Income Tax Appellate Tribunal - Ahmedabad
Agro Alloys Mfg. Co. vs Income-Tax Officer on 15 December, 1982
Equivalent citations: 1983 4 ITD 180 Ahd
Bench: K Thakore, Y Meena
ORDER K.T. Thakore, Accountant Member

1. This set of six appeals though relate; to the different assessees involve a common ground and, therefore, for the sake of convenience they are disposed of together by this combined order.

2. We first proceed to deal with IT Appeal No. 2304 (Ahd.) of 1981 which relates to the assessment years 1979-80 and our decision in this appeal would govern our decision on the identical point in other appeals also. The assessee is a registered firm which derives income from manufacture of circles from aluminium ingots. The assessee, inter alia, claimed relief under Section 80HH of the Income-tax Act, 1961 ('the Act'), at 20 per cent of its profits and gains of business. The ITO restricted the claim to 20 per cent of Rs. 85,103 being the divisible income as determined prior to adjustment of interest to partners which was disallowed under the provisions of Section 40(b) of the Act. The said disallowance worked out. to Rs. 93,558. It may be stated that the ITO made the above computation without any discussion in his order.

3. Being aggrieved, the assessee carried the matter in appeal before the Commissioner (Appeals) and contended that interest disallowed under Section 40(b) form part and parcel of profits and gains of the business of the assessee and, therefore, deduction under Section 80HH should be determined with reference to gross amount of profits after making the disallowance under Section 40(b) and not on basis of net amount of profit fife hors the said disallowance. The learned Commissioner, however, did not find any substance in this argument. He pointed out that profits and gains of business have to be understood in normal commercial sense which would mean the net amount of profit as determined by the ITO before disallowance under Section 40(b). In other words, according to the Commissioner (Appeals) the relief under Section 40(6) had to be determined with reference to divisible income of the firm and not with reference to the income from profits and gains of business as determined under Section 28 of the Act. In coming to this decision, the Commissioner (Appeals) relied on the provisions of Section 80E.

4. Being aggrieved the assessee has come up in appeal before us. The learned representative of the assessee submitted that relief under Section 80HH had to be determined with reference to the income as determined in accordance with the provisions of the Income-tax Act which would include disallowance of interest paid to partners under Section 40(6). It was not possible to give the restricted meaning to provisions of Section 80HH as held by the Commissioner (Appeals). The learned departmental representative on the other hand supported the order of the Commissioner (Appeals) pointing out that relief under Section 80HH has to be determined in respect of profits 'derived from' industrial undertaking to which the provisions of the said section were applicable. There is no dispute that the provisions of Section 80HH were applicable in the instant case. The only controversy centered round the determination of the relief due, i.e., whether with reference to the net amount of profits excluding interest under Section 40(b) or on the gross amount of income from business inclusive of disallowance under Section 40(b). Relying on the observations of the

Supreme Court in the case of Carnbay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84, Shri Vaidya submitted that in that case the Supreme Court had occasion to construe the expressions 'attributable' and 'derived from.' It has been stated that the expression derived from is of narrower amplitude than the expression attributable to. Since the expression used in Section 80HH is derived from a restricted construction should be given in determining the profits and gains of the industrial undertaking to which the provisions of Section 80HH are applicable.

5. We have considered the rival submissions. In order to appreciate the controversy, we set out the provisions of Section 80HH as are relevant for our purpose:

(1) Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, or the business of a hotel, to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an, amount equal to twenty per cent thereof.

This section forms part of Chapter VI-A of the Act, which deals with deductions from the gross total income. It states that where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking to which the provisions of this section apply, there shall be allowed in computing the total of income of the assessee a deduction of 20 per cent of the amount of such profits. It Cambay Electric's case (supra), the Supreme Court while dealing with the provisions of Section 80E as is stood have laid down the following steps which are required to be taken before the special deduction is allowed. The said steps are as follows:

First, compute the total income of the concerned assessee in accordance with the other provisions of the Act, i.e., in accordance with all the provisions except Section 80E ; secondly, ascertain what rart of the total income so computed represents the profits and gains attributable to the business of the specified industry (here generation and distribution of electricity) ; and, thirdly, if there be profits and gains so attributable, deduct 8 per cent thereof from such profits and gains and then arrive at the net total income exigible to tax. As regards the first step mentioned above, the important words in Sub-section (1) are those that appear in parenthesis, namely, 'as computed in accordance with the other provisions of this Act' and these words clearly contain a mandate that the total income of the concerned assessee must be computed in accordance with the other provisions of the Act without reference to Section 80E and since in the instant case it is income from business the same as per Section 29 will have to be computed in accordance with Sections 30 to 43A which would include Section 41(2). It is also clear that under the second step the profits and gains attributable to the business of the specified industry (here generation and distribution of electricity) forms a component of the total income spoken of in the first step. Reading these two steps together, therefore, it is obvious that in computing the total income of the concerned assessee the balancing charge arising as a result of the sale of old machinery and buildings and worked out as per Section 41(2), irrespective of its real character, will have to be taken into account and included as income of the business. In other words, the balancing charge as worked out under Section 41(2) will have to be taken into account before computing the deduction of 8 per cent under the third step. On proper construction of Sub-section (1) and having regard to the legislative mandate contained in the three

steps that are required to be taken in the manner indicated above we are clearly of the view that the item of Rs. 7,55,807 will have to be taken into account before computing the 8 per cent deduction contemplated by the said provision. (p. 91) It is true that the expression 'as computed in accordance with the other provisions of this Act' do not appear in Section 80HH of the Act. The scheme of Section 80HH is slightly different inasmuch as it deals with deductions from gross total income. The expression 'total income' is defined in Section 80B(5) which means total income computed in accordance with the provisions of this Act before making any deduction under this chapter or under Section 280-O. Therefore, the aforesaid expression finds its place in the definition clause itself as stated above. It, therefore, does not make any difference so far as applicability of Section 80HH's concerned. If the first step is applied, then it would require computation of profits and gains in accordance with the provisions of the Act, namely, Sections 28 and 29 of the Act. The latter section requires computation of profits and gains in accordance with the provisions laid down in Sections 30 to 44A of the Act. Thus, once having determined the total income it will be the gross total income for the purpose of Section 80HH. The second step is to cull out the profits and gains derived from the industrial undertaking. In doing so, the disallowance under Section 40(b) has to be taken into consideration as the interest paid to partners is nothing but appropriation of profits by the firm. The character of interest to partners is in no way different than the other profits as it would be evident from the following observations of the Supreme Court in CIT v. R.M. Chidambaram Pillai [1977] 106 1TR 292. At page 296 it is stated as follows:

The scheme of the Act, eyeing it with special reference to Sections 10(4)(6) and 16(1)(b), designate employee's salary as profit, where the servant is none other than a partner, i.e., co-owner of the business. If such be the rationale of the relevant provisions, the key to the solution of the problem is within easy reach.

Salaries are profits known by a different name and must be treated as such for taxation purposes ...

Section 10(4)(6) is a special provision ; so also Section 16(1)(b). Parliament has power to provide for possible leakages and safeguard against loss of revenue. Oftentimes, partners siphon off substantial profits in the guise of salaries and so arrange such distribution of income via salaries that tax evasion becomes legally protected. To pre-empt such possibility the law has gone out of its way to exclude manipulation by including salaries as profits. The special provision cannot alter the nature of salaries as is obvious in commercial calculations, striking of balance-sheets, in suing for unpaid salaries and the like. Moreover, Indian law does recognise a firm as a person for many purposes and the contrary tenor of English law has no tenability in our country. The very need for Sections 10(4)(6) and 16(1)(6) stresses that otherwise 'salary' will retain its true character and not be regarded as profits. The other categories in both these sections also bring home the purpose to be to prevent evasion, not to inject jurisprudential changes.

Since the character of salary, interest, commission or other remuneration paid to a partner by the firm is the same, applying the above principle to the interest paid to partners the interest has to be treated as profit for the purpose of profit of the industrial undertaking for the purpose of determining the relief under Section 80HH. Once these profits are so determined 20 per cent relief as set out in the third step has to be determined. There is no dispute that the relief at 20 per cent is

exigible to the industrial undertaking in question.

6. There is one more aspect of the matter and that is provisions laid down in Section 80HH are intended to give relief to industrial undertakings which are set up in specified areas. In construing the above provisions we have to bear in mind the observations of their Lordships of the Gujarat High Court in the case of CIT v. Satellite Engg. Ltd. [1978] 113 ITR 208 as follows:

... the legislature has been progressively relaxing the provisions relating to earning of tax benefits by new industrial undertakings, the end in view being to encourage the setting up of new industries by substantial investment of new capital. Any interpretation of such provision must, therefore, be in consonance with this avowed aim and object of the legislature and not such as would defeat the same. (p. 216) Therefore, viewed from any angle the decisions of the authorities below are clearly unsustainable and the relief due to the assessee has to be determined with reference to gross amount of profit after including interest to partners as aforesaid.

7. Now we turn to IT Appeal Nos. 2306 and 2307. The assessee is a registered firm which carries on business in manufacture and sale of electric starters, voltage stabilizers, etc. It, inter alia, claimed relief under Section 80HH on the basis of gross amount of its profits inclusive of interest and salary paid to partners amounting to Rs. 59,065, for the assessment year 1978-79. Similarly, for the assessment year 1979-80 it claimed relief under Section 80HH on the gross amount of profit inclusive of interest to partners amounting to Rs. 74,229. Both the ITO as well as the AAC negatived the contention of the assessee and held that the assessee was entitled to relief under Section 80HH on basis of the net amount of profit exclusive of interest paid to partners which was disallowed under Section 40(b).

8. For the reasons set out in detail in IT Appeal No. 2304 (Ahd.) of 1981 (supra) we uphold the contention of the assessee and direct the ITO to allow relief to the assessee on the basis of gross amount of profits inclusive of amount disallowed under Section 40(b) as are relatable to the industrial undertaking in question, for both the years under appeal.

9. Now we turn to IT Appeal Nos. 2308 to 2310. The controversy involved in these appeals are identical with that discussed by us in the appeals relate to two assessees earlier. The only difference is in regard to the assessment year 1977-78. For that year the ITO allowed relief under Section 80HH as claimed by the assessee and thereafter, proceeded to rectify the assessment under Section 154 of the Act and in the process, inter alia, restricted the relief under Section 80HH on the net amount of profits after excluding interest disallowed under Section 40(b).

This view of the matter was upheld by the Commissioner (Appeals).

10. Before us, this decision is challenged not only on the ground that the relief has not been properly allowed but also on the ground that order under Section 154 was erroneous and not maintainable. Taking the second ground first, we agree with the learned representative of the assessee that the question relating to relief under Section 80HH is a highly complex issue and, therefore, in order to withdraw relief initially granted proceedings under Section 154 would not lie. Inotherwords.it could

not be said that there was patent error in the order of the ITO while he allowed relief under Section 80HH after including the interest disallowed under Section 40(6). The orders of the authorities below are liable to be quashed on this ground. We are, however, not restricting our decision on this point alone but also holding that on merit, for the reasons set out in detail in IT Appeal No. 2304 (Ahd.) of 1981, the assessee is entitled to relief under Section 80HH on the basis of gross amount of profits inclusive of interest disallowed under Section 40(6).

11. Now coming to the assessment years 1978-79 and 1979-80, it is agreed by both the sides that the controversy is fully covered by our decision in IT Appeal No. 2304 (Ahd.) of 1981 and except that the figure of business income and the interest disallowed under Section 40(b) are different, there is no distinction in regard to the claim as made by the assessee for relief under Section 80HH.

12. For the reasons set out in IT Appeal No. 2304 (supra) we uphold the contention of the assessee for both the years and direct the ITO to allow relief under Section 80HH on the basis of gross amount of profits as determined by him including interest under Section 40(6).

13. In the result all the appeals are allowed.