

KARNATAKA HIGH COURT

Commissioner of Income-Tax

Vs.

Diamond Dies Manufacturing Corporation Ltd.

I.T.R.C. No. 25 of 1994

(S.A. Hakeem and S. Rajendra Babu, JJ.)

10.06.1988

ORDER

S.A. Hakeem, J.

1. By this reference under section 256(1) of the Income-tax Act, 1961 ("the Act"), the Income-tax Appellate Tribunal, Bangalore Bench, has referred the following question of law for the opinion of this court :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the subsidy of Rs. 3,30,600 received from the Central Government for setting up industries in backward areas cannot be allocated towards any particular asset or assets and the assessee is entitled to depreciation on the cost of assets as claimed by it ?"

2. The brief facts of the case are as follows :

During the previous year relevant to the assessment year 1977-78, the assessee received a subsidy of Rs. 3,30,600 from the Central Government for setting up an industrial unit in a backward area. The Income-tax Officer allocated the subsidy between land, building, electrical installations and plant and machinery holding that since it went to reduce the cost of the assets in terms of section 43(1) of the Act, he reduced the written down value of the assets and allowed depreciation on the reduced cost. The finding of the Income-tax Officer was confirmed by the Commissioner of Income-tax (Appeals). On further appeal by the assessee, the Tribunal, following the decision of the Special Bench of the Tribunal in *Pioneer Match Works v. Income Tax Officer*¹ held that the said subsidy cannot be allocated to any particular asset or assets and, therefore, it does not go to reduce the cost of the assets in terms of section 43(1) of the Act. At the instance of the Revenue, the

Tribunal has referred the above question for our opinion.

3. It cannot be disputed that the scheme for grant of subsidy was introduced to encourage setting up of industrial units in selected backward areas. Under the scheme, a "new industrial unit" means the industrial unit which has made investment in land, building and

¹(I.T.A. Nos. 2899 and 2971/Mad/1977-78)

plant and machinery during the operative period of the scheme. "Fixed Capital Investment" means "investment in land, building and plant and machinery". The scheme also prescribes the method for assessing the total fixed capital investment for the purpose of granting the subsidy. Certain restrictions are placed on the grant of subsidy and certain obligations are imposed regarding proper utilization of the subsidy for ensuring satisfactory production results for a period of at least five years from the date of commencement of production results for a period of at least five years from the date of commencement of production. Under the scheme, the maximum central investment subsidy admissible to an eligible industrial unit is 15% of the fixed capital investment made on or after March 1, 1973, or Rs. 15,00,000, whichever is less.

4. The main contention of Sri K. Srinivasan, learned counsel for the Revenue, is based on the interpretation of the expression "actual cost" occurring in section 43(1) of the Act, which means "the actual cost of the assets to the assessee reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority." It is urged that the central subsidy for acquisition of the capital assets goes to reduce the actual cost thereof. On the contrary, it is urged by Sri Sarangan, learned counsel for the assessee, that the actual cost of the assets is only a measure for the purpose of arriving at the quantum of subsidy to be granted under the scheme and in the absence of any particular allocation, it cannot be allocated to various assets for the purpose of deduction envisaged under section 43(1) of the Act.

5. The scheme for the grant of the subsidy, as stated earlier, is to develop industries in selected backward areas. On a perusal of the scheme, it is clear that the subsidy amount granted is a percentage of the total fixed capital investment, which is only taken as a measure for quantifying the subsidy. In the pro forma prescribed under the scheme to find out the total fixed capital investment, it can be seen that in addition to the land, building, plant and machineries, other assets on which depreciation is not admissible, such as tools, goods carrier, promotional and preoperative expenses capitalized or to be capitalized and margin money for working capital are also included. Nowhere has the scheme provided as to how the subsidy should be utilized and for which assets. For instance, it is open to the assessee to legitimately reduce the cost of land in its books of account to the full extent of the subsidy, in which case the cost of plant and machinery will remain at invoice price uninfluenced by the amount of subsidy. In the circumstances, it appears that the amount received by way of subsidy could be utilized for any purpose such as acquiring land on which no depreciation is admissible or on plant and machinery or for erection of buildings or for working capital or for repaying the loans already borrowed. Hence, unless the subsidy received has a nexus, direct or indirect, with meeting a portion of the actual cost of any

specific capital asset, it cannot be brought within the purview of section 43(1) of the Act.

6. In *Commissioner of Income Tax v. Godavari Plywoods Ltd²*, the Andhra Pradesh High Court has held that there is no provision in the central subsidy scheme to show that entrepreneurs are granted subsidy for the specific purpose of meeting a portion of the cost of the unit. Under the scheme, the cash subsidy is quantified by determining the same at a specified percentage of the fixed capital cost. The specified of the fixed capital cost taken as the basis for determining the subsidy is only a measure adopted under the scheme for

²168 ITR 632

quantifying the subsidy. The subsidy is granted more as recompense for the hardships and inconveniences which the entrepreneurs may encounter while setting up industries in backward areas, which lack infrastructure. The subsidy, therefore, cannot be deducted from the actual cost of the assets to the assessee and depreciation should be allowed without reducing the same by the amount of subsidy granted. We are in respectful agreement with the view taken by the learned judges of the Andhra Pradesh High Court.

7. In that view of the matter, the question of law referred is answered in the affirmative and in favor of the assessee.

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