Commissioner Of Income Tax,Meerut, ... vs M/S Virmani Industries Private ... on 12 October, 1995

Equivalent citations: 1995 SCC (6) 466, JT 1995 (7) 322, 1995 AIR SCW 4160, 1995 (6) SCC 466, 1996 TAX. L. R. 89, 1995 KERLJ(TAX) 518, 1996 UPTC 245, (1996) 21 CORLA 234, (1995) 129 CURTAXREP 189, (1995) 216 ITR 607, (1995) 7 JT 322 (SC)

Author: B.P. Jeevan Reddy

Bench: B.P. Jeevan Reddy, S.B Majmudar

PETITIONER:
COMMISSIONER OF INCOME TAX,MEERUT, ETC. ETC.

Vs.

RESPONDENT:
M/S VIRMANI INDUSTRIES PRIVATE LIMITED, ETC. ETC.

DATE OF JUDGMENT12/10/1995

BENCH:
JEEVAN REDDY, B.P. (J)
BENCH:
JEEVAN REDDY, B.P. (J)
MAJMUDAR S.B. (J)

CITATION:
1995 SCC (6) 466 JT 1995 (7) 322
1995 SCALE (5)718

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T B.P. JEEVAN REDDY, J.

A common question arises in these three appeals. It relates to the meaning and interpretation of sub-section (2) of Section 32 of the Income-Tax Act. I would be enough if we state the facts in Civil

Appeal No.1052 of 1976.

The respondent-assessee, Virmani Industries Private Limited, was engaged in the manufacture of soap and oil during the previous year relevant to the Assessment Year 1956-57. The business was stopped in that year whereafter the factory was let out on hire. Ten years later, i.e., in the previous year relevant to Assessment Year 1965-66, the assessee started the business of manufacture of steel pipes. For the purpose of this business a part of the old machinery used i the manufacture of soap and oil was utilised.

In the assessment proceedings relating to Assessment Year 1956-57, depreciation under Section 32(1) (ii) was found to be more than the profits and gains of the assessee for that assessment year. In the assessment proceedings relating to Assessment Year 1965-66, the assessee claimed that the unabsorbed depreciation, to the extent it pertained to the old machinery utilised in the new business, should be brought forward and set off against the profits of the new business. This claim was rejected by the Income Tax Officer and by the Appellate Assistant Commissioner on the ground that such a set off is permissible only where the business carried on in the subsequent assessment year is the same business which was carried on in the earlier assessment year. The Income Tax Appellate Tribunal, however, disagreed with the said view and upheld the assessee's. At the request of the Revenue, the Tribunal referred the following question to the Allahabad High Court under Section 256(1) of the Income-Tax Act, 1961:

> "Whether on the facts and in the circumstances of the case the unabsorbed depreciation in respect of a part of the machinery used in the soap and oil manufacturing business which was again used for the new business of manufacture of steel pipes should be allowed to be set off against the profits of the new business of manufacture of steel pipes carried on by the assessee in the accounting period relevant to the assessment year 1965-66 ?".

The High Court answered the question in the affirmative, i.e., in favour of the assessee. The High Court understood Section 32(2) to mean:

> 1. in computing the net income from the business, deduction is to be allowed on account of depreciation of buildings, plants and machinery, etc. used in the business at the prescribed rate. If such depreciation allowance cannot be completely absorbed by the "profits and gains chargeable to tax" - which expression includes profits and gains arising not only under the head "business" but also under other heads - Then the unabsorbed depreciation is treated to be the depreciation allowance for the next year and so on until it is completely wiped out.
>
> 2. there is a distinction between business loss and unabsorbed depreciation. The limitations applicable to carrying forward of unabsorbed depreciation. In other words, it is not necessary that the same business should be continued in the following assessment year nor is it necessary that the machinery which earned the depreciation in the previous year should also be used for the purpose of the business in the

> following year. All that is necessary is that the assessee must carry on some business in the succeeding year in which the set off of the unabsorbed depreciation is claimed. If there is no business, there can be no depreciation allowance but it does not follow that the business in the succeeding year should have some depreciable assets. Even if there are no depreciable assets, yet the unabsorbed depreciation of the previous year has to be carried forward and deemed to be the depreciation allowance for the succeeding year. Similarly there is no limitation that the unabsorbed depreciation can be carried forward only for eight years.

In view of the above understanding of Section 32(2), the High Court held that the assessee was entitled to set off the unabsorbed depreciation allowance relating to the assessment Year 1956-57 against the income of the Assessment Year 1965-66. The High Court disagreed with the view taken by the Bombay High Court in Sahu Rubber Private Limited v. Commissioner of Income-tax [(1963) 48 I.T.R.464]. It was of the opinion that the view taken by it is supported by the decision of this Court in Commissioner of Income-tax v. Jaipuria China Clay Mines (P) Limited {(1966) 59 I.T.R.555].

While it is not necessary to state the facts in Civil Appeal No.2849 of 1977, it is sufficient to state that in this decision the Bombay High Court followed the decision of the Allahabad High Court in Commissioner of Income Tax v. Virmani Industries (P) Ltd. [(1974) 97 I.T.R. 461]. It distinguished its earlier decision in Sahu Rubbers Private Limited as one rendered with reference to the proviso to Section 10(2) (vi) of the Indian Income-Tax Act, 1922. The Court held that though the said proviso corresponds to Section 32(2) of the present Act, even so the fact that it was only a proviso, and not a substantive provision, did colour the decision in Sahu Rubber Private Limited. The Court pointed out that under the present Act Section 32(2) is an independent and a substantive provision.

It is brought to our notice by Dr. Gauri Shankar, learned counsel for the appellant-Revenue that there has been a divergence of opinion among the High Courts in the country as to the meaning and interpretation of Section 32(2). He referred to the decision of the Madras High Court in East Asiatic Company Private Limited v. Commissioner of Income-Tax [(1986) 161 I.T.R. 135] taking the view that for claiming the benefit of Section 32(2), it has to be established that the assessee was carrying on the same business as in the previous year and that if the business is not in existence in the following year, the unabsorbed depreciation of the previous year cannot be adjusted in such following year. It accepted the decision of the Bombay High Court in Sahu Rubber Limited as laying down the correct law and disagreed with the basis and reasoning on which the said decision was distinguished in the later decision of that Court in Commissioner of Income Tax v. Estate and Finance Limited [(1978) 111 I.T.R. 119]. Dr Gauri Shankar brought to our notice that Madras High Court had indeed taken the said view even earlier in Commissioner of Income Tax v. Dutt's Trust, Calicut [(1942) 10 I.T.R. 477] and Tube Suppliers Ltd. v. Commissioner of Income Tax [(1985) 152 I.T.R. 694]. Counsel further pointed out that in yet another decision of the Bombay High Court in Hindustan Chemical Works Ltd. v. Commissioner of Income Tax [(1980) 124 I.T.R. 561], a similar view has been expressed. Dr. Gauri Shankar has fairly brought to our notice that besides the Allahabad High Court in Virmani and the Bombay High Court in Estate and Finance Limited, the Calcutta High Court in Commissioner of Income Tax v. Kishanlal and sons (Udyog) Pvt. Ltd. {(1985)

154 I.T.R. 735], Andhra Pradesh High Court in Hyderabad Construction Co. Ltd. v. Commissioner of Income Tax [(1981) 129 I.T.R. 81] and Karnataka High Court in Additional Commissioner of Income Tax v. Kapila Textiles (P) Ltd. [(1981) 129 I.T.R. 458) have taken a view similar to the one taken by the Allahabad High Court in Virmani.

The provision in Section 10(2) (vi) of the Indian Income Tax Act, 1922 owes its origin to the U.K. Income Tax Act, which was prior to its consolidation in 1952, administered through the provisions made in the Annual Finance Acts. The Finance Act of 1918, read with some changes made in 1925, dealt with this specific provision. This provision (which appeared later as Section 323(2) of the U.K. Income Tax Act, 1952) was as follows:

> "Where full effect cannot be given to any such allowance as aforesaid in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall, for the purpose of making the assessment for the following year, be added to the amount of such allowances, or, if there are no such allowances for that year, be deemed to be the allowances for that year, and so on for succeeding years."

This provision was adopted almost verbatim in the Indian Income Tax Act, 1922. As in the U.K. Act, the Indian Act also did not place any limit regarding the number of years upto which unabsorbed depreciation could be claimed for set off.

In 1936, an Income Tax Inquiry Committee, headed by J.B. Vacha, looked into the provision and made recommendation that as the allowance for depreciation is on account of loss in the value of land and machinery, such loss should only be regarded as an expense of the year in which it occurred and, therefore, depreciation should be allowed each year as expense in determining profit or loss of the year along with the other items of expenditure, as for instance, rent, insurance charges, etc. and the resultant loss, if any, should be carried forward and dealt with in the general section on carry forward. The Committee recommended that the special provision for carry forward of depreciation without limit of time should be abolished. This recommendation along with some others, was incorporated in this Bill introduced in the Assembly, but the Select Committee did not approve of the recommendation and retained the original clause as it stood, thus placing the carry forward of depreciation on a different footing from carry forward of loss. [See Para 454 of the Indian Income Tax Act, Vol.II by A.C. Sampath Iyengar, IVth Edn., 1952].

The provision in the Income Tax Act, 1922 remained unamended till 1961. The provision as it stood in 1937 was as follows:

> "Where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, 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 year and deemed to be part of that

> allowance, or, if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years."

The above provision was enacted in the 1961 Act as Section 32(2). The additional word "previous" after the word "following" is the result of a drafting change suggested by the XIIth Report of the Law Commission, which gave the draft for a new enactment of the Income Tax law. [This draft Bill given by the Law Commission was the basis of the Income Tax Act, 1961].

Let us now turn to Section 32(2) and also note certain other relevant provisions. Section 32(1) of the Income-Tax Act provides for depreciation on buildings, machinery, plant, etc. owned by the assessee and used for the purpose of the business or profession. The rates of depreciation vary. Sub-section (2) of Section 32, as it stood at the relevant time, read thus:

> "32(2) where, in the assessment of the assessee or, if the assessee is a registered firm (or an unregistered firm assessed as a registered firm, in the assessment of its partners) full effect cannot be given to any allowance under clause (i) or clause (ii) or clause (iv) or clause (v) or 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."

(Emphasis added) Section 57 provides for deductions out of income from other sources chargeable under Section 56. One of the deductions provided by Clause (ii) of Section 57 is the depreciation provided by sub-section (1) as well as sub- section (2) of Section 32.

Inasmuch as Section 32(2) refers to sub-section (2) of Section 72 and sub-section (3) of Section 73, it would be appropriate to reproduce the said provisions. Sub-section (2) of Section 72 says:

> "(2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section."

(One of the reasons for providing this preference in favour of business loss may be the time-limit of eight years applicable thereto besides the other limitation that for availing of the said benefit, the business carried on in the subsequent year should be the same business as was carried on in the preceding year.) Sub-section (3) of Section 73 reads:

> "(3) In respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in

relation to speculation business as they apply in relation to any other business."

We may first consider the meaning of the expression "profits or gains chargeable". On first impression, the said expression appears to refer only to profits or gains of business or profession chargeable under Section 28. But this court has repeatedly held that the said expression is not so confined and that it refers to income under all the heads of income specified in Section 14. In Jaipuria China Clay Mines (P) Limited, the facts were these: the total income of the respondent-assessee for the Assessment Year 1952-53 before charging depreciation was Rs.14,041/-. After deducting depreciation of Rs.5,360/-, the Income Tax Officer computed the profit at Rs.8,681/-. Against this profit, he set off the losses of an earlier year. Having done this, the Income Tax Officer computed the income of the assessee from dividends at Rs.2,01,130/- and levied tax on it. The assessee claimed that the unabsorbed depreciation aggregating to Rs.76,857/- should be deducted from the dividend and if it is so done, the total income would get reduced to Rs.1,32,955/-. The Income Tax Officer rejected the claim. When the matter was ultimately carried to this Court, it took note of the opening words of sub-section, viz., "where, in the assessment of the assessee or if the assessee is a registered firm, in the assessment of its partners, full effect cannot be given to any such allowance....." and held on that basis that the expression "profits or gains chargeable" in the said sub-section is not confined to profits and gains from business or profession but takes within its ambit all heads of income. This Court was of the opinion that while amending Section 10(2) (vi) of the Indian Income Tax Act, 1922 by the Amendment Act 25 of 1953, the Parliament has accepted the interpretation placed upon the said expression by several High Courts to the above effect. It referred to the decisions of Lahore High Court in Karam Ilahi Mohammad Shafi v. Commissioner of Income Tax [(1929) 3 I.T.C. 456], Madras High Court in A. Suppan Chettiar & Co. v. Commissioner of Income Tax [(1929) 4 I.T.C. 211], East Punjab High Court in Laxmichand Jaipuria Spg. & Wvg. Mills. In re. [(1950) 18 I.T.R. 919] and Bombay High Court in Ambika Silk Mills Co. Ltd. v. Commissioner of Income Tax [(1952) 22 I.T.R. 58] besides the judgment of the Judicial Commissioner, Nagpur in Ballarpur Collieries v. Commissioner of Income Tax [(1929) 4 I.T.C. 255] interpreting the said expression as covering all heads of income. The Court further pointed out that even after the said amendment, the Bombay and Gujarat High Courts have taken the same view in Commissioner of Income Tax v. Ravi Industries Ltd. [(1963) 49 I.T.R. 145] and Commissioner of Income Tax v. Girdharlal Harivallabhadas Mills Company Limited [(1064) 51 I.T.R. 693] respectively. The contrary view taken by the Madras High Court in Commissioner of Income Tax v. B. Nagi Reddy [(1964) 51 I.T.R. 178] was disapproved. The court then observed:

> "Bearing these two considerations in mind, if one looks at the language of proviso (b) to section 10(2) (v), the first question that arises is: What is the meaning of the expression "in the assessment of the assessee or if the assessee is a registered firm, in the assessment of the partners, full effect cannot be given to any such allowance in any year?" Taking the case of the partners of a registered firm, the assessment must be their individual assessment, i.e, assessments in which the profits from the firm and other sources are pooled together. The legislature is clearly assuming that effect can be given to depreciation allowance in the assessment of a partner; the only way effect can be given in the assessment of a partner is by setting it of against income, profits and gains under other heads. The learned counsel for the revenue tried to

> meet this inference by suggesting that what the legislature contemplated was an assessment of those partners who were carrying on other business. But in our opinion this suggestion is unsound. What would happen if a partnership consists of four partners, two carrying on other business, Mr. Sastri was unable to explain. Now, if this is the inference to be drawn from these words, it is quite clear that the words "no profits or gains chargeable for that year" are not confined to profits and gains derived from the business whose income is being computed under section 10."

To the same effect is the decision in Rajapalayam Mills Ltd. v. Commissioner of Income Tax. Madras [(1978) 115 I.T.R. 777]. The Court observed that when the profits or gains of a business for a particular assessment year are to be computed under Section 10 (of 1922 Act), the current depreciation allowance for the assessment year in question is deductible under clause (vi) of Section 10(2), but the depreciation allowance of the preceding years would be liable to be taken into account only if, and to the extent to which, it is not absorbed by the total income of the assessee computed under different heads and chargeable to tax for those assessment years. The Court observed:

> "Now, it is well settled, as a result of the decision of this court in CIT v. Jaipuria China Clay Mines (P) Ltd., [1966] 59 ITR 555 (SC), that the words `no profits or gains chargeable for that year' are not confined to profits and gains derived from the business whose income is being computed under s.10, but they refer to the totality of the profits or gains computed under the various heads and chargeable to tax."

and added:

> "It is, therefore, clear that effect must be given to depreciation allowance first against the profits or gains of the particular business whose income is being computed under s.10 and if the profits of that business are not sufficient to absorb the depreciation allowance, the allowance to the extent to which it is not absorbed would be set off against the profits of any other business and if a part of the depreciation allowance still remains unabsorbed, it would be liable to be set off against the profits or gains chargeable under any other head and it is only if some part of the depreciation allowance still remains unabsorbed that it can be carried forward to the next assessment year..... But where any part of the depreciation allowance remains unabsorbed after being set off against the total income chargeable to tax, it can be carried forward under prov. (b) to cl. (vi) to the following year and set off against the year's income and so on for succeeding years. The method adopted by the statute for achieving this result is that the carried forward depreciation allowance is deemed to be part of and stands on exactly the same footing as the current depreciation for the assessment year and is thus allowable as a deduction under cl.(vi)."

Both these decisions are rendered by a Bench of three learned Judges and are binding upon us.

The next question is whether for availing the benefit of Section 32(2), is it necessary that the business carried on in "the following previous year" should be the same business as was carried on

in the preceding previous year as has been held by the Madras High Court in East Asiatic Company Private Limited. We are of the opinion that in the absence of any words to that effect, no such requirement ought to be read into the said sub-section. A look at Section 72 shows that where the Parliament intended to provide such a limitation, it did so expressly. Section 72 deals with carry-forward and set off of business loss. The proviso to clause (1) of sub-section (1) of Section 72 expressly provides that such a course is permissible only where "the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant for that assessment year". In the absence of any words to that effect, it must be held that for availing the benefit of Section 32(2), it is not necessary that the business carried on in the following year is the same business as was carried on in the previous year.

The other question is whether the assets which earned the depreciation in the preceding year should exist and should continue to be used for the purpose of business in the following year. In the absence of any words in the said sub-section to that effect, we cannot read this requirement also into the said sub-section. This is evident from the words "or if there is no such allowance for that previous year, be deemed to be the allowance for the previous year"

> occurring in the sub-section.
>
> Yet another question which has to be answered before we can answer the question concerned in this appeal is whether it is necessary that in the following year the assessee must carry on business, i.e., some or other business, to avail of the benefit of the said sub-section? Two views are possible in this behalf, viz., (1) since the sub-section speaks of unabsorbed depreciation being carried forward to the next year and "added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance" the sub-section necessarily contemplates existence of a business in the following year and (2) inasmuch as the sub-section not only speaks of adding the unabsorbed depreciation to the depreciation allowance allowed in the following year but also says that in the absence of such allowance, the carried forward depreciation allowance shall be the allowance for that year, it means that in the following year the assessee need not carry on any business or profession for availing the benefit of sub-section (2) of Section 32. We are inclined to adopt the second of the above two views having regard to the decisions of this Court in Jaipuria China Clay Mines (P) Limited and Rajapalayam Mills Limited. We have extracted the relevant observations from both the judgments hereinabove, which say that the unabsorbed depreciation allowance has not only to be set off against other heads of income in the relevant previous year but where it is carried forward, it "stands on exactly the same footing as the current depreciation".

Now, coming back to the facts of this case, the assessee had carried on a business in the accounting year relevant to the Assessment Year 1956-57. Then there was a gap of about eight years whereafter he started a new business in the accounting year relevant to the Assessment Year 1965-66. In the intervening years, he was in receipt of income from property only. The assessee did not claim that the unabsorbed depreciation relating to the Assessment Year 1956-57 should be set off against the

property income in the said intervening years. He made such a claim only when he commenced another business in the accounting year relevant to the Assessment Year 1965-66, i.e., in the assessment proceedings relating to Assessment Year 1965-66. Probably, the assessee was under the impression that he was not entitled to set off the unabsorbed depreciation until and unless he had income from business in the following year. (He seems to have been under yet another impression, viz., not only should he have business income in the following year to claim the benefit of Section 32(2) but also that the very same assets should also be used for the business in the following year. This is evident from the fact that his claim for setting off the unabsorbed depreciation allowance was confined to the extent it pertained to the old machinery utilised in the new business.) In the light of the interpretation of sub-section (2) of Section 32 affirmed by us in this judgment, however, what should have been done is this: the unabsorbed depreciation allowance relating to the Assessment Year 1956-57 should have been set off against the income (income from property) in the following year, i.e., in the following previous year (relevant to assessment Year 1957-58) and if the income in that year was not sufficient to absorb the entire depreciation allowance so carried forward, it had to be carried forward to the next following year and so on. Only if some depreciation allowance still remained to be absorbed, it could have been set off against the total income for the Assessment Year 1965-66.

It is true that the question which was referred to the Tribunal under Section 256(1) of the Income Tax Act merely raises the question whether the unabsorbed depreciation pertaining to the Assessment Year 1956-57 can be carried forward and set off against the income for the accounting year relevant to the Assessment Year 1965-66, yet we thought it necessary to clarify the true position of law. We answer the aforesaid question in the following words:

> If after setting off the unabsorbed depreciation allowance relating to the Assessment Year 1956-57 against the income for the following assessment years, any depreciation allowance still remained unabsorbed it could have been set off against the income for the accounting period relevant to the Assessment Year 1965-66.
>
> In the light of the views expressed by us hereinabove, it is not necessary to go into the question raised by Dr. Gauri Shankar, learned counsel for the Revenue with respect to the meaning of the words "the following previous year". The contention of the learned counsel was that the said expression means literally what it says and it does not mean any following previous year. His submission was that if the chain of setting off snaps for the reason that there is no income in any of the following years, it snaps once for all and that the process of setting off cannot be restarted.
>
> For the above reasons, Civil Appeal No. 1052 of 1976 is disposed of in the above terms and the question referred by the Tribunal under Section 256(1) of the Income Tax Act, 1961 is answered in the terms aforesaid. No costs.
>
> The question referred to the High Court in Civil Appeal No. 2840 of 1977 runs thus:

"Whether on a proper interpretation of sections 56, 57(ii) and 32(2) of the Income-Tax Act, 1961, the unabsorbed depreciation of Rs.70,700/- brought forward since 1952-53 could be set off against the business income assessed in the assessment year 1963-64 when the source in respect of which the depreciation was computed has ceased to exist"?

Since the facts of this appeal are rather involved and we did not have the assistance of the counsel for the assessee (the assessee remained unrepresented), we think it appropriate to remand the matter to the High Court for disposal afresh in accordance with law and this judgment. This appeal is allowed accordingly. No costs. CIVIL APPEAL NO.7372 OF 1995:

The High Court has refused to answer the reference, made at the instance of the Revenue, on the ground that the Revenue has failed to file the paper-book inspite of a period of ten years having elapsed since the reference. At the same time, the Court noted the submission of the learned counsel for the Revenue that the question referred herein is concluded by the decision of the said Court (Bombay High Court) in Estate and Finance Limited. In view of our judgment in Estate and Finance Limited, we allow this appeal also and remit the same to the High Court with a request to dispose it of according to law and in the light of this judgment. No costs.