

PETITIONER:
SHUBHLAXMI MILLS LIMITED

Vs.

RESPONDENT:
ADDITIONAL COMMISSIONER OF INCOME-TAX, GUJARAT

DATE OF JUDGMENT 28/03/1989

BENCH:
PATHAK, R.S. (CJ)
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MISRA RANGNATH

CITATION:
1989 AIR 1406 1989 SCR (2) 86
1989 SCC (2) 465 JT 1989 (2) 1
1989 SCALE (1) 724

ACT:

Income Tax Act, 1961--S. 33(1) read with S. 34(3)(a) and Explanation thereto--Creation of a reserve fund in the relevant previous year is a condition precedent for claiming deduction on account of 'development rebate'.

HEADNOTE:

Sub-s. (1) of S. 33 of the Income Tax Act, 1961 provides that subject to the provisions of s. 34 thereof development rebate may be claimed as a deduction in respect of any machinery or plant. Clause (a) of sub-s. (3) of s. 34 stipulates that the said deduction shall not be allowed unless an amount equal to 75 per cent of the development rebate is debited to the profit and loss account of the relevant previous year and credited to a reserve account; and the Explanation thereto provides that the deduction shall not be denied by reason only that the amount so credited to the reserve account exceeded the amount of the profit of such previous year.

The appellant-assessee which had a textile mill claimed a sum as development rebate for the assessment year 1962-63. The Income Tax Officer rejected the claim on the ground that the assessee had not created a reserve as contemplated

sub-s. (3) of s. 34 and his order, on appeal, was upheld by the Assistant Commissioner. In second appeal, the claim of the assessee found favour with the Appellate Tribunal; but on a reference made by it at the instance of the Revenue, the High Court held that the assessee had failed to comply with the conditions of sub-s. (3) of s. 34. The appellant contended that the view taken by the High Court was erroneous and that it was not necessary that a reserve should have been created in the previous year.

Dismissing the appeal,

HELD: In order to claim the deduction on account of development rebate under sub-s. (1) of s. 33 it is obligatory that the debit entries in the profit and loss account and the credit entry in a reserve account should be made in the relevant previous year in which the machinery or plant is installed or first put to use. The development rebate contemplated by sub-s. (1) of s. 33 cannot be allowed as a deduction unless a reserve account has been created in the previous year in which the installation or first use occurs. Any doubt in so reading the provisions because of a want or insufficiency of profit in the previous year has been removed by the Explanation to clause (a) of sub-s. (3) of s. 34. [91D-E]

What is contemplated is the creation of a Reserve Fund in the relevant previous year irrespective of the result of the profit and loss account disclosed by the books of the assessee. Mere book entries will suffice for creating such Reserve Fund. The debit entries and the entries relating to the Reserve Fund have to be made before the profit and loss account is finally drawn up. That is a condition for securing the benefit of development rebate. [89E-F]

West Laikdihi Coal Co. Ltd., Calcutta v. Commissioner of Income-tax, West Bengal 11, [1973] 87 ITR 501; Commissioner of Income-tax, Delhi Central v. Modi Spinning & Weaving Mills Co. Ltd., [1973] 89 ITR 304 and Indian Overseas Ba

Ltd. v. Commissioner of Income-tax, Madras, [1970] 77 I
512, distinguished.

Additional Commissioner of income-tax v. Vishnu Indu
trial Enterprises, [1980] 122 ITR 919 and Commissioner
Income-tax v. U.P. Hotel and Restaurants Ltd., [1984] 1
ITR 598, overruled.

Dodballapur Spinning Mills Ltd. v. Commissioner
Incometax, Karnataka-2 and Anr., [1980] 121 ITR 94 a
Indian Oil Corporation Ltd. v. S. Rajagopalan, Income T
Officer, Companies Circle H(I) Bombay and Others, [1973]
ITR 241, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 47 (N
of 1975.

From the Judgment and Order dated 3.10.1974 of t
Gujarat High Court in I.T. Reference No. 30 of 1973.
Bishambar Lal for the Appellant.

V.S. Desai, B. Rao and Ms. A. Subhashini for the Responde
M.B. Lal for the Intervener. (N.P.)

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The Judgment of the Court was delivered by
PATHAK, C.J. This appeal by certificate granted by t

High Court of Gujarat is directed against the judgment
the High Court on the following questions referred to it
the Appellate Tribunal:

"1. Whether, on the facts and in the circumstances
the case, the Tribunal was right in holding that the asse
see cannot be denied the benefit of carry forward of deve
opment rebate?

2. Whether, on the facts and in the circumstances
the case, the Tribunal was justified in directing that t
Income-tax Officer should determine the development reba
and such development rebate should be allowed to be carri
forward and set off when profits are available and if,
that year, the assessee fulfils the necessary requiremen
for such allowance like creation of adequate reserve?"

The assessee is a limited Company. It has a textile mi

at Cambay in the State of Gujarat. For the assessment year 1962-63, the previous year being the calendar year 1961, the assessee claimed that a sum of Rs. 1,26,233 should be allowed as development rebate under s. 33 of the Income-tax Act, 1961. The Income-tax Officer rejected the claim on the ground that the assessee had not created a reserve as contemplated by sub-s. (3) of s. 34 of the Income-tax Act, 1961. The Appellate Assistant Commissioner of Income Tax dismissed the appeal filed by the assessee. In second appeal the claim by the assessee found favour with the Income Tax Appellate Tribunal. At the instance of the Revenue the questions set forth earlier were referred to the High Court for its opinion. The High Court has answered the question in favour of the Revenue and against the assessee. It has held that the assessee had failed to comply with the conditions of sub-s. (3) of s. 34 of the Act.

In this appeal by the assessee it is urged that the view taken by the High Court is erroneous and that it is not necessary that a reserve should be created in the previous year during which the machinery or plant was installed.

Sub-s. (1) of s. 33 provides that development rebate may be claimed as a deduction in respect of a new machinery or plant installed

⁸⁹ after 31 March, 1954 which is owned by the assessee and wholly used for the purposes of the business carried on by him, and that the allowance of the deduction is subject to the provisions of s. 34. CI. (a) of sub-s. (3) of s. 34 provides that the deduction referred to in s. 33 shall not be allowed unless an amount equal to 75 per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking, other than f

or distribution by way of dividends or profits or for remittance outside India as profits or for the creation of an asset outside India. The Finance Act, 1966 added an Explanation to this clause. The Explanation declared that the deduction referred to in s. 33 could not be denied by reason only that the amount debited to the profit and loss account of the relevant previous year and credited to the aforesaid reserve account exceeded the amount of the profit of such previous year (as arrived at without making the deposits aforesaid) in accordance with the profit and loss account. The Explanation was inserted with retrospective effect from the commencement of the Act. Before the Explanation was enacted a difference of opinion had existed between the High Courts on the question whether the statute required the creation of a reserve in the previous year in which the machinery or plant was installed, when the amount of the profit of that previous year was either nil or insufficient for the purposes of enabling the creation of such reserve. It is not necessary to refer to these cases, for it seems clear to us that the Explanation, which applied to the assessment year under consideration before us, removes the doubt altogether. What is contemplated is the creation of a Reserve Fund in the relevant previous year irrespective of the result of the profit and loss account disclosed by the books of the assessee. Mere book entries will suffice for creating such a Reserve Fund. The debit entries and the entries relating to the Reserve Fund have to be made before the profit and loss account is finally drawn up. That is a condition for securing the benefit of development rebate and if that condition is not satisfied we fail to see how the deduction on account of development rebate can be claimed at all.

Learned counsel for the assessee relies on West Laikdi

Coal Co. Ltd., Calcutta v. Commissioner of Income-tax, We
Bengal 11, [1973] 87 ITR 501 and Commissioner of Income-ta
Delhi Central v. Modi Spinning & Weaving Mills Co. Ltd
[1973] 89 ITR 304. Those were cases decided under the prov
sions of the Indian Income-tax Act, 1922 and there was
Explanation such as we have before us. Re-
ference was made to the decision of this Court in Indi
Overseas Bank Ltd. v. Commissioner of Income-tax Madra
[1970] 77 ITR 512. In that case, however, the question w
whether the creation of a reserve in compliance with s.
of the Banking Companies Act constituted sufficient compl
ance with the requirements of proviso (b) to s. 10(2) (vi
of the Indian Income-tax Act, 1922. Reference has also be
made to Additional Commissioner of Income-tax v. Vishnu I
dustrial Enterprise, [1980] 122 ITR 919. We do not find
possible to agree with the view taken by the Allahabad Hi
Court in that case that the development reserve need not
created in the relevant previous year during which the n
machinery or plant is installed, and that a profit must ha
been earned during the previous year to permit the creati
of a reserve fund. We think that the Explanation is clea
and that there can be no doubt that it envisages the cre
tion of a Reserve Fund notwithstanding that there is
profit or insufficient profit from which such reserve may
provided. To contemplate otherwise would be to negate t
entire scheme incorporated in s. 33 read with s. 34 of t
Act. For the same reason we are unable to affirm the vi
taken by the Allahabad High Court in Commissioner
Income-tax v. U.P. Hotel and Restaurants Ltd., [1984] 1
ITR 598. Our attention has been drawn by the learned couns
for the assessee to Dodballapur Spinning Mills Ltd.
Commissioner of Income-tax, Karnataka-2 and Anr., [1980] 1

ITR 94 where reference has been made to a circular issued by the Central Board of Direct Taxes dated 14th October, 1965 and to a subsequent circular dated 30 January, 1976. We have carefully considered the matter and we do not think that the circulars affect the true position in law.

On behalf of the assessee reliance was placed on *Indi Oil Corporation Ltd. v. S. Rajagopalan*, Income-tax Office Companies Circle II (1) Bombay and others, [1973] 92 ITR 2 where the Bombay High Court has held that there was no obligation on the assessee to create a reserve in the year of installation if there was no taxable income in the relevant year. Some of the submissions addressed in that case may be set forth in detail. A powerful argument was addressed by learned counsel for the assessee and it was pointed out that the expression "shall be allowed" in clause (a) of sub-s. (1) of s. 33 indicated that the development rebate is to be assessed and thereupon it becomes allowable and that sub-s. (2) of s. 33 which provides for the allowance of development rebate mentions that the sum "to be allowed" by way of development rebate for the assessment year shall be only such amount as shall be sufficient to reduce the total assessable income to nil and the amount of development rebate to the extent to which

91 it has not been allowed shall be carried forward to the following assessment years for eight subsequent years. Reference was also made to the distinction between the expressions "to be allowed" and "actually allowed" used in the relevant provisions. It was also argued that the utilisation by the assessee of the development rebate reserve for the purposes of the business of the undertaking contemplated the existence of an actual fund which could be utilised for the purposes of the business, and that an illusory debit entry in the profit and loss account and an illusory credit

entry in the development rebate reserve account were not contemplated. The High Court accepted the submission and concluded that it was not mandatory that the necessary debit and credit entries must be made in the assessment year following the year of installation in which the development rebate is determined under s. 33. Having considered the matter at some length in the present case, it seems to be clear that in order to claim the deduction on account of development rebate under sub-s. (1) of s. 33 it is obligatory that the debit entries in the profit and loss account and the credit entry in a reserve account should be made in the relevant previous year in which the machinery or plant is installed or first put to use. The development rebate contemplated by sub-s. (1) of s. 33 cannot be allowed as a deduction unless a reserve account has been created in the previous year in which the installation or first use occurs. Any doubt in so reading the provisions because of a want of insufficiency of profit in such previous year has been removed by the Explanation to clause (a) of sub-s. (3) of s. 34. The significance of the words "actually allowed" in clause (a) of sub-s. (3) of s. 34 has been considered by the High Court in the judgment under appeal, and we are in entire agreement with the view taken by the High Court in that regard.

A number of other cases have also been placed before us by learned counsel for the assessee, but as they deal with the point on the basis of considerations substantially the same as have been referred to in the cases mentioned earlier, we think it unnecessary to deal with them specifically.

Upon the aforesaid considerations we hold that the High Court is right in answering the questions in favour of the Revenue and against the assessee. In the result, the appeal is dismissed but there is no order as to costs.

S- H.L.C. Appeal di
missed.
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JUDIS