

CASE NO.:
Appeal (civil) 2474 of 1991

PETITIONER:
COMMISSIONER OF INCOME TAX, HYDERABAD

RESPONDENT:
P.J. CHEMICALS LTD. ETC.

DATE OF JUDGMENT: 14/09/1994

BENCH:
M.N. VENKATACHALIAH, C.J. & S.C. AGRAWAL

JUDGMENT:
JUDGMENT

1994 SUPPL. (3) SCR 561

The Judgment of the Court was delivered by

VENKATACHALIAH, CJI. The first batch of cases consists of both civil appeals and petitions for grant of special leave preferred by the Revenue assailing the correctness of the opinion pronounced by several High Courts on a question of law referred to them for opinion on cases stated under Section 256 of the Income Tax Act, 1961. In some of the cases, there are some delays in filing them. We condone the delays. In the special leave petitions, we grant special leave. These are cases in which the High Courts have held that subsidies granted to industries on a percentage of the capital cost are not deductible from the "actual cost" under Section 43(1) of the Act for purpose of calculation of depreciation etc.

2. The second batch consists of matters in which the High Court has taken a contrary view against the assessee and where the assessee has come up in appeal. There is thus a divergence of judicial opinion on this question.

3. We may refer to the facts of one case on either side to place the controversy in perspective.

In Civil Appeal No. 2474 of 1991, the Commissioner of Income-tax, Andhra Pradesh-I, Hyderabad has questioned the correctness of the order dated 28.11.90 of the Division Bench of the Andhra Pradesh High Court in Income Tax Case No. 267 of 1989, The respondent-assessee, M/s P.J. Chemicals Ltd., filed its return of income for the assessment year 1983-84 declaring a net loss of Rs. 6,90,643. In the course of its return, the assessee had capitalised the entire pre-operative expenditure amounting to Rs. 25,64,395 and claimed depreciation thereon. There were, however, some disallowances of the items in this capitalisation and a ratio of 80:20 was accepted as the formula for ascertaining the capital. That, however, is not the controversy in this appeal. The point is as to the deductibility of a central subsidy of Rs. 9,97,085 which the assessee had received from the "actual cost" for purposes of calculation of depreciation etc. The Income Tax Officer was of the opinion that the statutory concept of "actual cost" in Section 43(1) compelled the deduction of this sum of Rs. 9,97,085. He did so accordingly. In the appeal preferred by the assessee before the Commissioner of Income Tax (Appeals)-II, Hyderabad, the appellate authority following the Board's Circular No. 190 dated 1.3.76 upheld the order of the Income Tax Officer and affirmed the deduction. Before the Appellate Commissioner, the assessee had placed reliance on the decision of the Andhra Pradesh High Court in Commissioner of Income Tax v. Godavari Plywoods Ltd., (168) ITR 632; but the appellate authority was not persuaded.

In the second appeal before the Income Tax Appellate Tribunal, Hyderabad

Bench in I.T.A. No. 1507/Hyd./87, the Tribunal reversed the authorities below and allowed the assessee's appeal. The Tribunal said :

"In this short appeal preferred by the assessee for assessment year 1983-84, the only substantial ground take pertains to the deduction of the sum of Rs. 9,97,085 being the Central Subsidy from the cost of the relevant asset resulting in the slashing of allowance admissible under the income-tax Act.

2, We have heard the learned representative on both sides. On behalf of the assessee reliance has been placed on a decision of the A.P. High Court in Commissioner of Income-Tax v, Godavari Plywood Ltd., (169) ITR 632 wherein it has been held that a subsidy like the case in made cannot be deducted in computing the actual cost and the depreciation will have to be calculated on the cost without deducting therefrom the subsidy amount."

4. At the instance of the Revenue, the Income Tax Appellate Tribunal stated a case and referred the following question of law for the opinion of the High Court:

"Whether on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal is justified in holding that Central Subsidy should not be deducted from the actual cost of assets for purpose of allowing depreciation?"

5. On a consideration of the matter the High Court following its earlier view in Godavari Plywoods' case (supra) answered the question in the affirmative and against the Revenue. The Revenue has now come up in appeal.

6. Civil Appeal No, 3699 of 1990 is a case typical of the opposite point of view where the assessee has come up in appeal. The appellant, M/s Jank Steel Tubes Pvt. Ltd., filed returns of income for the assessment year 1978-79 declaring a loss. Some time thereafter the appellant revised its returns. It claimed that the subsidy of Rs. 7,58,000 received by it should not be deducted while computing depreciation on the "actual cost". The Income Tax Officer by his order dated 27.5.1980 rejected the claim of the appellant and reduced the "actual cost" by the amount of the subsidy. The appeal preferred by the appellant before the Commissioner of Income Tax (Appeals) was dismissed on 9,10,1980. The appellant filed a second appeal in I.T.A. No, 4810 (Del.)/80 before the Income Tax Appellate Tribunal, Jabalpur Bench, Camp at New Delhi. The Tribunal has discussed this point in Para 4 of the appellate order. It allowed the appellant- assessee's claim,

7. On the motion of the Revenue under Section 256(1) of the Income Tax Act, 1961 the Tribunal referred the following question of law for the opinion of the High Court (along with another question not relevant for this case) :

"(2) Whether, on (he facts and in the circumstances of the case, the capital subsidy of Rs, 7,58,000 received by the assessee should be deducted from the value of the plant and machinery and building and sheds while working out the written down value for allowing depreciation to the assessee under Section 32 of the Act for the accounting period relevant to the assessment year 1978-79?"

The High Court answered this question in the affirmative and in favour of the Revenue observing:

"Turning now to the next question raised, which is with regard to capital subsidy, it has been held by us in our earlier decision in I.T.R. 22 of 1986 Commissioner of Income Tax v, Jindal Brothers, decided on March 14, 1989, that the amount of subsidy received by the assessee has to be deducted from the value of the assets while working out its written down value for purposes of depreciation. In terms thereof, this question is answered in the affirmative in favour of revenue and against the assessee."

The assessee has come now up in appeal.

8. The pronouncements of the various High Courts on this point indicate a sharp divergence of judicial opinion. The High Courts of Allahabad, Andhra Pradesh, Bombay, Calcutta, Gauhati, Gujarat, Karnataka, Kerala, Madras, Madhya Pradesh, Orissa and Rajasthan have taken a view upholding the assessee's claim. (See ; Lucknow Producers Co-operative Milk Union Ltd. v. Commissioner of Income-Tax, (143) ITR 60; Godavari Plywoods' case (supra) Commissioner of Income-tax v, Elys Plas-tics Pvt. Ltd., (188) ITR 11; Commissioner of Income-Tax v. Dewas Synthetics (P) Ltd., (188) ITR 16; Commissioner of Income-Tax v. Meghalaya Plywood Ltd., (202) ITR 343; Commissioner of Income-Tax v. Grace Paper Industries Pvt. Ltd. and Ors., (183) ITR 591; Commissioner of Income-Tax v. Diamond Dies Manufacturing Corporation Ltd., (172) ITR 655; Commissioner of Income-Tax v. Kerala State Drugs and Pharmaceuticals Ltd., (184) ITR 424; Srinivas Industries v. Commissioner of Income-Tax, (188) ITR 22; Commissioner of Income-Tax v. Steel Tubes of India Ltd., (181) ITR 90; Commissioner of Income-Tax v. Kalinga Jute Products Pvt. Ltd., (196) ITR 633 and Commissioner of Income-Tax v. Ambica Electrolytic Capacitors Pvt. Ltd. and Ors., (191) ITR 494.

The nature and incidents of the subsidies in the present batch of cases are broadly similar to the subsidies which came up for consideration in the above cases.

9. The Punjab and Haryana High Court's judgments under appeal have taken the opposite view.

10. Such rebate as obtains on the point turns on the definition of "actual cost", in Section 43(1) of the Income Tax Act, 1961. Section 43(1) provides definitions of certain terms and inter-alia stipulates that for purposes of Sections 28 to 41 and 43, "actual cost" 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." Thus, if a portion of the cost is met directly or indirectly by any person or authority, the "actual cost" would, for the purposes of the aforesaid sections, be cost minus the subsidies. The "actual cost" of an asset which should be given meaning in a commercial sense, logically includes whatever even any other person or authority has met; but the legislative intent is that the assessee should not have the benefit of a depreciation on a cost which he did not himself pay.

11. Indeed, provision for wastage of capital in the earning of income by way of depreciation was not an initially recognised concept. The Millard Tucker Committee in United Kingdom said : "For more than a generation after the imposition of the present income tax, no relief whatever was given to the using up, in the course of carrying on a business, of any kind of fixed assets."

12. In Corporation of Birmingham V. Barnes, (19) Tax Cases 195, the House of Lords took the view that it was not right to deduct any sums received from any outside source from the "actual cost". Lord Atkin said :

"the actual cost to the person 'by whom the trade is carried on' used in this context have no relation to the source from which that person has received the money which he has expended on the plant....."

But it is said that the words 'to that person' in the phrase 'actual cost to that person' plainly indicate that the Section is intending to confine the relief to an aggregate equal to the sum of money which the person has defrayed out of his own resources, the cost of the burden which has ultimately fallen upon him. My Lords, I confess I do not think that this is the natural meaning of the words. What a man pays for construction or for the purchase of a work seems to me to be the cost to him; and that whether someone has given him the money to construct or purchase for himself, or before the event has promised to give him the money after he has paid for

the work, or after the event has promised or given the money which recoups him what he has spent." (pp.215-17)

In the Court of Appeal, Romer L.J. had observed :

"Is it possible to say that, in view of those words, when a trader has had given to him as a present Us plant and machinery, there has been any 'actual cost' to him in respect of that plant and machinery? The question to be put to the trader is this: 'What did the plant and machinery actually cost you?' Supposing, in this case, that the Dunlop Rubber Company, for their own purposes, had constructed a tramway at a cost of o 54,752 and had then presented it to the Birmingham Corporation, is it possible that the Birmingham Corporation could say that the tramway had cost them any-thing? Surely not. Instead of themselves constructing the tramway and then presenting it to the Corporation, the gift might have been effected in another way. The Dunlop Company might have said to the Corporation : 'You construct the tramway and then we will repay to you the cost to which you have been put.' What would be the answer of the corporation to the question : 'What did that tramway cost you in the end?' I should have thought the Corporation might conceivably have said : 'Well, the tramway cost us f 54,752, but, having regard to the fact that, that was repaid to us by the Dunlop Rubber Co., the actual 'cost to us was nil.' I find, like Lord Justice Slesser, the words in Sub-rule (6) too strong to enable me to say that the only object and effect of the section is to correct the anomaly that was pointed out in Rickman's case (1906) 1 K.B. 311. For these reasons, I think the appeal should be allowed and the decision of the Commissioner's restored." [P.213]

Disagreeing with said observations, Lord Atkin said :

".....I myself should not have thought the answer of Birmingham Corporation to the question put by Lord Justice Romer would have been what he suggests. On the hypothesis that the Dunlop Company had recouped the Corporation the whole of the cost of the first tramway I should have thought the answer to "What did it cost "you?" or "What did it actually cost you?" would have been "It actually cost us o 54,752 but none of the burden of that cost "will fall on the Corporation, for the Dunlop Company have paid "us the full amount....." [P. 217]

The view of Lord Atkin was followed by the Bombay High Court in Commissioner of Income Tax v. Poona Electric Supply Co. Ltd., (14) ITR 622 and in Commissioner of Income Tax, Bombay City-I v. Bombay Suburban Electric Supply Co. Pvt. Ltd., (106) ITR 752 etc. arising under the 1922 Act. It is urged by Dr, Gauri Shanker, learned Senior Counsel for the Revenue, that as the intention of the legislature was that depreciation should be allowed only on the "actual cost" to the assessee, i.e. what is spent by the assessee from his own resources - (otherwise the expression would have been "cost" and not "actual cost") - the legislature intervened by proposing an amendment to nullify the effect of the decision. The Income Tax (Amendment) Bill contained an amendment proposal but it lapsed because the Parliament was dissolved. It was reintroduced in 1952 and passed as Income Tax (Amendment) Act, 1953. Explaining this change, this Court in Calcutta Electric Supply Co. Ltd v. Commissioner of Income Tax, (194) ITR 296 at 302 stated that : "The 1922 Act was amended by the Income-tax (Amendment) Act, 1953, with effect from April 1, 1952, in this respect."

This amendment was introduced as an Explanation to the definition of "actual cost" in Section 10(5) of the Income-tax Act, 1922, to nullify the effect of the judicial interpretations to the contrary. Though, at the stage of the Bill, the proposal was to exclude from the concept of "actual cost", any moneys reimbursed to the assessee in this regard by any outside source, the amendment, as finally effected, permitted only a limited exclusion. The Explanation reads as follows:

For the purposes of this sub-section, the expression 'actual cost' 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 Government or by any public or local authority....."

13. The question in the present context is not whether if a portion of the costs is met directly or indirectly by any other person or authority, it should be deducted or not. Quite obviously, the plain meaning of the section is that it shall be. But the real question is as to the character and nature of a subsidy whether it was really intended to subsidise the cost of the capital or was intended as an incentive to encourage entrepreneurs to move to backward areas and establish industries, the specified percentage of the fixed capital cost which is the basis for determining the subsidy being only a measure adopted under the scheme to quantify the financial aid. The contention is that it is not a payment, directly or indirectly, to meet any portion of the "actual cost" but intended as an incentive to entrepreneurs, its quantification determined at a percentage of the fixed capital cost.

In Godavary Plywoods' case (supra), the Andhra Pradesh High Court, adopting this view, observed.

"Nowhere had the scheme provided as to how the subsidy should be utilised and for which assets. It was 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 would remain at invoice price uninfluenced by the amount of subsidy. The amount received by way of subsidy could be utilised for any purpose such as acquiring land on which no depreciation was 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 had a nexus, direct or indirect, to meet a portion of the actual cost of any specific capital asset, it could not be brought within the purview of section 43(1) of the Act. Therefore, the subsidy could not 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."

In Commissioner of Income Tax v. Grace Paper Industries Pvt. Ltd. (supra), the Gujarat High Court said :

The dictionary meaning of 'subsidy' is 'a grant of money from a Government to a private enterprise considered as beneficial to the public'. The Government, in order to determine the amount of cash subsidy, decided to follow one of the recognised methods of working it out on the basis of the amount invested by an entrepreneur in acquiring capital assets and specified a certain percentage of the amount so invested in the capital assets as cash subsidy. The basis adopted for determining the cash subsidy with reference to the cost or value of fixed assets was only a measure for quantifying the subsidy and the subsidy was not given for the specific purpose of meeting any portion of the cost of the fixed assets. Consequently, the subsidy did not form part of the actual cost of plant and machinery within the meaning of section 43 of the Income-tax Act, 1961. It cannot be deducted from the cost of assets in computing depreciation, development rebate and investment allowance."

14. On the contrary in Commissioner of Income Tax v. Jindal Brothers Rice Mills, (179) ITR 470, the Punjab & Haryana High Court has said :

"When it is specified in the incentive policy that 15 per cent of the cost of plant, machinery and building would be provided by the State Government, the underlying object is to reduce the value of the plant, machinery and building by 15 per cent of the actual cost. The actual cost would so stand reduced within the meaning of section 43(1) of the Act.....We are equally not impressed by the reasoning that the basis adopted for determining the cash subsidy with reference to the fixed capital cost is only a measure adopted and cannot make the subsidy as given only for the specific purpose

of meeting any portion of the fixed capital cost.....

The incentive by way of subsidy is given for each item separately and it would not be open to the assessee to appropriate the subsidy for a purpose other than for which it was given to him. Even if the assessee wrongly maintains the account books and utilises the entire subsidy against the value of the land to reduce its cost, the Income-tax Officer would not overlook the matter and would appropriate the subsidy by reducing the cost of the machinery, plant and building for which the subsidy was specifically granted. There is a nexus between the cost of each item and the subsidy under each head."

15. On a consideration of the matter the view that commends itself as acceptable is the one which has commended itself to the majority of the High Courts. It is, of course, not the numerical strength that prevails-though the fact that a particular view has commended itself to a majority of the High Courts in the country is a matter for consideration-but the tensile strength of the acceptable logic in those decisions. It is aptly said that "a Judge who announces a decision must be able to demonstrate that he began from recognized legal principles and reasoned in an intellectually coherent and politically neutral way to his result". In the present case the reasoning underlying, and implicit in, the conclusion reached by the majority of the High Courts cannot be said to be an unreasonable view and on a preponderance of preferability that view commends itself particularly in the context of a taxing statute. The expression "actual cost" needs to be interpreted liberally, The subsidy of the nature, we are concerned with, does not partake of the incidents which attract the conditions for their deducibility from "actual cost".

Government subsidy, it is not unreasonable to say, is an incentive not for the specific purpose of meeting a portion of the cost of the assets, though quantified as or geared to a percentage of such cost. If that be so, it does not partake of the character of a payment intended either directly or indirectly to meet the "actual cost". We should prefer the reasoning of the majority of the High Courts to the one found acceptable by the High Court of Punjab and Haryana.

16. In the result, we affirm the judgments of the High Courts which have answered the question against the Revenue and dismiss the first batch of appeals and allow the second batch preferred by the assessee and in reversal of the opinion of the High Court, answer the question referred against the Revenue.

In the circumstances, there will be no order as to costs.