Karnataka High Court The Commissioner Of Income Tax vs Himatasingike Seide Ltd. on 4 August, 2006 Author: R Gururajan Bench: R Gururajan, J Rahim ORDER R. Gururajan, J. 1. Revenue is before us seeking for an answer to the following question of law: Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the assessment order passed by the Assessing Officer allowing the claim of the assessee for adjustment of the unabsorbed depreciation against the income from other sources was in order and hence cannot be considered to be erroneous or prejudicial to the interests of revenue and in cancelling the order Under Section 263? 2. Facts are as under: The respondent-assessee is 100% export oriented industrial unit in terms of the provisions of Section 10-B. Any profits and gains derived by it from the said export oriented undertaking are not liable to be included in the total income of the assessee. Although the industrial operations are stated to have been commenced in assessment year 1988-89, the assessee however, did not claim the benefits Under Section 10-B in assessment years 1988-89, 1989-90 and 1990-91. On the other hand, it claimed the said benefits for a connective period of 5 years starting from assessment year 1992-93. In assessment year 1994-95, the assessee is stated to have other income beyond the profits and gains of the export oriented commercial unit. Un-absorbed depreciation available to the assessee in assessment year 1988-89 was carried forward to this year and was claimed by the assessee to be adjustable against the income from other sources, thereby it reduced for assessment purposes at nil. The Assessment Officer, in the assessment order passed on 17.3.1995 accepted the above claim of the assessee and assessed the total income at nil. The CIT, exercised its power Under Section 263 and passed an order on 25.3.1996. He considered the above action on the part of the Assessing Officer of adjusting the brought forward unabsorbed depreciation against the income from the sources of the assesses to be wrong and bad in law and causing loss to the Revenue. He directed that the unabsorbed depreciation and unabsorbed investment allowance should be adjusted against the income of the export oriented business undertaking and the total income of the assessee should accordingly be recomputed afresh. Aggrieved by the same, the assessee preferred an appeal. The Tribunal has chosen to allow the appeal filed by the assessee. Thereafter, a reference application was filed by the Revenue and accepting the reference application, a question of law as referred to above was framed four our decision. 3. Heard the learned Counsel elaborately for some time. Sri. Indra Kumar, learned Counsel appearing for the Revenue takes us to the provision of Section 10-B and also the other provisions of the Act to say that the Tribunal is wrong in reversing the order passed by the Commissioner of Income Tax in the case on hand. According to him, the unabsorbed depreciation ought to have been taken note of for the purpose of exemption Under Section 10-B of the Act. According to him in the case on hand, the asseasee cleverly has chosen to show nil for the purpose of tax by way of novel method unknown to Income Tax Laws. He also says that the Commissioner was right in rejecting the case of the asseasee. 4. Per contra, Sri. S. Parthasarathi, learned Counsel however pleads that Section 10-B provides for total exemption and the conclusion so made by him could also

be on commercial basis. He would therefore says that the Tribunal was fully justified in holding in his favour. 5. At the time of arguments, we directed the parties to place before us the computation of total income arrived at by the assesaee. The assessee has placed before us a photocopy of the calculation. The said calculation is also taken into consideration for the purpose of finding in the case on hand. It is seen from the material on record that the assessee-respondent has chosen to file a nil return. Thereafter, the Commissioner has chosen to issue a show cause notice for the assessment year 1992-93 and 1994-95 on the ground that exemption Under Section 10-B for export profits was wrongly computed in as much as the unabsorbed depreciation brought forward from the earlier years was not set off against the business income but was set off against income from other sources, for the assessment year 1994-95. For the assessment year 1992-93, the brought forward balance representing unabsorbed depreciation relating to assessment years 1988-89 to 1990-91 and unabsorbed investment allowance relating to assessment years 1989-90 and 1990-91 were carried forward instead of being adjusted against profits from the undertaking. A reply was obtained and thereafter, the Commissioner has chosen to hold that it is a fit case for taking action Under Section 263 of the I.T. Act to set right the loss of revenue caused by the impugned orders of the Assessing Officer. Both the assessments are revised to take into account as proper deductions, the unabsorbed depreciation and investment allowance awaiting adjustment in each of these years. The Assessing Officer should recompute the income exempted Under Section 10-B and the income, if any, liable to tax in the normal courses. Against this order, a second appeal was filed and the Tribunal has chosen to hold that the order passed Under Section 263 is bad in law. To come to this conclusion, the Tribunal has chosen to look into Section 10-B and also Section 32 in the matter of depreciation and in the matter of calculation. 6. Section 10-B is a special provision in respect of the newly established 100ft export oriented undertaking. It provides for a tax deduction on the turnover on account of 100% export oriented undertaking. In the case on hand, the appellant has submitted a computation of total income and for the said computation, he has taken the net profit, disallowance, entertainment of expenses, donation interest accrued but not due depreciation etc. He has arrived at a figure of Rs. 11,17,87,315/-. He has claimed the entire amount as an exemption Under Section 10-B of the Act. The same has been accepted by the department. However, he has derived business income from other sources. The said amount works out to Rs. 41,09,479/-. Even for this income from other business sources, he has chosen to take unabsorbed depreciation of assessment year 1988-89. Totally the very amount thereby he has shown as taxable income nil for the relevant assessment year. The assessing officer has chosen to accept the same. The Commissioner of Income Tax noticing the nil income issued a notice Under Section 263 of the Income Tax, obtained reply and thereafter, he comes to a conclusion that the assessing officer failed to apply the provisions of Sections 29 to 43 especially Section 32(2) and Sub-section (3) of Section 32A in the case on hand. He Was of the view that the orders are erroneous and prejudicial to the interest of the revenue, in so far as the exemption Under Section 10-B was allowed on an inflated amount without deducting the

unabsorbed depreciation and unabsorbed investment allowance in the case on hand. When the matter was taken to the Tribunal, the Tribunal in its order states that there is no force in the argument that while other income is available for subscription of earlier year's depreciation brought forward to this year, the said depreciation will have to be adjusted against the profits and gains of the export oriented undertaking for allowing exemption in respect of such profits and gains. 7. At this stage, we should notice the definition of total income in terms of Section 2(45) of the Income Tax Act. Total Income has been defined as the total amount of income referred to in Section 5, computed in the manner laid down in this Act. Section 4 provides for charge of income Tax Act. Section 5 provides for scope of total income. Sub-Section 1 of Section 5 says that subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which- a) is received or is deemed to be received in India in such year by or on behalf of such person; or b) accrues or arises or is deemed to accrue or arise to him in India during such year or; c) accrues or arises to him outside India during such year; provided- that, in the case of a person not ordinarily resident in India within the meaning of Sub-section (6) of Section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India. Chapter III provides for incomes which do not form part of total income. Chapter IV provides for computation of total income. Section 32 of the Income Tax Act provides for deduction on depreciation. Section 32(2) provides for adjustment for subsequent years. If we see Section 10-B, it provides for exemption of payment of tax with reference to profits and gains derived by 100% export oriented undertaking. To arrive at a profit and gain, one has to unnecessarily take into consideration the total income in terms of the Act. To arrive at the income one has to take into consideration, the various additions and deletions in terms of the Act. In fact, the petitioner knowing fully (sic) has chosen to take into consideration the allow ability of depreciation for the purpose of calculation of total income. But curiously an argument has been advanced that exemption in terms of Section 10-B could also be on commercial basis not necessarily in terms of the calculation. We do not accept this submission. Section 10-B cannot be read in isolation of other provisions. It is only an exemption provision. Exemption cannot be fanciful and it has some rational with other provisions of the Act. Therefore, a combined reading of the definition of exemption, total income tax liability deductibility etc. , one has to come to a conclusion that calculation as far as possible is to be in terms of the Income Tax Act. That is exactly what has been done by the assessee. Having calculated in a particular manner, now it does not lie in the mouth of the assessee to contend contra in these proceedings. It cannot be argued that calculation so provided is on a mistaken basis or that could be on commercial basis. We are not prepared to accept this argument advanced by the assessee. Exemption also has to be scrutinized by the Department as otherwise there is every chance of exemption being mis-used by an assessee. It may be true that even after taking into consideration, the unabsorbed depreciation, the assessee may get exemption but none the less he cannot take only

a portion of depreciation just to suit his income for the purpose of nil liability and adjust the balance of unabsorbed depreciation for other business income once again to show nil liability. When the unabsorbed depreciation could have been taken for arriving an exempted income, the assessee cannot play with the figures for the purpose of showing nil liability as has been done in the case on hand. The intention of the Legislature is only to provide 100% exemption for export income and not for other income. The petitioner by dividing depreciation contrary to Section 32 has virtually taken exemption from payment of tax even for other business income in the case on hand. That cannot be allowed as rightly ruled by the Commissioner. The allowance of the depreciation by the Tribunal, in our view, is prejudicial to the interest of revenue as argued by the Department. The Tribunal has taken a narrow view of the matter without taking into consideration, the laudable object of exemption and at the same time providing for tax liability towards other liability. The interpretation has to be meaningful and acceptable and it cannot be against the intention of the legislation. Legislation never wanted the entire income to be exempted by taking advantage of Section 10-B of the Act. The approach of the Tribunal to our mind is incorrect and hence, we find substance in the argument of the revenue. 8. Several case laws have been placed before us by the parties concerned. 9. 155 ITR 120 (Distributors (Baroda) P. Ltd., v. Union of India and Ors.) deals with Section 80AA of the Income Tax Act. In the said Judgment, the Supreme Court has ruled that in so far as Sub Section (1) of Section 80M of the Income Tax Act is concerned, the deduction required to be allowed under that provision is liable to be calculated with reference to the amount of dividend computed in accordance with the provisions of the Act and forming part of the gross total income and not with reference to the full amount of dividend received by the assesses. 10. In case of 113 ITR 84, the Court considered as under: The question which arose in Cambay Electric Supply Go's case (113 ITR 84) was whether unabsorbed depreciation and unabsorbed development rebate were liable to be deducted in arriving at the figure of profits and gains exigible to deduction of 8% contemplated in Sub-section(1) of Section 80E. The argument of the assessee was precisely the same as the one advanced in the present case, namely, that the words "such profits and gains" in the latter part of Sub-Section/(1) of Section 80E were intended to refer only to the category of profits and gains referred to in the earlier part of that provision, namely, "profits and gains attributable to the business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule" and not to the quantum of the profits and gains included in the total income, so that the profits and gains exigible to the deduction of 8ft were the profits and gains attributable to the specified business in their entirety and not the profits and gains as computed in accordance with the provisions of the Act. The assessee contended that, in the circumstances, unabsorbed depreciation and unabsorbed development rebate were not liable to be deducted from the profits and gains attributable to the specified business for arriving at the figure exigible to the deduction of 8%. This argument of the assessee was rejected by the court and the court held

that the profits and gains exigible to the deduction of 8ft were profits and gains computed in accordance with the provisions of the Act and forming part of the total income and hence unabsorbed depreciation and unabsorbed development rebate were liable to be excluded from the profits and gains attributable to the specified business in arriving at the figure exigible to 8% deduction. 11. In the case of Commissioner of Income Tax v. Virmani Industries Pvt. Ltd., and Ors. in 216 ITR 607, the Court considered the issue of unabsorbed depreciation in terms of Section 32(2) of the Income Tax Act. 12. The Rajasthan High Court in the case of Commissioner of Income-Tax v. Sun Stone Engineering Industries Pvt. Ltd., has ruled that for the purpose of determination of the relief under Section 80HH of the Act, the gross total income of the assessee has to be worked out after deducting unabsorbed losses and unabsorbed depreciation and the income eligible for deduction under 80HH will be the net income as computed in terms of the provisions of the Act. The Rajasthan High Court again in the case of Commissioner of Income-tax v. Surendra Textiles in 258 ITR 387 ruled that: the gross total income of the assessee has to be worked out after deducting unabsorbed loss and unabsorbed depreciation and the income eligible for deduction Under Section 80HH of the Income-Tax Act, 1961, will be the net income as computed in accordance with the provisions of the Act and not the gross income. 13. The Bombay High Court in the case of Indian Rayon Corporation Ltd., v. Commissioner of Income-tax (261 ITR 99) has considered the depreciation in the matter of special deduction. In the said case, the following reference was made: whether on the facts and circumstances of this case, the Tribunal was justified in coming to the conclusion that depreciation allowance ought to be deducted while computing the total income for the purposes of deduction Under Section 80HH. The Bombay High Court noticed the case of Cambay Electric Supply Industrial Co. Ltd., v. CIT . After noticing the Bombay High Court ruled as under: The scheme of Sections 4 and 5 of the Income Tax Act does indicate that income-tax is a tax in respect of income computed as per the provisions of the Act. There is a distinct dichotomy between cases of computation of normal income under the Act de hors Chapter VI-A and computation of taxable income where the assessee claims the benefit of deduction under Chapter VI-A because the Legislature has intended that these special deductions should be restricted to the profits derived from a newly established undertaking. The Court ruled ultimately at page 107 reading as under: That Chapter VI-A, for the purposes of computing such deductions, constituted a separate code by itself. In order to compute the total taxable income of the assessee, deductions computed Under Section 80HH have to be reduced from the gross total income of the assessee. The question basically in this matter is concerning computation of deduction under Chapter VI-A in which Section 80HH falls. Profits and gains of a newly established undertaking, therefore, have got to be computed as per the provisions of Section 29 to Section 43A and if the assessee claims relief under Chapter VI-A of the Act, then it is not open to the assessee to disclaim depreciation allowance. This is because Chapter VI-A is an independent code by itself for computing these special types of deductions. In other words, one must first calculate the gross total income from which one

must deduct a percentage of incomes contemplated by Chapter VI-A. That such special incomes were required to be computed as per the provisions of the Act, viz., Section 29 to Section 43A, which included Section 32(2). Therefore, one cannot exclude depreciation allowance while computing profits derived from a newly established undertaking for computing deductions under Chapter VI-A. Therefore, the appellant's claim for allowance of deduction Under Section 80HH, without taking into consideration the current depreciation will have to be rejected. 14. All these Judgments would support the argument that calculation cannot be at the whims and fancies of an assessee for exemption of tax. It has to be in accordance with the provisions of the Act. 15. 199 ITR 235 is pressed into service by Sri. Parthasarathi, learned Counsel. We have carefully gone through the said Judgment. In the said Judgment, the Division Bench of the High Court has no doubt ruled that computation of profits and gains of new unit may be made without deducting depreciation and investment allowance. But the facts of the present case stands on a different footing compared to the facts in the case on hand. The petitioner has chosen to calculate depreciation in such a way that he has chosen nil liability. 16. He also relies on 106 ITR 399. In the said case, it is stated that Section 2(9) of the Act provides that the words and expressions used in the Act, but not defined in it and defined in the Income-tax Act, shall have the meanings respectively assigned to them in the Income-tax Act. The Court ruled that the basic material for the computation of surtax is the total income as computed under the Income-tax Act. Adjustments in that total income have to be made as specified in Schedule I. There is no provision in Schedule I for making any adjustment in respect of relief under Section 80-I and 80-J. The expression "part of income, profits and gains not includible in the total income" in Rule 4 of the second Schedule cannot be construed or understood as referring to deductions, allowances etc., made under the Income-tax Act for purposes of computation of total income. The contention of the Commissioner could, therefore, not be accepted. A reading of the said Judgment would show that it was rendered in totally different circumstances. 17. Taking into consideration, various aspects of the matter including the object of providing exemption in our view, the Commissioner is fully justified in holding that the assessee is not justified in showing nil return. We therefore, deem it proper to answer the questions of law in favour of the revenue. Consequently, the order of the Tribunal has to be set aside and the order of the Commissioner has to be accepted. No costs.