Bom) have clearly held that in order to claim unabsorbed depreciation, it is not necessary that the depreciable assets have to be utilised in the new business.

24. We respectfully agree with the said view and hold that the deeming provision in the said subsection has to be given its full effect and the allowance has to be treated as a depreciation allowance in the succeeding years irrespective of the business carried on.

25. So far as unabsorbed development rebate is concerned, the position is clearer. Sub-s. (2) of Section 33 of the Act provides that the development rebate can be carried forward to the succeeding years for the purpose of reduction of the total income of the assessee. The question whether the assessee in the subsequent assessment year is carrying on its original business where development rebate had been initially allowed or not is of little relevance. The development rebate once allowed can be carried forward for the subsequent years for the aforesaid purpose.

26. For the reasons given above, we answer question No. 1 in the affirmative and in favour of the assessee.

27. It is not possible for us to answer question No. 2 because of the manner in which it has been framed. It has been found by the Tribunal that the claim for deduction of interest arose in the new

business started by the assessee in the assessment year 1970-71. The new business was carried on with a new party, viz., M/s. New Era Fabrics Private Ltd. The assessee hired knitting machines and the godown of New Era Fabrics Private Ltd. for the purpose of such business and in the transaction advanced funds to the owner at a rate of interest lower than that at which the assessee borrowed from its own financier. The deduction can be claimed, if at all, under Section 36 of the I.T. Act, 1961. Section 57 of the Act, which deals with income from other sources, in our view, has no application. It appears that at all stages the deduction claimed has been considered under Section 57 of the Act.

28. We remand the matter to the Tribunal for being re-examined and the Tribunal will dispose of the same in accordance with law and keeping in view what has been stated hereinabove.

29. The reference is disposed of accordingly.

30. There will be no order as to costs.

Cases Referred.

1[1963] 48 ITR 464

2[1978] 111 ITR 119

3[1981] 129 ITR 458 (Ear)