Chaturvedi & Pithisaria's

INCOME TAX LAW

Ninth Edition

OMITTED/INOPERATIVE PROVISIONS OF 1961 ACT RELEVANT TO VOLUME 4

CONTENTS

	Page
Omitted/Phased-out provisions of section 32(1)(*iv*), (*v*) & (*vi*) of the 1961 Act	… 1
Omitted/Phased-out provisions of section 32A of the 1961 Act	… 17
Omitted/Phased-out provisions of section 32AB of the 1961 Act	… 69
Omitted/Phased-out provisions of section 32AC of the 1961 Act	… 98
Omitted/Phased-out provisions of section 32AD of the 1961 Act	… 102
Omitted/Phased-out provisions of section 33 of the 1961 Act	… 106
Omitted/Phased-out provisions of section 33A of the 1961 Act	… 136
Erstwhile provisions of section 33AB of the 1961 Act	… 146
Tea development account [for assessment years 1986-87 and 1987-88]	… 146
Omitted/Phased-out provisions of section 33AC of the 1961 Act	… 147
Omitted/Phased-out provisions of section 33B of the 1961 Act	… 154
Omitted/Phased-out provisions of section 34 of the 1961 Act	… 158
Depreciation allowance—conditions for	… 160
Allowance for development rebate—conditions for	… 164
Omitted/Phased-out provisions of section 34A of the 1961 Act	… 180
Omitted/Phased-out provisions of section 35 of the 1961 Act	… 182
Omitted/Phased-out provisions of section 35A of the 1961 Act	… 190
Omitted/Phased-out provisions of section 35AB of the 1961 Act	… 196
Omitted/Phased-out provisions of section 35AC of the 1961 Act	… 200
Omitted/Phased-out provisions of section 35B of the 1961 Act	… 208
Export markets development allowance [in relation to expenditure incurred between 1-3-1968 and 28-2-1983]	… 209
Omitted/Phased-out provisions of section 35C of the 1961 Act	… 247
Agricultural development allowance (for assessment years 1968-69 to 1984-85)	… 247
Omitted/Phased-out provisions of section 35CC of the 1961 Act	… 254
Rural development allowance (for assessment years 1978-79 to 1985-86)	… 254
Omitted/Phased-out provisions of section 35CCA of the 1961 Act	… 261
Omitted/Phased-out provisions of section 35CCB of the 1961 Act	… 271

LexisNexis

Page

Omitted/Phased-out provisions of section 36 of the 1961 Act … 274

Weighted deduction to employers employing blind or physically handicapped persons [omitted s. 36(1)(*iia*) of 1961 Act] … 274

Special reserve created by non-foreign scheduled banks [omitted s. 36(1)(*viiia*) of 1961 Act] … 275

Contribution towards a specified exchange risk administration fund by a public financial institution [omitted s. 36(1)(*x*) of 1961 Act] … 275

Expenditure in respect of a non-Y2K compliant computer system [s. 36(1)(*xi*) of 1961 Act] … 276

Banking cash transaction tax [s. 36(1)(*xiii*) of 1961 Act] … 277

Omitted/Phased-out provisions of sections 37(2) to (5) [excluding section 37(2B)] of the 1961 Act … 278

Entertainment expenditure [omitted ss. 37(2) & 37(2A) of 1961 Act] … 286

Expenditure on advertisement, etc. [omitted ss. 37(3), 37(4) & 37(5) of 1961 Act] … 302

Partial disallowance of certain expenses [omitted ss. 37(3A) to 37(3D) of 1961 Act] … 321

Omitted/Phased-out provisions of section 39 of the 1961 Act … 330

Omitted/Phased-out provisions of sections 40 & 40A of the 1961 Act … 332

Excessive or unreasonable remuneration, benefits, amenities or perquisites to directors, employees, etc. [omitted ss. 40(*c*), 40(*a*)(*v*) & 40A(5) of 1961 Act] … 340

No double deduction in case of banking companies [omitted s. 40(*d*) of 1961 Act] … 372

Provision for gratuity … 372

Disallowance of other expenditures [omitted ss. 40A(6), 40A(8) & 40A(12) of 1961 Act] … 375

Omitted/Phased-out provisions of section 44AC of the 1961 Act … 380

Erstwhile provisions of section 44AD of the 1961 Act … 388

Profits and gains of civil construction business, etc. [operative between 1-4-1994 and 31-3-2011] … 389

Omitted/Phased-out provisions of section 44AF of the 1961 Act … 394

Omitted/Phased-out provisions of section 44D of the 1961 Act … 397

LexisNexis

Omitted/Phased-out provisions of section 32(1)(*iv*), (*v*) & (*vi*) of the 1961 Act

[*Page 5636 of Volume 4 of Chaturvedi & Pithisaria's Income Tax Law, 9th Edition*]

Initial depreciation.—*1922 Act.*—Provisions for allowance of initial depreciation were introduced in the 1922 Act by the Indian Income-tax (Amendment) Act, 1946. It was then made allowable in respect of—

(*i*) new buildings erection whereof was begun and completed between 1-4-1946, and 31-3-1948, at the rate of 15 per cent. of the cost of building;

(*ii*) new buildings other than at (*i*), at the rate of 10 per cent. of the cost;

(*iii*) new machinery or plant installed after 31-3-1945, at the rate of 20 per cent. of the cost thereof.

Amendments to such provisions were made from time to time enlarging the period of erection and completion of buildings under **clause (*i*)** up to 31-3-1956, and diminishing the period of installation of machinery or plant. The rates were kept the same.

Ultimately, the device of development rebate allowance was adopted with effect from 1-4-1955, in respect of new ships, machinery or plant. For the assessment year 1955-56, transitional arrangement was made so that initial depreciation was not allowed in respect of machinery or plant for which development rebate was admissible. By the Finance Act, 1956, initial depreciation was totally withdrawn in respect of new machinery or plant installed after 31-3-1956.

In respect of buildings newly erected on or after 1-4-1956, initial depreciation remained allowable at the rate of 10 per cent.

The grant of allowance was not followed by any condition save and except that the asset was newly erected or installed and was owned by, and used for the purposes of the business of, the assessee.

From 1-4-1961, a larger rate of 20 per cent. of the actual cost was introduced for buildings newly erected after 31-3-1961, which were used solely for the purpose of residence of persons employed in the business and drawing remuneration not exceeding Rs. 200 per month or for the purpose of welfare of such persons as hospitals, creches, etc.

Initial depreciation was, however, available for one year only, *i.e.,* for the year of erection or installation, as the case may be.

1961 Act.—The 1961 Act, originally, reflected the existing provisions of the 1922 Act, *viz.*,—

(*i*) there was no provision for initial depreciation in respect of machinery or plant, in any case;

(*ii*) there was no provision for initial depreciation in respect of buildings except those which were used solely for the purpose of residence of persons employed in the business and drawing a salary up to Rs. 200 per month or for the purpose of welfare of such persons; and

(*iii*) development rebate deduction was retained in respect of machinery or plant (and ships).

From 1-4-1966, there was an amendment of the law when the salary provision was enhanced from Rs. 200 per month to Rs. 7,500 per year.

From 1-4-1968, a **new clause (*v*)** was inserted in section 32(1) extending the benefit of initial depreciation in the case of new buildings (the erection of which is completed after 31-3-1967) owned by an Indian company and used as an approved hotel. Further amendments were made by the Finance Acts of 1976, 1978 and 1983.

The final position (operative up to assessment year 1987-88) may be summarised as follows:—

Initial depreciation was allowable, up to assessment year 1987-88, under **section 32(1)(*iv*)** in respect of building newly erected after 31-3-1961, and used—

(*i*) solely for the purpose of residence of persons employed in the business and drawing a salary of not more than Rs. 10,000 [Rs. 2,400 up to assessment year 1965-66 and Rs. 7,500 up to assessment year 1976-77] for a year; or

LexisNexis

(*ii*) solely or mainly for the welfare of such persons as a hospital, creche, school, canteen, library, recreational centre, shelter, rest-room or lunch room.

The quantum of allowance was 40 per cent. [20 per cent. up to assessment year 1978-79] of the actual cost of the building to the assessee. A temple meant for workmen was held eligible to such allowance [*Atlas Cycle Industries Ltd. v. CIT,* (1982) 134 ITR 458 (Punj)].

The word 'employed' used in section 32(1)(*iv*) is a very wide expression and takes within its ambit not only persons who are contractually employed in the strict sense of the term, but all persons engaged in the business of the assessee. It has no relation to the capacity in which the assessee contracts to employ them. What is required is that such persons should be so 'engaged' in the business that one can say that they are 'employed'. That being so, an apprentice will clearly fall within the expression 'persons employed in the business' [*CIT v. Tata Engineering & Locomotive Co. Ltd.,* (1993) 201 ITR 1036, 1041 (Bom)]. In the facts of that case, the assessee was held entitled to initial depreciation under section 32(1)(*iv*) in respect of the apprentice school building and the apprentice shop building.

The initial depreciation was allowed, for assessment year 1979-80, under section 32(1)(*iv*) in respect of the buildings constructed and actually handed over to the assessee on 9-3-1979 for the residence of the employees of the assessee drawing less than Rs. 10,000 as salary [*Madhya Pradesh State Mining Corporation v. CIT,* (1996) 218 ITR 495, 498-99 (MP)].

Unlike the provisions of section 10(2)(*vi*) of the 1922 Act in relation to allowance of initial depreciation, for granting initial depreciation under section 32(1)(*iv*) of the 1961 Act, the date of commencement of the erection of the building concerned is not relevant. Under the 1961 Act provisions, only the date of completion of the erection of the building is material, *viz.*, it must have been completed after 31-3-1961 [*Addl. CIT v. Indian Copper Corporation Ltd.,* (1985) 155 ITR 529 (Pat); *CIT v. Indian Copper Corporation Ltd.,* (1986) 161 ITR 327, 335 (Pat)].

In *CIT v. Bharat Earth Movers Ltd.* [(1985) 156 ITR 269 (Karn)], the assessee claimed initial depreciation under section 32(1)(*iv*) in respect of the co-operative stores building, which was constructed for the benefit of the employees, on the ground that it was a canteen. It was held that the building was not a canteen and therefore no initial depreciation was allowable.

In *CIT v. Tata Robins Frazer Ltd.* [(1999) 236 ITR 206, 210 (Pat)], it has been held that where even certain buildings of the workers are located not within the factory premises but are in the vicinity of the factory area at a distance and for the use of the factory workers roads, culverts, sewage lines, etc., are constructed on the land owned by the assessee, the assessee has been held entitled for depreciation under section 32(1)(*iv*) on the expenditure on construction incurred by the assessee.

In *Modipon Ltd. v. CIT* [(2001) 247 ITR 40, 42, 44, 46 (Del)], the Tribunal was correct in upholding the Officer's action in rejecting the assessee's claim for initial depreciation under section 32(1)(*iv*) for the assessment year 1969-70 as regards 64 out of total 336 houses constructed for the residence of employees because of the non-fulfilment of the condition that the salary of the employee concerned should be less than Rs. 7,500 per annum.

In *CIT v. Bhagat Ram Jai Narain* [(2001) 252 ITR 741, 747-48 (All)], a too technical extreme view has been taken to the effect that where in the building given to an eligible employee for his residence purposes by the assessee-firm, in which two minor sons of the said employee were admitted to the benefits of the partnership, the said two minor sons of the employee have also resided with their father, the benefit of initial depreciation under section 32(1)(*iv*) has been denied to the assessee-firm on the sole ground that keeping in view the provisions of section 30(2) of the Indian Partnership Act, 1932 (9 of 1932), as the said two sons were leaving in the said property in their own right as they had a right in the said property, it could not be said that the said property was being *used solely* for the purpose of residence of the eligible employee.

In *G.K. Choksi & Co. v. CIT* [(2001) 252 ITR 863, 875-76 (Guj)], it has been held that initial depreciation under section 32(1)(*iv*) cannot be claimed by an assessee carrying on 'profession' because 'business' in section 32(1)(*iv*) does not include 'profession'. In that case, a firm of the chartered accountants has been held not entitled to initial depreciation under section 32(1)(*iv*).

In *CIT v. Gujarat State Fertilizer Co.* [(2002) 255 ITR 294, 296, 299-300 (Guj)], it has been held that the assessee is entitled to the allowance of depreciation under section 32(1)(*iv*) in respect of lunch room, extension of canteen and partition wall.

It is pertinent to note that for assessment years 1962-63 to 1983-84 initial depreciation under section 32(1)(*iv*) *was not deductible* in determining the written down value of the asset concerned for the purposes of allowing normal depreciation under section 32(1)(*ii*). However, for assessment years 1984-85 to 1987-88, such initial depreciation *was deductible* in determining the written down value of the asset concerned for the purposes of allowing normal depreciation under section 32(1)(*ii*).

LexisNexis

In *CIT v. Asian Techs Ltd.* [(1999) 240 ITR 396, 400, 401, 402 (Ker)], paragraphs 22.3 and 22.5 of the departmental circular No. 372, dated 8-12-1983 have been extracted and it has been observed: 'It is true that going by the circular the amendment brought under the Finance Act, 1983 (11 of 1983), would apply in computing the written down value of such buildings for the assessment year 1984-85, even though initial depreciation under section 32(1)(*iv*) had been allowed in the assessment year 1983-84 or any earlier assessment year.'. The High Court has found it difficult to give such an interpretation to the statutory provisions. It has been opined that the 40 per cent initial depreciation granted under section 32(1)(*iv*) was a one-time benefit granted in respect of a class of buildings, namely, buildings erected by the assessee in the previous year. Therefore, the effect of the omission (w. e. f. 1-4-1984) of the last portion of section 32(1)(*iv*) would be felt only in cases where section 32(1)(*iv*) was to be made applicable. Section 32(1)(*iv*) could be made applicable for the assessment year 1984-85 only in the case of an assessee who had erected building in the previous year relevant to that assessment year. In that view of the matter, such omission would have effect only in cases where initial depreciation under section 32(1)(*iv*) was granted in respect of specified assets with effect from 1-4-1984, for and from assessment year 1984-85. Therefore, the Tribunal was held right in holding and in directing the Officer to take the written down value as at the beginning of the year without further reducing it by the amount of initial depreciation granted under section 32(1)(*iv*). In this case, the assessment year relevant was 1984-85 and the initial depreciation was granted not for assessment year 1984-85 but for an earlier assessment year.

In *CIT v. Sri Ganapathy Mills Co. Ltd.* [(2002) 256 ITR 657, 657-58 (Mad)], the Tribunal was held right in law in holding that the initial depreciation under section 32(1)(*iv*) for the assessment years prior to 1984-85 should not be taken into account while computing the written down value in respect of the assessment year 1985-86. This view has been **followed in** *CIT v. Madurantakam Co-operative Sugar Mills Ltd.*, (2003) 263 ITR 388, 391 (Mad) and in *CIT v. Sundaram Industries Ltd.* [(2003) 130 Taxman 393 (Mad)] in relation to assessment year 1984-85.

In the context of the provisions of section 32(1)(*v*), a similar view has been taken in *CIT v. Adyar Gate Hotel Ltd.* [(2001) 252 ITR 129, 132 (Mad)], wherein it has been observed : 'That initial depreciation cannot be subtracted from the value of the building for determining the written down value at the commencement of the assessment year 1984-85 and the depreciation allowed in that year calculated with reference to the reduced figure. The depreciation to be allowed in that assessment year is to be allowed with reference to the written down value as at the commencement of the year which figure had been calculated by excluding the initial depreciation as that was the mode in which the written down value was required to be determined prior to 1-4-1984.'.

LexisNexis

Under section 32(1)(*iv*), initial depreciation is admissible on canteens, hospitals, shelters, etc. and the claim of the assessee for initial depreciation on cycle sheds was rightly allowed [*Industrial Cables* (*India*) *Ltd. v. CIT*, (2005) 272 ITR 314 (Punj)].

In *Raasi Cements Ltd. v. CIT* [(2005) 275 ITR 582 (AP)], it has been held that the term 'solely' in section 32(1)(*iv*) indicates that the buildings should be occupied by the employees drawing a salary of Rs. 10,000 per annum or less and, in the instant case, the assessee was found not to have fulfilled this condition thus, it was not entitled to initial depreciation under section 32(1)(*iv*).

The assessee held exigible for initial depreciation on the cycle stand and workers' toilets [*CIT v. Mahavir Spinning Mills Ltd*., (2007) 293 ITR 492 (Punj)].

The appellant, a firm of chartered accountants, was not entitled to claim initial depreciation for the assessment year 1984-85 under section 32(1)(*iv*) in relation to a building constructed by it for the purpose of residence of its low paid employees, as the allowance was not available to professionals and was available only to an assessee carrying on a business [*G.K. Choksi & Co. v. CIT*, (2007) 295 ITR 376 (SC)].

By the omission (w. e. f. 1-4-1988) of section 32(1)(*iv*) by the Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986 (46 of 1986), this section could not be interpreted to mean that the definition of the expression 'welfare centre' includes hospitals. No one refers to a hospital as a welfare centre and no one would include hospital in the expression 'welfare centre' normally. Since hospital was not included in the Appendix, the claim of the assessee could not be granted [*CIT v. Kovai Medical Centre & Hospitals Ltd.,* (2009) 313 ITR 262 (Mad)].

The assessee held entitled to initial depreciation under section 32(1)(*iv*) on the cost of new residential quarters [*CIT v. Modi Industries Ltd.*, (2010) 327 ITR 570 (Del)].

Reference may also be made to *CIT v. Rieta Biscuit Co.* (*P.*) *Ltd.* [(2010) 320 ITR 521 (Punj)].

This allowance was to be granted only once, in respect of the previous year of erection of the building.

Another provision for allowance of initial depreciation was made in **section 32(1)(*v*)** inserted by the Finance (No. 2) Act, 1967 (20 of 1967), with effect from 1-4-1968. This new clause provided for the grant of an "initial"

depreciation allowance, up to assessment year 1987-88, in a sum equal to 25 per cent. of the actual cost of construction of a new building (the erection of which is completed after 31-3-1967), to an Indian company, in a case where such building was used by the company as premises for running a hotel, and the hotel was for the time being approved in this behalf by the Central Government. A conference hall in a hotel was held eligible for such allowance [*CIT v. U.P. Hotel-Restaurant Ltd.,* (1980) 123 ITR 626 (All)]. This deduction was allowed in respect of the previous year in which the erection of the building was completed or, if the building was first put to use in the immediately succeeding previous year, then, in respect of the previous year of the user.

Such approval must be by the Department, which is specifically empowered in that behalf to grant approval on behalf of the Central Government for the purposes of this particular provision [*Hotel Horizon P. Ltd. v. Secretary to the Department of Tourism,* (1989) 175 ITR 284 (Del)]. Approval once granted cannot be rescinded on the ground that the same was granted due to oversight [*CIT v. Hotels* (*Andhra*) *P. Ltd.,* (1989) 175 ITR 295, 298 (AP)].

In *Geetha Hotels P. Ltd. v. CIT* [(2002) 254 ITR 649, 651-52 (Mad)], it has been held that the initial depreciation under section 32(1)(*v*) was not allowable, for assessment year 1979-80, in respect of electrical installations and sanitary fittings embedded in the hotel building itself because the electrical installations and sanitary fittings which by themselves are 'plant' for the purpose of depreciation in the scheme of section 32, cannot be regarded as 'building' when such fittings are fitted to the hotel building.

In *Hotel & Allied Trades* (*P.*) *Ltd. v. CIT* [(1998) 149 CTR (Ker) 223, 225, 226], it has been held that as the assessee, an Indian company engaged in the business of a hotel, has established the requisite conditions of section 32(1)(*v*), it was entitled to initial depreciation under that section on the additional block of 16 rooms, which was completed in the previous year relevant to assessment year 1981-82.

However, the assessee was held not entitled to initial depreciation under section 32(1)(*v*) in a case where the building was incomplete and was not used for business of hotel during the previous year relevant to assessment year 1980-81 [*Hotel & Allied Trades* (*P.*) *Ltd. v. CIT,* (1999) 238 ITR 226, 228-29 (Ker)].

It is pertinent to note that for assessment years 1968-69 to 1983-84 initial depreciation under section 32(1)(*v*) *was not deductible* in determining the written down value of the asset concerned for the purposes of allowing normal depreciation under sec-tion 32(1)(*ii*). However, for assessment years 1984-85 to 1987-88, such initial depreciation *was deductible* in determining the written down value of the asset concerned for the purposes of allowing normal depreciation under section 32(1)(*ii*).

Initial depreciation in replacement of development rebate.—Development rebate allowable under section 33 was withdrawn in respect of ships acquired, or machinery or plant installed, after 31-5-1974, except in certain cases specified in section 16 of the Finance Act, 1974 (20 of 1974) (later amended by the Finance Act, 1975 (25 of 1975)). Initial depreciation was introduced by **section 32(1)(*vi*)**, as an impetus and encouragement, with effect from 1-4-1975, *i.e.,* for and from assessment year 1975-76.

It was available in respect of the following assets, namely, (*i*) new ships and new aircraft acquired, by a person engaged in the business of operation of ships or aircraft, after 31-5-1974; (*ii*) new machinery or plant (other than office appliances or road transport vehicles) installed after 31-5-1974 for the purposes of business of generation or distribution of electricity or any other form of power; (*iii*) such new machinery or plant installed after 31-5-1974 for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in items 1 to 24 (items 1 to 23, for assessment year 1975-76) of the Ninth Schedule to the Act; and (*iv*) such new machinery or plant installed after 31-5-1974, in a small-scale industrial undertaking (as defined) for manufacture or production of any article or thing. The rate of allowance was 20 per cent. of the actual cost. The allowance was restricted only for one year, namely, the year of acquisition or installation, or if first put to use in the immediately succeeding previous year, then such later year. It was not to affect the written down value for the purpose of allowance of normal depreciation, but it shall be taken into account for calculating the terminal allowance, or the balancing charge, as the case may be. The allowance may, however and at the option of the assessee, be forsaken. The expressions "new ship", "new aircraft" and "new machinery or plant" have been defined in the *Explanation* to section 32(1)(*vi*).

It may be remembered that the benefit of initial depreciation shall not be available in respect of (*a*) machinery or plant installed in any office premises or any residential accommodation, including a guest house, (*b*) ship, aircraft, machinery or plant in respect of which development rebate is allowable and (*c*) ship or air-craft acquired, or machinery or plant installed, after 31-3-1976.

The expression 'installed', in section 32(1)(*vi*), would include placing the apparatus in position for service or use [*CIT v. Instrumentation Ltd.,* (1993) 201 ITR 117, 119 (Raj)]. In the facts of that case, the Tribunal was held justified in directing that initial depreciation in respect of tools and instruments was allowable.

This initial depreciation under section 32(1)(*vi*) was **discontinued** as investment allowance under section 32A became deductible.

LexisNexis

The initial depreciation under section 32(1)(*vi*) was not to be deducted in determining the written down value of the building, etc., for the purpose of grant of normal depreciation allowance under section 32(1)(*ii*).

However, the initial depreciation allowed was to be taken into account for the purposes of other provisions of the Act [see, *Popular Ltd. v. CIT,* (1955) 28 ITR 309 (Mad); *Asoka Mills Co. Ltd. v. CIT,* (1958) 33 ITR 377 (Bom)], *e.g.,* balancing charge, terminal allowance, etc.

In *CIT v. Senapathy Whiteley Ltd.* [(1986) 158 ITR 181 (Karn)], the assessee was a manufacturer of insulation boards which were used only in electrical industry. It was held that the assessee was a manufacturer of 'paper' within the meaning of item 18 of Schedule IX and was eligible for initial depreciation.

The crucial words in the then section 32(1)(*vi*) were 'new machinery or plant installed for purposes of business of generation or distribution of electricity or any other form of power'. The use of the words here 'for purposes of business of' admitted of only one interpretation, namely, that the machinery or plant installed must be for the purposes of business of generation or distribution of electricity or any other form of power. In other words, it is only where the business was of generation or distribution of electricity or any other form of power that the installation of new machinery or plant qualified for initial depreciation in terms of section 32(1)(*vi*) [*Dalmia Biscuits Ltd. v. CIT,* (1992) 194 ITR 749, 750-51 (Punj)]. In the facts of that case, the assessee, manufacturing and selling biscuits, was held not entitled to initial depreciation under section 32(1)(*vi*) in respect of the electric generator installed by it as the business of the assessee was not that of generation or distribution of electricity or any other form of power. Similarly, the assessee, manufacturing electrical items, has been held not entitled to initial depreciation in respect of generator installed by it [*Universal Electrics Ltd. v. CIT,* (1992) 196 ITR 860, 877 (Cal)].

On a conjoint reading of the then section 32(1)(*vi*) and *Explanation* (*3*) thereto, it became abundantly clear that the expression 'machinery and plant' in the *Explanation* referred back to the 'plant and machinery' described in section 32(1)(*vi*) which clearly excluded 'office appliances or road transport vehicles'. That being so, motor-cars, trucks, cycles, typewriters and calculators could not be treated as plant or machinery for the purposes of that section and, therefore, their value could not be taken into consideration in determining the ceiling of Rs. 7.5 lakhs for the purpose of determining whether an industrial company was a small-scale industrial undertaking or not [*CIT v. Reunion Engineering Co. (P.) Ltd.,* (1993) 203 ITR 274, 279 (Bom)].

For the purpose of determining whether an industrial undertaking was a small-scale undertaking or not, resort had to be taken to the *Explanation* (*3*) to section 32(1)(*vi*) and not to any other provision of law whereby an industrial undertaking was to be regarded as such for other purposes [*CIT v. J.H. Kharawala,* (1994) 208 ITR 691, 697 (Guj)]. In the facts of that case, the assessee was held not entitled to claim initial depreciation as a 'small-scale industrial undertaking' as it did not fall within the definition of that expression as given in *Explanation* (*3*) to section 32(1)(*vi*), even though the undertaking was registered as a small-scale industrial undertaking with the Small-Scale Industrial Department of the State Government.

In the facts of *Industrial Machinery v. CIT* [(1993) 114 Taxation 97 (Guj)], the assessee was held entitled to initial depreciation in respect of new machinery installed during the year under consideration. Further, humidification plants manufactured by the assessee were held covered by item 8 of Schedule IX and, therefore, entitled to initial depreciation.

In the facts of *CIT v. Fashion Prints Ltd.* [(1996) 217 ITR 456, 460, 462 (Bom)], it has been held that the Tribunal was not right in holding that the activities of the assessee in dyeing, printing and processing grey cloth produced by others amounted to manufacture or production of textiles as specified under item 21 of the list in the Ninth Schedule to the 1961 Act so as to entitle it to initial depreciation under section 32(1)(*vi*) for the assessment years 1976-77 and 1977-78. Thus, the assessee was held not entitled to the benefit of initial depreciation under section 32(1)(*vi*) for those two years.

In *B. Malani & Co. v. CIT* [(1995) 214 ITR 192, 193, 194 (Bom)], the machinery eligible for initial depreciation was installed in 1975 and the production was started in the year 1977. Initial depreciation for the assessment year 1976-77 was held not allowable in respect of such machinery because the same was not put to use during the relevant previous year.

Also see, *CIT v. Janta Ginning & Pressing Factory,* SLP (Civil) No. 7980 of 1984: (1990) 186 ITR (St.) 33 (SC).

Where the assessee has purchased the plant and machinery on hire purchase basis, in order to ascertain whether the assessee was a small-scale industrial undertaking, the provisions of clause (*b*) of *Explanation* (*3*) to section 32(1)(*vi*) were attracted. According to that clause (*b*), in the case of any machinery or plant hired by the assessee, the actual cost thereof as in the case of owner of such machinery or plant shall be taken to be the value of such machinery or plant. The additional cost incurred by the hirer in putting such plant or machinery to use by him was not to be taken into account for arriving at the aggregate value of the machinery and plant installed by the hirer-assessee, as on the last day of the previous year, for the purposes of the business of the undertaking not exceeding Rs. 7,50,000, so that the undertaking could be regarded as a small-scale industrial undertaking

within the meaning of *Explanation* (*3*) to section 32(1)(*vi*) [*CIT v. Gopal Plastics* (*P.*) *Ltd.,* (1995) 215 ITR 136, 141, 145 (Mad)]. In the facts of that case, the assessee was held to be a small-scale industrial undertaking as the aggregate value of the machinery and plant installed was below Rs. 7,50,000, ignoring the service and installation charges of Rs. 10,005 incurred by the assessee-hirer.

In the facts of *CIT v. First Leasing Co. of India Ltd.* [(1995) 216 ITR 455, 460, 468 (Mad), **affirmed on another point in** (1998) 231 ITR 308 (SC)], the assessee was held entitled to initial depreciation under section 32(1)(*vi*) on machinery leased out.

Where the assessee purchased cloth manufactured by others and then bleached, dyed and tentered the same, the activity of the assessee did not amount to any manufacturing activity so as to enable the assessee to claim initial depreciation under section 32(1)(*vi*) [*CIT v. S.S.M. Processing Mills,* (1997) 227 ITR 596, 606 (Mad), **followed in** *CIT v. Rajalakshmi Textiles Processors Ltd.,* (1998) 146 CTR (Mad) 52, 54, 55].

Similarly, the conversion of grey cloth into finished calendered cloth by applying certain mechanical and chemical process could not amount to manufacturing of textiles entitling the assessee for claiming initial depreciation [*CIT v. Anjani Kumar & Co. Pvt. Ltd.,* (1997) 227 ITR 786, 789 (Raj)].

In *CIT v. Indian Textile Paper Tube Co. Ltd.* [(1997) 138 CTR (Mad) 342, 344, 347 = (1998) 234 ITR 47 (Mad), **followed in** *CIT v. Indian Textile Paper Tube Co. Ltd.*, (1998) 234 ITR 53, 54-55 (Mad)], it has been held that the assessee-respondent, which was manufacturing paper tubes and cones (required as accessories for winding yarn) as part of textile machinery, was not entitled to initial depreciation because such manufacturing activity was not covered by item 8 of the Ninth Schedule which read 'Industrial and agricultural machinery'.

Where the business activity of the assessee at the material time consisted of purchase of grey cloth, colour, chemicals, etc., and subjecting that cloth to bleaching, dyeing, printing, calendering, starching and then selling it as finished products like 'printed chhint', the assessee has been held to have engaged in the business of manufacturing textiles and was entitled to claim deduction of initial depreciation for the assessment year 1976-77 [*CIT v. Kashiram Textiles Mills Pvt. Ltd.,* (1999) 240 ITR 487, 488-89 (Guj), **following** *Ujagar Prints v. Union of India,* (1989) 179 ITR 317 (SC) on the point of manufacturing activity].

In *CIT v. United Bleachers Ltd.* [(2000) 241 ITR 291, 292-93 (Mad)], the assessee was engaged in the business of bleaching, dyeing and pre-shrinking of cotton cloth of various customers. It has been held that the activities so carried on did not amount to manufacture of articles or things. Therefore, the assessee was not entitled to initial depreciation for the assessment year 1976-77. This has been so held **following** earlier Madras decision [227 ITR 596 (Mad)].

LexisNexis

In *CIT v. Sundaram Spinning Mills* [(2000) 241 ITR 350, 351, 354 (SC)], it has been held that the manufacture of yarn would amount to manufacture of 'textiles' within the meaning of entry No. 21 of the Ninth Schedule to the 1961 Act and the assessee was entitled to higher rate of initial depreciation for the assessment year 1976-77. This view has been **followed in** *CIT v. Alagappa Cotton Mills* [(2002) 253 ITR 100, 102-03 (Mad)].

Where the diesel generating set was inextricably linked with the machinery for manufacturing gears and process of manufacturing, the assessee was held entitled to initial depreciation under section 32(1)(*vi*) for the assessment year 1975-76 [*CIT v. Escorts Transmissions Ltd.,* (2001) 249 ITR 546, 549 (Del)].

Where the aggregate value of the machinery and plant installed, inclusive of the cost of installation, exceeded Rs. 7.5 lakhs, the assessee could not be regarded as a small scale industrial undertaking so as to be eligible for initial depreciation under section 32(1)(*vi*) for the assessment year 1976-77 [*CIT v. Usha Electronics* (*India*) *Pvt. Ltd.,* (2001) 249 ITR 695, 699-700 (Del)].

The assessee was held entitled to initial depreciation for the assessment year 1976-77 in respect of plant and machinery used for manufacture of steel wires [*CIT v. Hindustan Kokoku Wires Ltd.,* (2001) 250 ITR 41, 42-44 (Del)].

In the facts of *CIT v. Opal Construction* [(2003) 262 ITR 674, 674-75 (All)], the assessee, a small scale undertaking, has been held to be an industrial undertaking eligible for initial depreciation @ 30 per cent. on structural steel and tubular structure.

Also see, *Advani Oerlikon Ltd. v. CIT,* (1997) 141 Taxation 394, 395 (Bom).

Where the initial depreciation was to be allowed upto a particular period, it is not possible for the assessee to claim initial depreciation for a period falling beyond that particular period [see, *Barwood Estate v. State of Tamil Nadu,* (1995) 215 ITR 520, 522 (Mad)].

Manufacture or production of spark plugs and fuel injection equipment for 'agricultural machinery' cannot be equated to production of 'agricultural machinery' so as to entitle the assessee to initial depreciation in respect of it [*CIT v. Motor Industries Co. Ltd.,* (1998) 229 ITR 137, 148-49 (Karn)].

Extra shift depreciation (up to assessment year 1987-88).—*Subject-matter of allowance.*—The subject-matter of extra-shift allowance was machinery or plant, except those specifically excluded by inscription of the letters "N.E.S.A." (meaning "No Extra Shift Allowance") against their enumeration in sub-item (*ii*) of item III of Part I, Appendix I to the Income-tax Rules, 1962, used in a concern or factory and certain machinery, etc., enumerated at the end of sub-item (*iv*) of that item. No such allowance was, however, available in respect of the factory building or furniture. Electric meters were depreciable assets of the Electric Supply concern installing them, and they were entitled to multiple shift allowance [*Amalgamated Electricity Co. Ltd. v. CIT,* (1974) 97 ITR 334 (Bom)]. Similarly, wiring and fitting of electric machinery were eligible for extra-shift allowance [*Addl. CIT v. Wheel & Rim Co. of India Ltd.,* (1979) 118 ITR 16, 17 (Mad)]. But, rolling stock and locomotive of a railway company, which might have been used for twenty-four hours, were not entitled to extra-shift allowance [*CIT v. Dehri Rohtas Light Railway Co. Ltd.,* (1979) 116 ITR 847, 850-51 (Cal)].

As there is no provision for extra-shift depreciation allowance in respect of a building or furniture and fittings, the Tribunal has erred in concluding that the building and furniture in the case of the assessee was entitled for extra-shift depreciation allowance [*CIT v. General Fibre Dealers* (*P.*) *Ltd.,* (2001) 248 ITR 622, 625 (Cal)].

In *CIT v. East India Electric Supply and Traction Co. Ltd.* [(1991) 188 ITR 717, 726 (Cal)], it has been held that electric machinery used by an Electric Supply Undertaking was entitled to extra-shift allowance even after amendment of Part I of Appendix I to the Income-tax Rules, 1962, by the Income-tax (Sixth Amendment) Rules, 1969, effective for and from assessment year 1970-71.

In the facts of *CIT v. Anglo India Jute Mills Co. Ltd.* [(1993) 202 ITR 104, 107 (Cal)], it has been held that generators, motors and centrifugal pumps are rotary machines, and not stationary plant, were entitled to extra-shift depreciation allowance.

In *CIT v. Saran Khandsari Udyog* [(1993) 204 ITR 447, 449 (All)], it has been held that the generator was entitled to triple-shift depreciation allowance as it could not be said to be an 'electrical machinery'. Also see, *CIT v. Hindusthan Sanitaryware & Industries Ltd.,* (1992) 106 CTR (Cal) 268, 269; *CIT v. P. Veriah,* (1995) 211 ITR 244, 245 (Ker); *CIT v. Audco India Ltd.,* (1995) 123 CTR (Bom) 169, 171; *CIT v. Light Roofings Ltd.,* (1995) 215 ITR 916, 918 (Mad); *CIT v. S.R.P. Tools Ltd.,* (2000) 242 ITR 636, 637-38 (Mad).

Where the Tribunal has affirmed the view of the first appellate authority to the effect that the generating set could not be treated as independent of the whole concern, and that the extra-shift allowance should be granted by taking the entire concern as one unit, it has been held that no question of law arose from the Tribunal's order [*CIT v. Saraswati Industrial Syndicate Ltd.,* (2002) 257 ITR 779, 780 (Punj)].

In *CIT v. H.M.T. Ltd.* [(1993) 203 ITR 818, 819 (Karn)], the assessee was held entitled to extra-shift depreciation allowance in respect of water system and sanitation and technical documentation. Also see, *CIT v. H.M.T. Ltd.,* (1993) 203 ITR 811, 814 (Karn); *CIT v. H.M.T. Ltd.,* (1993) 203 ITR 820, 822 (Karn).

In *Hindustan Aeronautics Ltd. v. CIT* [(1994) 206 ITR 338 (Karn), special leave petition granted by the Supreme Court on one point: (1993) 203 ITR (St.) 4 (SC)], bins, racks and shelves used in a factory have been held entitled to extra-shift depreciation allowance. But, radar, which is a wireless equipment and not machinery or plant, has been held not entitled to extra-shift depreciation allowance.

In *CIT v. New India Sugar Mills Ltd.* [(1992) 105 CTR (Cal) 246, 248], the assessee was held entitled to extra-shift depreciation allowance in respect of transformer, pumping set and tube wells as these did not come under the head 'hydraulic works, pipelines and sluices'.

In the facts of *Bharat Suryodaya Mills v. CIT* [(1995) 212 ITR 6, 8 (Guj)], it has been held that extra-shift depreciation allowance was not available in respect of electrical machinery.

In *CIT v. Walchandnagar Industries* [SLP (Civil) No. 8934 of 1994: (1994) 207 ITR (St.) 19 (SC)], their Lordships of the Supreme Court have, by an order dated 15-3-1994, *dismissed* a special leave petition by the Department to appeal against the judgment dated 15-3-1993 of the Bombay High Court in ITR No. 516 of 1979, whereby the High Court on a reference held that the assessee was entitled to extra-shift allowance at 50 per cent. of full normal depreciation even though the sugarcane industry was seasonal.

In *CIT v. Karnataka Power Corporation* [SLP (Civil) Nos. 15680-15681 of 1994: (1994) 209 ITR (St.) 89-90 (SC)], their Lordships of the Supreme Court have, by an order dated 12-7-1994, dismissed a special leave petition against the judgment dated 4-12-1992 of the Karnataka High Court in ITRC Nos. 49 and 50 of 1992, whereby the High Court, on a reference, *inter alia*, held that the generator building was 'plant' and entitled to extra-shift depreciation.

In *Godavari Sugar Mills Ltd. v. CIT* [(1994) 208 ITR 801, 806 (Bom)], the Tribunal was held justified in law in determining that the extra-shift depreciation allowance for a seasonal factory as in the case of the appellant has to be calculated in proportion to the number of days the plant and machinery had actually worked and not an amount equal to the full amount of normal depreciation and thereby rejecting the claim of the appellants for

LexisNexis

extra-shift depreciation to the extent of Rs. 11,291. Also see, *Borosil Glass Works Ltd. v. CIT,* (1997) Tax LR 596 (Bom).

In *CIT v. Premier Vegetable Products Ltd.* [(1995) 215 ITR 578, 581 (Raj)], it has been held that electric motors and starters were not part and parcel of plant and machinery and were electrical machinery not entitled to extra-shift depreciation allowance.

In *CIT v. D.P.S. (I.) Pvt. Ltd.* [(1996) 222 ITR 371, 372, 374-75 (Cal)], the Tribunal was held not justified in law in holding that data processing machines, central air-conditioning plants and air-conditioners were entitled to extra-shift allowance though the words NESA (No Extra Shift Allowance) were inscribed against such machinery and plant.

In *East India Hotels Ltd. v. CIT* [(1997) 223 ITR 1, 5 (SC)], it has been ruled that plant and/or machinery installed in a hotel was entitled to extra-shift depreciation allowance. Further, an approved hotel was entitled, in addition, to extra depreciation allowance. In taking such view, the Supreme Court has **impliedly approved** the view taken in *S.P. Jaiswal Estates (P.) Ltd. v. CIT* [(1995) 216 ITR 145 (Cal)] and has **impliedly overruled** the view taken in *S.P. Jaiswal Estates Pvt. Ltd. v. CIT* [(1991) 188 ITR 603 (Cal)]. In view of this Supreme Court ruling [223 ITR 1 (SC)], the decision in *S.P. Jaiswal Estates Pvt. Ltd. v. CIT* [(1994) 209 ITR 307, 311 (Cal)] and *CIT v. Meghdoot Hotels (Pvt.) Ltd.* [(1996) 220 ITR 190, 192 (All)] **do not represent the correct state of law on the point. Following** the Supreme Court decision [223 ITR 1 (SC)], the assessee was held entitled to extra-shift allowance in respect of plant and machinery installed in its restaurant section of the hotel [*CIT v. Geetha Hotels (P.) Ltd.,* (2001) 250 ITR 879, 880 (Mad); *CIT v. Shyam Enterprises (P.) Ltd.,* (2001) 252 ITR 858, 859 (Mad)] or in its lodging section [*Geetha Hotels (P.) Ltd. v. CIT,* (2002) 257 ITR 178, 179-80 (Mad)].

Although in *CIT v. Abad Hotels India (P.) Ltd.* [(2000) 241 ITR 15, 16-17 (Ker)], the Kerala High Court has **followed** the Supreme Court decision in *East India Hotels Ltd. v. CIT* [(1997) 223 ITR 1 (SC)] and has held that the assessee was entitled to extra-shift allowance on the hotel building as if it were a 'plant', the said Kerala decision **cannot** be said to have **laid down the law correctly** on the point because the said Kerala decision has been **reversed in** *CIT v. Abad Hotels India P. Ltd.* [(2001) 251 ITR 204 (SC)] as a 'plant', even though the point as to the entitlement of the extra-shift allowance was not specifically in issue before the Supreme Court in appeal decided.

In the facts of *CIT v. Lake Palace Hotels & Motels Pvt. Ltd.* [(1997) 226 ITR 561, 564, 578 (Raj)], hotel was held not eligible for extra-shift allowance even though it was being run 24 hours a day because it was not a 'plant'.

Where it was clear that electricity was not used as a power to work the plant and machinery, but it was used as a raw material in the very process itself, the electrical sub-station attached to the Travancore Electro Chemical Industries Ltd. was held part of its main plant and machinery and it could not be treated as 'electrical machinery' disentitling the assessee to claim extra-shift depreciation allowance [*Travancore Electro Chemical Industries Ltd. v. CIT,* (1997) 224 ITR 273, 280, 281 (Ker), **followed in** *Travancore Electro Chemical Industries Ltd. v. CIT,* (1998) 229 ITR 272, 275-76 (Ker)].

In *CIT v. Kiran Crimpers* [(1997) 225 ITR 84, 101 (Guj), **followed in** *CIT v. Garden Silk Mills Pvt. Ltd.*, (2001) 252 ITR 804, 807, 808 (Guj)], the Tribunal was held not justified in holding that air-conditioners, which were necessary for functioning of the crimping yarn machine of the assessee were eligible to extra-shift depreciation allowance. This was so because air-conditioners were covered by specific entry inscribed NESA (No Extra Shift Allowance).

In *CIT v. Saraspur Mills Ltd.* [(2002) 254 ITR 522, 529 (Guj)], it has been held that the exhaust fans, which are electrical machinery do not form an integral part of textile machinery, but fall in the category of electrical machinery, which is not eligible for extra-shift allowance, even though the same is used in textile factory.

In *CIT v. Paresh S. Shah* [(1999) 238 ITR 254, 256 (Bom)], it has been held that no extra-shift allowance can be allowed on computers because these are covered by specific entry inscribed NESA [No Extra Shift Allowance]. This view has been **followed in** *CIT v. United Computers Services P. Ltd.* [(1999) 240 ITR 597, 598-99 (Bom)]; *CIT v. Computility India P. Ltd.* [(1999) 152 Taxation 430 (Bom)].

Electrical transformers, which falls within the category of excepted items under the heading 'Electrical machinery' with inscription NESA, are not eligible for extra-shift allowance even though such transformers are in the premises of the assessee as the same are under the control and supervision of the Electricity Board [*CIT v. J.K.K. Textiles Processing Mills,* (2000) 242 ITR 165, 168-69 (Mad)].

In *CIT v. New Horizon Sugar Mills (P) Ltd.* [(2000) 242 ITR 578, 579-80 (Mad)], it has been held that it is clear from para. III(*iv*)(4)(*d*) of Part I of Appendix I to the Income-tax Rules, 1962, that storage tanks are plant or machinery and that it is only the storage tanks which are owned by mineral oil concerns that are not eligible for

LexisNexis

extra-shift depreciation allowance. In that view of the matter, molasses storage tank has been held eligible for extra-shift depreciation allowance for assessment year 1983-84.

In *CIT v. General Fibre Dealers* [(2000) 246 ITR 686, 691 (Cal)], the Tribunal was held not justified in allowing extra-shift allowance on building and furniture which were not plant and machinery.

Where it is stated by the Tribunal that there was no extra-shift working in the concern of the assessee, the Tribunal was held not entitled to claim extra-shift allowance in respect of poultry farming equipment [*CIT v. M.D. Pendse,* (2001) 250 ITR 411, 412-13 (Bom)].

Hotel building is not a plant and, therefore, the assessee is not entitled to extra-shift depreciation allowance [*CIT v. Abad Hotels India P. Ltd.,* (2001) 251 ITR 204, 205 (SC)]. Also see, *CIT v. Hotel Ratnada International* (*P.*) *Ltd.,* (2002) 124 Taxman 723, 724 (Raj).

In *CIT v. Maharashtra Apex Corporation Ltd.* [(2002) 254 ITR 98, 99 (SC), **affirming** *CIT v. Maharashtra Apex Corporation Ltd.,* (1998) 234 ITR 484 (Karn)], it has been held that the assessee, carrying on the business of leasing plant and machinery, was entitled to extra-shift depreciation allowance even though it was the lessee who had used the machinery in double shift.

In *CIT v. Mahanagar Telephone Nigam Ltd.* [(2002) 254 ITR 627, 628, 629-30 (Del)], the appeal under section 260A has been dismissed because there was no merit in the appeal against the order of the Tribunal holding that extra-shift allowance was allowable, for assessment year 1987-88, on underground cables linking two exchanges treating the same as part of the plant of the assessee.

As 'cinema theatre' is not a plant the same is not eligible for extra-shift depreciation allowance [*CIT v. A.B.A. Sons,* (2003) 264 ITR 469, 470, (SC)].

Extra shift allowance has to be calculated on the basis of the number of days on which the concern worked as a whole double shift or triple shift and not on the basis of each item of machinery being used in double shift or triple shift [*CIT v. Hind Woollen & Hosiery Mills,* (2007) 294 ITR 412 (Punj)].

Reference may also be made to *Parkside Explosives & Industries Ltd. v. CIT* [(2005) 278 ITR 561 (Mad)]; *CIT v. Oswal Woollen Mills Ltd*. [(2007) 289 ITR 266 (Punj)].

In *Colour Chem Ltd. v. CIT* [(1997) 225 ITR 164, 172-73 (Bom)], the assessee was held not entitled to extra-shift allowance on certain items of machinery and plant because the same were falling within the sweep of 'electrical machinery' not eligible for extra-shift allowance.

In the facts of *Asiatic Seafoods v. CIT* [(1998) 229 ITR 172, 174-75 (Ker)], the finding of the Tribunal that the freezing plant, in the case on hand, is a part of the refrigeration plant and hence not entitled to extra-shift allowance was held to be correct. Further, the assessee must establish that it has worked double shift or triple shift, as the case may be, before claiming extra-shift depreciation allowance.

An assessee is entitled to extra shift depreciation allowance in respect of such machinery which worked extra shift even though other machinery did not so work [*CIT v. Khodiyar Pottery Works,* (1986) 158 ITR 69 (Guj), special leave petition dismissed by the Supreme Court: (1984) 150 ITR (St.) 77 (SC)]. Thus, as held in *CIT v. Khodiyar Pottery Works Ltd.* [(1993) 115 Taxation 50, 52 (Guj)], the claim of the assessee for extra-shift depreciation allowance in respect of the machineries which worked on triple shift is allowable even though the other machinery or plant did not work in triple shift. Also see, *Travancore Electro-Chemical Industries Ltd. v. CIT,* S.L.P. (Civil) No. 15449 of 1985 : (1986) 159 ITR (St.) 107 (SC).

In *CIT v. Punalur Paper Mills Ltd.* [(1988) 170 ITR 37 (Ker)], the assessee was held entitled, in view of the circular of the Board bearing F. No. 10/83/63-ITA (*II*), dated 28-9-1970, to extra-shift depreciation allowance in respect of entire machinery and not only in respect of such machinery which worked during the relevant previous year.

Relying on the said Circular dated 28-9-1970, in *CIT v. Transpek Industry Pvt. Ltd.* [(1992) 194 ITR 581, 583, (Guj)], a new plant, which worked only for 53 days in the relevant previous year, was held eligible for extra-shift depreciation allowance for the entire year.

Similarly, in *Hindustan Machine Tools Ltd. v. CIT* [(1992) 197 ITR 18, 20, 22 (Karn)], it has been held that drawings and designs which, admittedly, are plant are entitled to extra-shift depreciation allowance if it is shown that the assessee's concern had worked multiple shifts and it is not necessary to determine whether the drawings and designs themselves had actually been employed in the working of the multiple shifts.

In *Godavari Sugar Mills Ltd. v. CIT* [(1994) 208 ITR 801, 806 (Bom)], it has been held that the said circular dated 28-9-1970, is confined to 'a concern'. It does not apply to all concerns belonging to a particular assessee. In the instant case, evidently, the two sugar factories, though belonging to the same assessee, are two independent concerns. The above circular of the Board, therefore, has no application.

LexisNexis

In *National Standard Duncan Ltd. v. CIT* [judgment delivered on 10-7-1989, by the Calcutta High Court and the same has been referred to by the Calcutta High Court in (1993) 199 ITR 579, 587], wherein reliance was placed on the said circular dated 28-9-1970, it has been ruled that the Board's circular or instruction contrary to the interpretation of the rule made by the Court cannot bind the Court. However, a benevolent circular issued by the Board, not on the basis of construction of the rule contrary to the decisions of the Court but to mitigate any hardship on the application of statutory provisions as interpreted by the Court even if it deviates from the statutory provision, may be issued, which would be binding on the income-tax authorities.

In *Sriram Bearings Ltd. v. CIT* [(1993) 199 ITR 579, 587-88 (Cal)], wherein reliance was placed by the assessee on Instruction No. 1605, dated 26-2-1985, it has been held that this instruction was issued long after the decision of the Tribunal in the instant case. Therefore, the Tribunal was held justified in deciding the matter against the assessee-company by holding that allowance for double shift and triple shift working should be calculated with reference to the number of days for which the particular plant or machinery had actually worked extra-shift. It was also observed that the said instruction was prospective in its application.

In *Travancore Chemical & Manufacturing Co. Ltd. v. CIT* [(1993) 199 ITR 484, 488 (Ker)], the matter was remanded to the Tribunal to consider the claim of the assessee for extra-shift depreciation allowance afresh in the light of the abovesaid circular dated 28-9-1970, and Instruction No. 1605, dated 26-2-1985.

However, a contention of the assessee based on the said circular dated 28-9-1970, did not find favour with the Allahabad High Court in *CIT v. J.K. Cotton Spinning & Weaving Mills Co. Ltd.* [1991) 188 ITR 80 (All)].

On the point of extra shift allowance, reference may also be made to *CIT v. Sriramakrishna Steel Industries Ltd.* [(1998) Tax LR 630, 631 (Mad)]; *CIT v. Sun-N-Sand Hotel* [SLP (Civil) Nos. 7635-7636 of 1981 : (1986) 161 ITR (St.) 131 (SC)]; *CIT v. Phalton Sugar Works Ltd.* [(1986) 162 ITR 622 (Bom)]; *CIT v. Maharashtra Apex Corporation Ltd.* [CC No. 463 of 1998 : (1998) 230 ITR (St.) 89 (SC)].

Departmental circulars.—The following two departmental **circulars**, which are reproduced here from (1993) 199 ITR 484, 488-89 (Ker), are relevant to the calculation of extra-shift depreciation allowance:—

I. *'Calculation of depreciation—Extra-shift allowance in respect of plant and machinery.*—The Board have decided that where a concern has worked double shift or triple shift, extra-shift allowance will be allowed in respect of the entire plant and machinery used by the concern without making any attempt to determine the number of days on which each machine actually worked double or triple shift during the relevant previous year.' [*Circular No. 10/83/69-IT(A-II), dated 28-9-1970*].

II. *'Calculation of depreciation for extra-shift working of plant and machinery under section 32 of Income-tax Act, 1961 (43 of 1961), read with rule 5 of Income-tax Rules, 1962— Instruction under section 119(1) of Income-tax Act.*—The Board had laid down in their letter No. 10/83/69/IT(A-II), dated 28-9-1970, that extra-shift allowance will be allowed in respect of the entire plant and machinery used by a concern which has worked extra-shift, without making any attempt to determine the number of days on which each machinery or plant actually worked extra-shift during the relevant previous year. In Circular No. 109, dated 20-3-1973 [see (1973) 89 ITR (St.) 30: under section 32(1), *post*], it was mentioned that the said allowance should be calculated for the period for which the concern has actually worked extra-shift expressed in terms of the proportion which such period bears to the 'normal number of working days during the previous year'. Except machinery or plant against which the letters NESA appear and those listed under clause (*iv*) of Item III in Part I of the Schedule, the balance of the machinery or plant of the concern would be entitled to extra-shift allowance.

2. Subsequently, the Allahabad High Court in *Kundan Sugar Mills v. CIT* [(1977) 106 ITR 704], the Calcutta High Court in the case of *Anantapur Textiles Ltd. v. CIT* [(1979) 116 ITR 851] and lately the Madras High Court in *South India Viscose Ltd. v. CIT* [(1982) 135 ITR 206], have held that extra-shift allowance would be admissible with reference to the number of days on which the particular machinery or plant has worked extra-shift and not on the basis of the working of the concern. It may be mentioned that Board's letter dated 28-9-1970, and the Circular No. 109, dated 20-3-1973 [see (1973) 89 ITR (St.) 30] have not been cited before these Courts and, therefore, had not been considered by them. Receipt audit has been raising objections on the basis of these decisions where the Assessing Officers had allowed extra-shift allowance on the basis of the working of the concern as a whole instead of the working of individual plant and machinery.

3. The instructions issued earlier have been considered again by the Board. In exercise of the powers conferred by section 119(1) of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes, being of the opinion that it is expedient for the proper administration of these provisions, directs that the grant of extra-shift allowance for plant and machinery be calculated with reference to the working of a factory situated at a place and not with reference to the number of days each machinery and plant has worked. Where a concern has more than one factory, the extra-shift allowance will be regulated for each factory in the above manner. As

LexisNexis

the determination of the number of days each machinery or plant has worked in a factory is cumbersome, the existing instructions and the present clarification are aimed at simplifying the calculation of extra-shift allowance.' [*Instruction No. 1605: F. No. 202/27/84-II* (*A-II*)*, dated 26-2-1985*].

In *CIT v. Jaipur Udyog Ltd.* [(1997) 225 ITR 1053, 1061 (Raj)], the Tribunal was held not justified in holding that extra-shift allowance equal to normal depreciation should be allowed, for assessment year 1967-68, for the full year in respect of the assets which were used during the year for more than 30 days but less than 180 days. This view has been **followed in** *CIT v. Jaipur Udyog Ltd.* [(1997) 227 ITR 345, 349 (Raj), a case relating to assessment year 1970-71 and *CIT v. Jaipur Udyog Ltd.,* (1997) 142 CTR (Raj) 534, 535, a case relating to assessment year 1968-69]. This view **does not seem to be correct on the point** in view of the Supreme Court ruling in *South India Viscose Ltd. v. CIT* [(1997) 227 ITR 286 (SC)], discussed hereunder.

In *South India Viscose Ltd. v. CIT* [(1997) 227 ITR 286, 300 (SC), **reversing** *South India Viscose Ltd. v. CIT,* (1982) 135 ITR 206 (Mad)], the Supreme Court has ruled that extra-shift allowance had to be calculated on the basis of number of days during which the concern had actually worked double shift or triple shift and the said allowance was not required to be calculated on the basis of the number of days a particular item of machinery or plant had worked double shift or triple shift. In view of this Supreme Court ruling, the decision in *CIT v. South India Viscose Ltd.* [(1987) 163 ITR 674, 677-78 (Mad)] **does not represent the correct state of law on the point.**

In that view of the matter, the assessee was held entitled to extra-shift allowance in respect of the machinery added during the previous year relevant to assessment year 1970-71 on the basis of double and triple shifts worked by the entire concern [*Sundaram Spinning Mills v. CIT,* (1997) 227 ITR 301, 302 (SC)].

The Supreme Court ruling [227 ITR 286 (SC)] has been **followed in** *CIT v. Alagappa Cotton Mills* [(1999) 235 ITR 327, 328 (Mad)]; *CIT v. Ambur Co-operative Sugar Mills Ltd.* [(1999) 240 ITR 828, 829 (Mad)]; *United Bleachers Ltd. v. CIT* [(2000) 241 ITR 295, 296 (Mad)]; *CIT v. D.P.F. Textiles Ltd.* [(2000) 241 ITR 548, 550 (Mad)]; *Sri Karunambikai Mills Ltd. v. CIT* [(2000) 243 ITR 799, 802 (Mad)]; *Jay Engineering Works Ltd. v. CIT* [(2003) 183 CTR (Del) 326, 329].

It may be noted that the Supreme Court has, in *South India Viscose Ltd. v. CIT* [(1997) 227 ITR 286, 300 (SC)], not considered it necessary to go into the question whether the above circular dated 28-9-1970 and Instruction No. 1605, dated 26-2-1985 issued by the Board could be taken into consideration for the purpose of construing the provisions of rule 5 and Appendix I to the Income-tax Rules, 1962, because such circular and instruction were in consonance with the construction placed by the Supreme Court on the said provisions.

In *Tirupur Textiles* (*P.*) *Ltd. v. CIT* [(1998) 98 Taxman 180, 182 (Mad)], **relying on** the abovesaid Instruction No. 1605, dated 26-2-1985, it has been held that when the Department itself is granting the benefit to the assessee, in the matter of allowing the extra-shift allowance, the Tribunal is not correct in holding that the extra-shift allowance has to be worked out on the basis of the working of each machinery and not on the basis of the working of the concern as a whole.

Occasion.—The occasion for claiming an extra shift depreciation allowance was double shift working, and from assessment year 1964-65, triple or multiple shift working of the factory or concern.

Extent of allowance.—An extra allowance up to a maximum of an amount equal to one-half of the normal depreciation allowance was allowed on account of double shift working. Similarly, an extra allowance up to a maximum of an amount equal to the normal depreciation allowance instead of one-half of the normal depreciation allowance was allowed if the factory or concern worked more than two shifts (triple shift or multiple shift).

How to calculate?—For the purpose of calculation of the extra shift depreciation allowance, the normal working days of a factory or concern were taken to be,—

—For and from assessment year 1970-71	*—For Assessment years earlier to 1970-71*
—in case of seasonal factory or concern, the number of days, on which the factory or concern actually worked during the previous year or 180 days, whichever was greater;	—300 days
—in any other case, the number of days on which the factory or concern actually worked during the previous year or 240 days, whichever was greater.	
The calculation of the extra allowance	The calculation of extra allowance for double shift working

LexisNexis

for double shift working was to be made in the proportion which the number of days for which the factory or concern worked double shift bore to the normal number of working days during the previous year. For example, where a non-seasonal concern worked 270 days during the previous year out of which it worked double shift on 135 days, the extra depreciation allowance for double shift working was to be $\frac{135}{270}$, *i.e.,* ½ of the one-half of the normal depreciation.

was to be made in the proportion which the number of days for which the factory or concern worked double shift bore to the normal number of working days throughout the previous year. For example, where a factory or concern worked 270 days during the previous year out of which it worked double shift on 135 days, the extra depreciation allowance for double shift working was to be $\frac{135}{300}$, *i.e.*, $\frac{9}{20}$ of the one-half of the normal depreciation.

Similarly, for triple or multiple shift working, the calculation of the extra allowance was to be made in the proportion which the number of days for which the factory or concern worked triple shift or multiple shift bore to the normal number of working days during the previous year.

Similarly, from assessment year 1964-65, for triple or multiple shift working, the calculation of the extra allowance was to be made in the proportion which the number of days for which the factory or concern worked triple or multiple shift bore to the normal number of working days throughout the previous year.

For example, where a non-seasonal factory or concern worked 270 days during the previous year out of which it worked triple shift on 135 days and double shift on another 90 days, the extra shift depreciation allowance for tripal shift working was to be $\frac{135}{270}$, *i.e.*, ½ of the normal allowance, and that for double shift working $\frac{90}{270}$, *i.e.,* ⅓ of one-half of the normal allowance.

For example, where a factory or concern worked 270 days during the previous year out of which it worked triple shift on 135 days and double shift on another 90 days, the extra shift depreciation allowance for triple shift working was to be $\frac{135}{300}$, *i.e.,* $\frac{9}{20}$ of the normal allowance, and that for double shift working $\frac{90}{300}$, *i.e.,* $\frac{3}{10}$ of one-half of the normal allowance.

LexisNexis

Constitutionality.—Sub-item (*iv*) of item III of Part I of Appendix I to the Income-tax Rules, 1962 (operative for assessment years 1970-71 to 1987-88) in so far as it relates to depreciation with regard to seasonal factories does not create unreasonable discrimination so as to be violative of article 14 of the Constitution [*Aska Co-operative Sugar Industries Ltd. v. Union of India,* (1988) 174 ITR 311 (Ori)].

Working out of extra-shift allowance up to assessment year 1969-70.—For the purpose of granting extra allowance for double-shift working, the normal number of working days were to be taken as 300 days. As for example, if a factory has worked double shift only for 100 days, the extra allowance for double shift would be (100/300) ⅓ of 50 per cent. of normal depreciation for the year. For working out extra-shift allowance in case of seasonal factories, the special provisions[1] for working out normal depreciation were not to be taken into account. In other words, extra-shift allowance in case of seasonal factory was also to be ascertained as per the method to be adopted in case of non-seasonal factories or concerns [*CIT v. Khedut Sahakari Udyog Mandli,* (1976) 104 ITR 206, 211-12 (Guj.); *Ganesh Sugar Mills Ltd. v. CIT,* (1969) 73 ITR 395, 399 (Cal); *Raza Sugar Co. v. CIT,* (1970) 76 ITR 541 (All); *Shadi Lal Sugar & General Mills Ltd. v. CIT,* (1976) 103 ITR 748 (All); *Kundan Sugar Mills v. CIT,* (1977) 106 ITR 704, 707 (All); *Raza Sugar Co. Ltd. v. CIT,* (1981) 130 ITR 421 (Del); *Buland Sugar Co. Ltd. v. CIT,* (1981) 130 ITR 434 (Del); *Addl. CIT v. Sarvaraya Sugars Ltd.,* (1981) 129 ITR 538 (AP—FB)]. Extra-shift allowance was to be calculated on the basis of the number of days any particular plant or machinery has worked and not on the basis of the number of days that the concern has worked [*Anantapur Textiles Ltd. v. CIT,* (1979) 116 ITR 851, 860-61 (Cal); *CIT v. North Dhemo Coal Co. Ltd.,*

1. Reference may be made to the second proviso to rule 8 of the 1922 Rules, as it stood prior to its substitution by *Notification No. S.O. 2363, dated 23-9-1960*; to the second proviso to rule 8(1); to the first proviso to rule 8(2) after such substitution; and to the second proviso to rule 5(1) of the 1962 rules, as it stood up to 31-3-1970.

(1977) 106 ITR 592 (Cal); *CIT v. Saraswati Industrial Syndicate Ltd.,* (1982) 136 ITR 366, 376 (Punj); *Sriram Bearings Ltd. v. CIT,* (1993) 199 ITR 579 (Cal)]. The extra allowance was computed for each plant or machinery that has worked double or triple shift [*Dhampur Sugar Mills Ltd. v. CIT,* (1980) 126 ITR 648 (All—FB), holding that the decisions in *L.H. Sugar Factories and Oil Mills P. Ltd. v. CIT,* (1979) 118 ITR 985 (All) and *Dhampur Sugar Mills Ltd. v. CIT,* (1980) UPTC 915 (All) **do not lay down correct law**]. The Allahabad Full Bench decision [126 ITR 648 (All—FB)] has been **followed in** *CIT v. J.K. Cotton Spinning and Weaving Mills Co. Ltd.* [(1991) 188 ITR 80 (All)]; *CIT v. Cawnpore Textiles Ltd.* [(1992) 108 CTR (All) 53]. Also see, *CIT v. Plastic Products Ltd.,* (1993) 112 Taxation 431 (All); *Juggilal Kamlapat Spinning and Weaving Mills Co. Ltd. v. CIT,* SLP (Civil) No. 15403 of 1991: (1992) 193 ITR (St.) 25 (SC); *Sir Shadilal Sugar & General Mills Ltd. v. CIT,* (1992) Tax LR 386, 391 (All).

In *Sir Shadilal Sugar & General Mills Ltd. v. CIT* [(1995) Supp (1) SCC 284, 287-88 (SC)], the Supreme Court has **approved** the view taken by the Full Bench of the Allahabad High Court [126 ITR 648 (All—FB)] and of the Andhra Pradesh High Court [129 ITR 538 (AP—FB)] holding that in case of a seasonal factory which has worked for 152 days the assessee is entitled to extra-shift allowance to be calculated worked for 152 days the assessee is entitled to extra-shift allowance to be calculated only on the basis of actual working days, *i.e.,* 152/300 days envisaged in rule 5 read with the Appendix I. The Supreme Court has also pointed out that the Allahabad decision [118 ITR 629 (All)] has been **overruled** by the Allahabad Full Bench [126 ITR 648 (All—FB)].

In this context, an artificial meaning has been ascribed to the "normal (depreciation) allowance" so as to mean "the amount of depreciation allowance (other than the extra depreciation allowance for multiple shift working) that would have been allowed under rule 5 if the machinery or plant had been used during the previous year for a period of 180 days or more, or in the case of a seasonal factory, if that factory had been worked by the assessee during all the working seasons of the previous year" [*J.K. Synthetics Ltd. v. CIT,* (1979) 118 ITR 629 (All)]. In that case, the assessee's factory worked, double shift, for a total number of 112 days in the year. The assessee was thus, entitled to 50 per cent. of the normal depreciation (as it did not work for 180 days) which worked out to Rs. 9,61,635 (50 per cent. of Rs. 19,23,270). It was held that the assessee was entitled to a double-shift allowance of Rs. ½

$\left(19,23,270 \times \frac{112}{300}\right)$ *i.e.,* Rs. 3,59,010. Also see, *Anantapur Textile Ltd. v. CIT,* 1979) 116 (ITR 851, 859-60 (Cal).

LexisNexis

Interpreting the provisions with regard to extra-shift depreciation allowance, as these were operative upto assessment year 1969-70, the Bombay High Court, in *Godavari Sugar Mills Ltd. v. CIT* [(1992) 193 ITR 756, 767-69 (Bom)], has laid down as follows:—

'(1) The assessee is entitled to extra-shift depreciation allowance as may be computed in accordance with the formula prescribed in the remarks column of item III of Part I of Appendix I referred to in rule 5 of the Income-tax Rules, 1962. The extra-shift allowance must be computed by applying the same formula for seasonal and non-seasonal factories alike, *i.e.,* by first working out the proportion which the number of actual working days of extra-shift bears to 300 days, apply the prescribed rate of depreciation to each item of machinery and plant for which extra-shift allowance is permissible and then compute the quantum at the rate of 50% or 100% of the "normal allowance" in the case of double shift and triple shift, respectively.

(2) The "Remarks column" of item III of Part I of Appendix I to the Income-tax Rules, 1962, constitutes a special law for calculation of extra-shift depreciation allowance. The said provision applies to the exclusion of the general provisions meant to be applied only for computation of "normal allowance". No extra-shift allowance is permissible in case of items of machinery and plant which have been specifically excepted by the inscription of the letters "N. E. S. A." against it in the said Appendix forming part of the rules.

(3) Second proviso to rule 5 is not applicable to computation of extra-shift allowance. It is a proviso in the true sense of the term and not an independent provision. The second proviso to rule 5 cannot be invoked by seasonal factories for computation of extra-shift allowance. The criteria of the factory being required to work for 180 days or more for grant of full normal allowance is not applicable for computation extra-shift depreciation allowance in the case of non-seasonal factories. Criteria of 300 days prescribed in the remarks column of item III of Part I of Appendix I is applicable alike to seasonal and non-seasonal factories and all concerns alike.

(4) *Explanation I* to item II of Part I of Appendix I shall have to be read consistently with the criteria of working out the proportion in the light of legal fiction of 300 days being prescribed as normal number of working days for the year.

(5) Specific provisions for computation of extra-shift allowance cannot be ignored or interpreted contrary to their plain meaning merely on the ground that the extension of the second proviso to rule 5 to cases of extra-shift allowance would be more just and reasonable according to the assessee.

(6) The rule-making authorities can prescribe different criteria and different methods of computation for calculation of normal allowance on the one hand and extra shift allowance on the other. There is no legal obligation to prescribe the same uniform rule for computation of extra-shift allowance. It is not correct to state that the plain and literal interpretation of the provisions would create an anomaly and the remarks column of item III of Part I of Appendix I, should be, therefore, applied to seasonal factories after deleting or omitting the last three sentences therefrom. No such exercise is permissible. Mere prescription of different methods of computation for calculation of normal allowance and extra-shift allowance does not create any anomaly.

(7) The construction of relevant rules by different High Courts of the country appears to us, with respect, to be correct. We, respectfully, follow the decisions of different High Courts which hold the field.

(8) The rule-making authority has created different legal fictions for computation of normal allowance and extra-shift allowance. The said fictions are to be applied in their respective areas of operation and cannot be inter-mixed or interchanged.'.

In the Bombay case [193 ITR 756 (Bom)], the assessee claimed deduction of a sum of Rs. 3,71,888 on account of extra-shift depreciation allowance for the assessment year 1964-65. Such calculation was made on the basis of the working days of the season and not 300 days on the ground that the working out on the basis of 300 days was applicable only to non-seasonal factories. Negativing the assessee's claim, it has been held that even in case of seasonal factories the working out of such depreciation allowance was to be made on the basis of 300 days. On that basis, the assessee was held entitled to a sum of Rs. 2,33,808 as allowed by the ITO and upheld by the Tribunal.

Questions of law.—(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee was entitled to extra shift allowance on the entire plant and machinery including that installed during the relevant previous year irrespective of the fact as to for how many days the concern has worked double shift or triple shift during the previous year [*CIT v. J.K. Synthetics Ltd.,* (1990) 182 ITR 409, 412 (Del), special leave petition granted by the Supreme Court : (1992) 198 ITR (St.) 164 (SC)].

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the assessee was entitled to extra-shift allowance on air-conditioning machine installed in the Nylon and Acrylic units [*CIT v. J.K. Synthetics Ltd.,* (1997) 140 Taxation 299, 301, 303 (Del)].

(3) Whether, on the facts and in the circumstances of the case, extra-shift allowance on new plant and machinery is to be allowed on the basis of the working of the undertaking as a whole or on the basis of the number of days the machinery had worked extra shifts during the year [*CIT v. Smithkline Beecham Consumer Brands Ltd.,* (1997) 226 ITR 764, 774 (Punj)].

(4) Whether the Tribunal was right in law in allowing extra-shift allowance on electric installations and electric machinery marked 'N.E.S.A.' in the Appendix I read with rule 5 of the Income-tax Rules, 1962 [*CIT v. Vardhman Spinning & General Mills Ltd.,* (1998) 98 Taxman 24, 25 (Punj)] Also see, *CIT v. Vardhman Spinning & General Mills Ltd.,* (1998) 99 Taxman 206, 209-10 (Punj).

(5) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in allowing extra-shift allowance on transformers, electric sub-station and electric motors which are stationary installations [*CIT v. Vardhman Spinning & General Mills Ltd.,* (1999) 237 ITR 795, 798 (Punj)].

(6) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee had claimed extra-shift allowance on computer only and not on data processing machines and computer is eligible for extra-shift allowance despite the fact that Appendix-I, III-C(3) of the Income-tax Rules, 1962, clearly, prohibit granting extra-shift allowance on both the above items [*CIT v. E. Merck Service & Agencies,* (2001) 248 ITR 10, 11, 12 (SC)].

Remand to the Tribunal.—Where the Tribunal has allowed extra-shift allowance without recording a proper finding of fact, the matter has been remanded to the Tribunal to consider the same in the light of circular No. 10/83/69, dated 28-9-1970 and Instruction No. 1605, dated 26-2-1985 [*CIT v. Travancore Chemical & Manufacturing Co. Ltd.,* (1998) 234 ITR 532, 535 (Ker)].

Where the Tribunal has allowed the claim of the assessee in respect of extra-shift allowance merely on the ground that the electrical machinery had become part and parcel of the plant to which it was installed, without examining the details of the electrical machinery, the matter has been remanded to the Tribunal for fresh

LexisNexis

adjudication in the light of the observations made in the judgment [*CIT v. Oswal Woollen Mills Ltd.,* (2002) 257 ITR 737, 742 (Punj)]. Similar course has been adopted in *CIT v. Oswal Woollen Mills Ltd.* [(2002) 257 ITR 781, 782-83 (Punj)].

Compulsory closure due to power cut.—Even under the old rules, the period of compulsory closure due to power cut was disregarded in determining the rates of normal as well as extra shift depreciation. The following departmental **circular** elaborates the point:—

Depreciation allowance—Normal and extra shift depreciation allowance—Days of compulsory closure due to power cut—Treatment of, for purposes of computation of depreciation allowance.—"A suggestion was recently made that the days of compulsory closure of factories brought about by power cut should not be excluded from the number of working days determined for the purposes of normal depreciation and of extra depreciation for additional shift working. The Board have carefully considered the request and are pleased to direct that for the purposes of calculating the normal depreciation allowance the days of compulsory closure attributable to power cut should not be excluded from the number of working days. In the case of double or triple shift allowance, however, the Board have decided that, since this allowance is really meant to cover the actual extra wear and tear resulting from the additional shifts, the days on which the machinery remains completely idle cannot be taken into account in computing the extra shift allowance." [*Circular No. 43 (XIX-4)-D of 1952, F. No. 27 (35)-IT/52, dated 17th November, 1952*].

Extra depreciation allowance for approved hotels.—For assessment years 1970-71 to 1987-88, an extra allowance of depreciation has been provided for deduction in case of machinery and plant installed by an Indian company in premises used by it as a hotel, where such hotel is for the time being approved by the Central Government for the purposes of section 33. The extent of such extra allowance is an amount equal to one-half of the normal allowance. In other words, a total of 150 per cent. of normal allowance is admissible in respect of such assets [sub-item (*iii*) of item III of Part I of Appendix I to the Income-tax Rules, 1962].

An approved hotel cannot claim extra-shift allowance in addition to extra depreciation allowance for approved hotels. An extra-shift allowance was for double or multiple shift working of the machinery or plant in a factory or concern, whereas extra depreciation allowance was allowable only in respect of machinery and plant installed in an approved hotel [*S.P. Jaiswal Estates Pvt. Ltd. v. CIT,* (1991) 188 ITR 603, 608 (Cal), **followed in** *S.P. Jaiswal Estates Pvt. Ltd. v. CIT,* (1994) 209 ITR 307, 311 (Cal) and *CIT v. Meghdoot Hotels* (*Pvt.*) *Ltd.,* (1996) 220 ITR 190, 192 (All)]. This view has **impliedly been overruled in** *East India Hotels Ltd. v. CIT* [(1997) 223 ITR 1, 5 (SC)].

In *CIT v. East India Hotels Ltd.* [(1994) 209 ITR 854, 860 (Cal)], the assessee was held entitled to extra depreciation as the same was an approved hotel for the assessment year 1982-83 although such approval was granted under section 33 after the withdrawal of the allowance of development rebate. Similar view has also been taken in *Covelong Beach Hotel* (*India*) *Ltd. v. CIT* [(2000) 242 ITR 512, 514 (Mad)] for the assessment year 1982-83.

The extra depreciation allowance for approved hotels cannot be claimed by a leasing company who has leased its machinery and plant to the hotel. This is so because to be eligible for extra depreciation allowance, the assessee must be an Indian company and the machinery and plant should be installed in the premises used by the assessee as an approved hotel [*First Leasing Co. of India Ltd. v. CIT,* (2000) 244 ITR 234, 234-35 (Mad). Also see, *CIT v. First Leasing Co. of India Ltd.,* (2000) 241 ITR 248, 251 (Mad)].

Approval of hotels.—The following **departmental circular** is relevant on the point:—

'Approval of hotels for the purpose of claiming the various tax concessions envisaged in the Income-tax Act, 1961.—Attention is invited to the Board's U. O. No. XVI/II/77, on the above subject. *Vide* this Circular, the Department of Tourism in the Ministry of Tourism and Civil Aviation was declared the delegated authority for according approvals under sections 32(1)(*v*)[2], 33(1)(*b*)(B)(*ii*), 80B(7) (since omitted) and s. 80J(6)(*d*)[3] of the Income-tax Act, 1961, to the domestic companies conducting the business of running hotels.

2. It appears that most of the field officers are not aware of this circular. I am, therefore, directed to enclose a copy of the said circular for their information and guidance.

3. It has, however, been observed that sometimes the administrative approvals granted by the Department of Tourism to domestic companies for running hotels is treated by the income-tax authorities as the approval under the various sections of the Income-tax Act. This is not correct. The administrative approval of the Department of Tourism for running a hotel is something absolutely different from the approvals granted by that Department in the capacity of a delegated authority enabling the companies to avail of the benefits under the various sections of the Income-tax Act. The Board have been advised that the hotel industry must come up before the delegated authority and seek approvals under the specific sections of the Income-tax Act. The

2. Section 32(1)(*v*) has been omitted with effect from 1-4-1988.

3. Section 80J has been omitted (w. r. e. f. 1-4-1989) by the Finance (No. 2) Act, 1996 (33 of 1996).

benefits under the various sections of the Income-tax Act referred to above should be given to the hotel industry only if they have in their possession specific approvals under the above sections and not on the basis of administrative approvals for running the hotel industry.' [*Circular No. 383, dated 22nd June, 1984]*.

'Enclosure XVI/II/77—Approval of hotels for the purpose of claiming the various tax concessions envisaged in the Income-tax Act, 1961

The attention of the Ministry of Tourism and Civil Aviation is invited to this Department's U.O. No. 4/13/68/ITA(I), dated September 29, 1969, and also their U.O. No. Dir. (Hotel)/69, dated October 16, on the above subject.

2. In order to avail itself of the various tax concessions granted under the Income-tax Act, 1961, a domestic company carrying on hotel business has to obtain the approval of the Central Government under the following sections of the Act:

(*i*) Approval under section 32(1)(*v*)[4] for the purposes of claiming initial depreciation on new buildings;

(*ii*) Approval under section 33(1)(*b*)(B)(*ii*) for the purposes of availing development rebate on new plant and machinery at higher rates applicable to priority industries;

(*iii*) Approval under section 80B(7)[5] for treatment as priority industry for the purposes of Chapter VI-A of the Income-tax Act. Such an approval would entitle the company to deduct 8 per cent. of the profits derived from its hotel business in computing its total income as provided in section 80-I[5] of the Act.

(*iv*) Approval under section 80J(6)(*d*)[6] for the purpose of claiming tax holiday benefits.

Relevant extracts of the above sections of the Income-tax Act are given in the Annexure (not given here).

3. The question regarding the grant of approval of domestic companies by the Central Government for the purposes of the various tax concessions as set out in the previous paragraph has been examined by the Board and they agree to the suggestion of the Department of Tourism in their U.O. Note under reference that the approval of hotels for the purposes of the various tax concessions envisaged in the Income-tax Act, 1961, should be accorded by the Department of Tourism because that Department is in a better position to judge whether a particular hotel measures up to the standards adopted by them in this behalf. In case of any doubt or if any clarification is needed, Department of Tourism may consult the Ministry of Finance, Department of Revenue, before any approval is granted under any of the aforesaid sections of the Income-tax Act, 1961.

4. There are various sections in the Income-tax Act, under which approval of the Government of India is needed for entitlement of the reliefs/concessions provided therein. Whenever approval of the Central Government is required for the purposes of the Income-tax Act, such approval, in the case of hotels, will be given by the Ministry of Tourism and Civil Aviation.

5. Since the actual relief in the computation of the taxable income will be allowed by the Income-tax Officer, Ministry of Tourism and Civil Aviation are requested to endorse two copies of their letter conveying the Central Government's approval in this behalf to the Ministry of Finance (Department of Revenue) for transmission to the Commissioner of Income-tax concerned.

6. A copy of the Press Note issued in this behalf is also enclosed.'.

LexisNexis

4. Section 32(1)(*v*) has been omitted with effect from 1-4-1988.
5. Section 80B(7) and 80-I were omitted with effect from 1-4-1973.
6. Section 80J has been omitted (w. r. e. f. 1-4-1989) by the Finance (No. 2) Act, 1996 (33 of 1996).

Omitted/Phased-out provisions of section 32A of the 1961 Act

[1][**S. 32A. Investment allowance.—**](1) In respect of a ship or an aircraft or machinery or plant specified in sub-section (2), which is owned by the assessee and is wholly used for the purposes of the business carried on by him, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction, in respect of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed or, if the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, of a sum by way of investment allowance equal to twenty-five per cent of the actual cost of the ship, aircraft, machinery or plant to the assessee:

[2][*Provided* that in respect of a ship or an aircraft or machinery or plant specified in sub-section (8B), this sub-section shall have effect as if for the words "twenty-five per cent", the words "twenty per cent" had been substituted:

Provided further that] no deduction shall be allowed under this section in respect of—

(*a*) any machinery or plant installed in any office premises or any residential accommodation, including any accommodation in the nature of a guest-house;

(*b*) any office appliances or road transport vehicles;

(*c*) any ship, machinery or plant in respect of which the deduction by way of development rebate is allowable under section 33; and

(*d*) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year.

[3][*Explanation.*—For the purposes of this sub-section, "actual cost" means the actual cost of the ship, aircraft, machinery or plant to the assessee as reduced by that part of such cost which has been met out of the amount released to the assessee under sub-section (6) of section 32AB.]

(2) The ship or aircraft or machinery or plant referred to in sub-section (1) shall be the following, namely:—

(*a*) a new ship or new aircraft acquired after the 31st day of March, 1976, by an assessee engaged in the business of operation of ships or aircraft;

(*b*) any new machinery or plant installed after the 31st day of March, 1976,—

(*i*) for the purposes of business of generation or distribution of electricity or any other form of power; or

[4][(*ii*) in a small-scale industrial undertaking for the purposes of business of manufacture or production of any article or thing; or

(*iii*) in any other industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule:]

[5][*Provided* that nothing contained in clauses (*a*) and (*b*) shall apply in relation to—

(*i*) a new ship or new aircraft acquired, or

(*ii*) any new machinery or plant installed,

after the 31st day of March, 1987, but before the 1st day of April, 1988, unless such ship or aircraft is acquired or such machinery or plant is installed in the circumstances specified in clause (*a*) of sub-section (8B) and the assessee furnishes evidence to the satisfaction of the Assessing Officer as specified in that clause;]

LexisNexis

---

1. Section 32A has been inserted by the Finance Act, 1976 (66 of 1976), s. 8 (w. e. f. 1-4-1976).

2. Subs., for "Provided that", by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989), s. 6(*a*)(*i*) (w. e. f. 1-4-1989).

3. Ins. by Act 3 of 1989, s. 6(*a*)(*ii*) (w. e. f. 1-4-1989).

4. Clauses (*ii*) and (*iii*) have been substituted by the Finance (No. 2) Act, 1977 (29 of 1977), s. 9(*a*)(*i*) (w. e. f. 1-4-1978), for the following:—

"(*ii*) for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Ninth Schedule; or

(*iii*) in a small-scale industrial undertaking for the purposes of business of manufacture or production of any other articles or things.".

5. Ins. by Act 3 of 1989, s. 6(*b*) (w. e. f. 1-4-1989).

[6][(*c*) any new machinery or plant installed after the 31st day of March, 1983, but before the [7][1st day of April, 1987,] for the purposes of business of repairs to ocean-going vessels or other powered craft if the business is carried on by an Indian company and the business so carried on is for the time being approved for the purposes of this clause by the Central Government.]

Explanation.—For the purposes of [8][this sub-section and sub-sections (2B), (2C) and (4)],—

[9][(1) (*a*) "new ship" or "new aircraft" includes a ship or aircraft which before the date of acquisition by the assessee was used by any other person, if it was not at any time previous to the date of such acquisition owned by any person resident in India;

(*b*) "new machinery or plant" includes machinery or plant which before its installation by the assessee was used outside India by any other person, if the following conditions are fulfilled, namely:—

(*i*) such machinery or plant was not, at any time previous to the date of such installation by the assessee, used in India;

(*ii*) such machinery or plant is imported into India from any country outside India; and

(*iii*) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Indian Income-tax Act, 1922 (11 of 1922), or this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;]

(2) an industrial undertaking shall be deemed to be a small-scale industrial undertaking, if the aggregate value of the machinery and plant (other than tools, jigs, dies and moulds) installed, as on the last day of the previous year, for the purposes of [10][the business of the undertaking does not exceed,—

[11][(*i*) in a case where the previous year ends before the 1-8-1980, ten lakh rupees;

(*ii*) in a case where the previous year ends after the 31st day of July, 1980, but before the 18th day of March, 1985, twenty lakh rupees; and

(*iii*) in a case where the previous year ends after the 17th day of March, 1985, thirty-five lakh rupees,] and for this purpose the value of any machinery or plant shall be,—]

(*a*) in the case of any machinery or plant owned by the assessee, the actual cost thereof to the assessee; and

(*b*) in the case of any machinery or plant hired by the assessee, the actual cost thereof as in the case of the owner of such machinery or plant.

[12][(2A) The deduction under sub-section (1) shall not be denied in respect of any machinery or plant installed and used mainly for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule, by reason only that such machinery or plant is also used for the purposes of business of construction, manufacture or production of any article or thing specified in the said list.

(2B) Where any new machinery or plant is installed after the 30th day of June, 1977, [13][but before the 1st day of April, 1987,] for the purposes of business of manufacture or production of any article or thing and such article or thing—

LexisNexis

---

6. Ins. by the Finance Act, 1983 (11 of 1983), s. 11(*a*)(*i*) (w. e. f. 1-4-1984).

7. Subs., for "1st day of April, 1988", by the Finance Act, 1986 (23 of 1986), s. 7(*a*)(*i*) (w. e. f. 1-4-1987).

8. Subs., for "this sub-section and sub-sections (2B) and (4)", by Act 11 of 1983, s. 11(*a*)(*ii*) (w. e. f. 1-6-1983). Earlier, the words, brackets, figures and letter "this sub-section and sub-sections (2B) and (4)" were substituted for "this sub-section and sub-section (4)" by the Finance (No. 2) Act, 1977 (29 of 1977), s. 9(*a*)(*ii*) (w. e. f. 1-4-1978).

9. Subs. by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), s. 32(*a*) (w. e. f. 1-4-1988), for the following:—

'(1) "new ship" or "new aircraft" or "new machinery or plant" shall have the same meanings as in the *Explanation* to clause (*vi*) of sub-section (1) of section 32;'.

10. Subs. by the Finance Act, 1981 (16 of 1981), s. 5 (w. e. f. 1-4-1981), for "the business of the undertaking does not exceed ten lakh rupees; and for this purpose the value of any machinery or plant shall be,—".

11. Subs. by Act 23 of 1986, s. 7(*a*)(*ii*) (with retrospective effect from 1-4-1985), for the following:—

'(*i*) in a case where the previous year ends before the 1st day of August, 1980, ten lakh rupees; and

(*ii*) in a case where the previous year ends after the 31st day of July, 1980, twenty lakh rupees,'.

12. Sub-sections (2A) and (2B) have been inserted by Act 29 of 1977, s. 9(*b*) (w. e. f. 1-4-1978).

13. Subs., for "but before the 1st day of April, 1982,", by the Finance Act, 1982 (14 of 1982), s. 8 (w. e. f. 1-4-1982).

(*a*) is manufactured or produced by using any technology (including any process) or other know-how developed in, or

(*b*) is an article or thing invented in,

a laboratory owned or financed by the Government, or a laboratory owned by a public sector company or a University or by an institution recognised in this behalf by the prescribed authority, the provisions of sub-section (1) shall have effect in relation to such machinery or plant as if for the words "twenty-five per cent", the words "thirty-five per cent" had been substituted, if the following conditions are fulfilled, namely:—

(*i*) the right to use such technology (including any process) or other know-how or to manufacture or produce such article or thing has been acquired from the owner of such laboratory or any person deriving title from such owner;

(*ii*) the assessee furnishes, along with his return of income for the assessment year for which the deduction is claimed, a certificate from the prescribed authority to the effect that such article or thing is manufactured or produced by using such technology (including any process) or other know-how developed in such laboratory or is an article or thing invented in such laboratory; and

(*iii*) the machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

Explanation.—For the purposes of this sub-section,—

(*a*) "laboratory financed by the Government" means a laboratory owned by any body [including a society registered under the Societies Registration Act, 1860 (21 of 1860)], and financed wholly or mainly by the Government;

[14][(*b*) * * * *;]

(*c*) "University" means a University established or incorporated by or under a Central, State or Provincial Act and includes an institution declared under section 3 of the University Grants Commission Act, 1956 (3 of 1956), to be a University for the purposes of that Act.]

[15][(2C) Where any new machinery or plant, being machinery or plant which would assist in control of pollution or protection of environment and which has been notified in this behalf by the Central Government in the Official Gazette, is installed after the 31st day of May, 1983, [16][but before the 1st day of April, 1987,] in any industrial undertaking referred to in sub-clause (*i*) or sub-clause (*ii*) or sub-clause (*iii*) of clause (*b*) of sub-section (2), the provisions of sub-section (1) shall have effect in relation to such machinery or plant as if for the words "twenty-five per cent", the words "thirty-five per cent" had been substituted.]

(3) Where the total income of the assessee assessable for the assessment year relevant to the previous year in which the ship or aircraft was acquired or the machinery or plant was installed, or, as the case may be, the immediately succeeding previous year [the total income for this purpose being computed after deduction of the allowances under section 33 and section 33A, but without making any deduction under sub-section (1) of this section or any deduction under Chapter VIA] is *nil* or is less than the full amount of the investment allowance,—

(*i*) the sum to be allowed by way of investment allowance for that assessment year under sub-section (1) shall be only such amount as is sufficient to reduce the said total income to *nil*; and

(*ii*) the amount of the investment allowance, to the extent to which it has not been allowed as aforesaid, shall be carried forward to the following assessment year, and the investment allowance to be allowed for the following assessment year shall be such amount as is sufficient to reduce the total income of the assessee assessable for that assessment year, computed in the manner aforesaid, to *nil*, and the balance of the investment allowance, if any, still outstanding shall be carried forward to the following assessment year and so on, so, however, that no portion of the investment allowance shall be carried forward for more than eight assessment years immediately succeeding the assessment year relevant to the previous year in which the ship or aircraft was acquired or the machinery or plant was installed or, as the case may be, the immediately succeeding previous year.

LexisNexis

14. Omitted by the Finance Act, 1987 (11 of 1987), s. 74(*a*)(*i*) (w. e. f. 1-4-1987). Prior to its omission, clause (*b*) stood as follows:—

'(*b*) "public sector company" means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956);'.

15. Sub-section (2C) has been inserted by Act 11 of 1983, s. 11(*b*) (w. e. f. 1-6-1983).

16. Ins. by Act 3 of 1989, s. 6(*c*) (w. e. f. 1-4-1989).

Explanation.—Where for any assessment year, investment allowance is to be allowed in accordance with the provisions of this sub-section in respect of any ship or aircraft acquired or any machinery or plant installed in more than one previous year, and the total income of the assessee assessable for that assessment year [the total income for this purpose being computed after deduction of the allowances under section 33 and section 33A, but without making any deduction under sub-section (1) of this section or any deduction under Chapter VI-A] is less than the aggregate of the amounts due to be allowed in respect of the assets aforesaid for that assessment year, the following procedure shall be followed, namely:—

(*a*) the allowance under clause (*ii*) shall be made before any allowance under clause (*i*) is made; and

(*b*) where an allowance has to be made under clause (*ii*) in respect of amounts carried forward from more than one assessment year, the amount carried forward from an earlier assessment year shall be allowed before any amount carried forward from a later assessment year.

(4) The deduction under sub-section (1) shall be allowed only if the following conditions are fulfilled, namely:—

(*i*) the particulars prescribed in this behalf have been furnished by the assessee in respect of the ship or aircraft or machinery or plant;

(*ii*) an amount equal to seventy-five per cent of the investment allowance to be actually allowed is debited to the profit and loss account of [17][any previous year in respect of which the deduction is to be allowed under sub-section (3) or any earlier previous year (being a previous year not earlier than the year in which the ship or aircraft was acquired or the machinery or plant was installed or the ship, aircraft, machinery or plant was first put to use)] and credited to a reserve account (to be called the "Investment Allowance Reserve Account") to be utilised—

(*a*) for the purposes of acquiring, before the expiry of a period of ten years next following the previous year in which the ship or aircraft was acquired or the machinery or plant was installed, a new ship or a new aircraft or new machinery or plant [other than machinery or plant of the nature referred to in clauses (*a*), (*b*) and (*d*) of [18][the second proviso] to sub-section (1)] for the purposes of the business of the undertaking; and

(*b*) until the acquisition of a new ship or a new aircraft or new machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India:

Provided that this clause shall have effect in respect of a ship as if for the word "seventy-five", the word "fifty" had been substituted.

Explanation.—Where the amount debited to the profit and loss account and credited to the Investment Allowance Reserve Account under this sub-section is not less than the amount required to be so credited on the basis of the amount of deduction in respect of investment allowance claimed in the return made by the assessee under section 139, but a higher deduction in respect of the investment allowance is admissible on the basis of the total income as proposed to be computed by the [19][Assessing Officer] under section 143, the [20][Assessing Officer] shall, by notice in writing in this behalf, allow the assessee an opportunity to credit within the time specified in the notice or within such further time as the [21][Assessing Officer] may allow, a further amount to the Investment Allowance Reserve Account out of the profits and gains of the previous year in which such notice is served on the assessee or of the immediately preceding previous year, if the accounts for that year have not been made up; and, if the assessee credits any further amount to such account within the time aforesaid, the amount so credited shall be deemed to have been credited to the Investment Allowance Reserve Account of the previous year in which the deduction is admissible and such amount shall not be taken into account in determining the adequacy of the reserve required to be created by the assessee in respect of the previous year in which such further credit is made:

Provided that such opportunity shall not be allowed by the [22][Assessing Officer] in a case where the difference in the total income as proposed to be computed by him and the total income as returned by the

LexisNexis

17. Subs., for "the previous year in respect of which the deduction is to be allowed", by the Finance Act, 1990 (12 of 1990), s. 7(*i*) (with retrospective effect from 1-4-1976).
18. Subs., for "the proviso", by Act 3 of 1989, s. 6(*d*) (w. e. f. 1-4-1989).
19. Subs., for "Income-tax Officer", by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 2 (w. e. f. 1-4-1988).
20. Subs., for "Income-tax Officer", by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 2 (w. e. f. 1-4-1988).
21. Subs., for "Income-tax Officer", by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 2 (w. e. f. 1-4-1988).
22. Subs., for "Income-tax Officer", by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 2 (w. e. f. 1-4-1988).

assessee arises out of the application of the proviso[23] to sub-section (1) of section 145 or sub-section (2) of that section or the omission by the assessee to disclose his income fully and truly.

(5) Any allowance made under this section in respect of any ship, aircraft, machinery or plant shall be deemed to have been wrongly made for the purposes of this Act—

(*a*) if the ship, aircraft, machinery or plant is sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired or installed; or

(*b*) if at any time before the expiry of ten years from the end of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed, the assessee does not utilise the amount credited to the reserve account under sub-section (4) for the purposes of acquiring a new ship or a new aircraft or new machinery or plant [other than machinery or plant of the nature referred to in clauses (*a*), (*b*) and (*d*) of [24][the second proviso] to sub-section (1)] for the purposes of the business of the undertaking; or

(*c*) if at any time before the expiry of the ten years aforesaid, the assessee utilises the amount credited to the reserve account under sub-section (4) for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any assets outside India or for any other purpose which is not a purpose of the business of the undertaking,

and the provisions of sub-section (4A) of section 155 shall apply accordingly:

Provided that nothing in clause (*a*) shall apply—

(*i*) where the ship, aircraft, machinery or plant is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by a Central, State or Provincial Act or a Government company as defined in section 617 of Companies Act, 1956[25] (1 of 1956); or

(*ii*) where the sale or transfer of the ship, aircraft, machinery or plant is made in connection with the amalgamation or succession, referred to in sub-section (6) or sub-section (7).

(6) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers to the amalgamated company any ship, aircraft, machinery or plant, in respect of which investment allowance has been allowed to the amalgamating company under sub-section (1),—

(*a*) the amalgamated company shall continue to fulfil the conditions mentioned in sub-section (4) in respect of the reserve created by the amalgamating company and in respect of the period within which such ship, aircraft, machinery or plant shall not be sold or otherwise transferred and in default of any of these conditions, the provisions of sub-section (4A) of section 155 shall apply to the amalgamated company as they would have applied to the amalgamating company had it committed the default; and

(*b*) the balance of investment allowance, if any, still outstanding to the amalgamating company in respect of such ship, aircraft, machinery or plant, shall be allowed to the amalgamated company in accordance with the provisions of sub-section (3), so, however, that the total period for which the balance of investment allowance shall be carried forward in the assessments of the amalgamating company and the amalgamated company shall not exceed the period of eight years specified in sub-section (3) and the amalgamated company shall be treated as the assessee in respect of such ship, aircraft, machinery or plant for the purposes of this section.

(7) Where a firm is succeeded to by a company in the business carried on by it as a result of which the firm sells or otherwise transfers to the company any ship, aircraft, machinery or plant, the provisions of clauses (*a*) and (*b*) of sub-section (6) shall, so far as may be, apply to the firm and the company.

Explanation.—The provisions of this sub-section shall apply only where—

(*i*) all the property of the firm relating to the business immediately before the succession becomes the property of the company;

(*ii*) all the liabilities of the firm relating to the business immediately before the succession become the liabilities of the company; and

LexisNexis

23. This has reference to the first proviso to section 145(1) (w. e. f. 1-4-1989) as it stood upto 31-3-1997.
24. Subs., for "the proviso", by Act 3 of 1989, s. 6(*e*) (w. e. f. 1-4-1989).
25. Repealed and replaced by Act 18 of 2013.

(*iii*) all the shareholders of the company were partners of the firm immediately before the succession.

(8) The Central Government, if it considers necessary or expedient so to do, may, by notification in the Official Gazette, direct that the deduction allowable under this section shall not be allowed in respect of any ship or aircraft acquired or any machinery or plant installed after such date [26][* * *] as may be specified therein.

[27][(8A) The Central Government, if it considers necessary or expedient so to do, may, by notification in the Official Gazette, omit any article or thing from the list of articles or things specified in the Eleventh Schedule.]

[28][(8B) Notwithstanding anything contained in sub-section (8) or the notification of the Government of India in the Ministry of Finance (Department of Revenue) No. G.S.R. 870(E), dated the 12th June, 1986, issued thereunder, the provisions of this section shall apply in respect of,—

(*a*) (*i*) a new ship or new aircraft acquired after the 31st day of March, 1987, but before the 1st day of April, 1988, if the assessee furnishes evidence to the satisfaction of the Assessing Officer that he had, before the 12th day of June, 1986, entered into a contract for the purchase of such ship or aircraft with the builder or manufacturer or owner thereof, as the case may be;

(*ii*) any new machinery or plant installed after the 31st day of March, 1987, but before the 1st day of April, 1988, if the assessee furnishes evidence to the satisfaction of the Assessing Officer that before the 12th day of June, 1986, he had purchased such machinery or plant or had entered into a contract for the purchase of such machinery or plant with the manufacturer or owner of, or a dealer in, such machinery or plant, or had, where such machinery or plant has been manufactured in an undertaking owned by the assessee, taken steps for the manufacture of such machinery or plant:

Provided that nothing contained in sub-section (1) shall entitle the assessee to claim deduction in respect of a ship or aircraft or machinery or plant referred to in this clause in any previous year except the previous year relevant to the assessment year commencing on the 1st day of April, 1989;

(*b*) a new ship or new aircraft acquired or any new machinery or plant installed after the 31st day of March, 1988, but before such date as the Central Government, if it considers necessary or expedient so to do, may, by notification in the Official Gazette, specify in this behalf.

(8C) Subject to the provisions of clause (*ii*) of sub-section (3), where a deduction has been allowed to an assessee under sub-section (1) in any assessment year, no deduction shall be allowed to the assessee under section 32AB in the said assessment year (hereinafter referred to as the initial assessment year) and a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year.]

[29][(9) * * * * *]].

LexisNexis

Introduction under 1961 Act.—*The Finance Act, 1976.*—By **the Finance Act, 1976** (66 of 1976), **section 32A** has been **inserted** (**w. e. f. 1-4-1976**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 202, dated 5-7-1976*, as follows:—

'**23.** *Investment allowance—section 32A.*—**23.1** As stated in the preceding paragraph, the Finance Act, 1976 (66 of 1976), has replaced the scheme of initial depreciation allowance by a scheme of investment allowance. The new scheme is broadly on the lines of the development rebate scheme that was discontinued earlier. The main respects in which the new investment allowance scheme differs from the development rebate scheme are explained hereinbelow.

23.2 Whereas development rebate was allowed, at varying rates, in respect of ships and machinery or plant installed in all industries, investment allowance will be admissible at the uniform rate of 25 per cent. only in respect of the following assets:—

---

26. The words ", not being earlier than three years from the date of such notification," have been omitted by Act 23 of 1986, s. 7(*b*) (w. e. f. 1-4-1986).

27. Sub-section (8A) has been inserted by Act 29 of 1977, s. 9(*c*) (w. e. f. 1-4-1978).

28. Sub-sections (8B) and (8C) have been substituted by Act 3 of 1989, s. 6(*f*) (w. e. f. 1-4-1989), for the following:—

"(8B) Subject to the provisions of clause (*ii*) of sub-section (3), no deduction shall be allowed under this section in the case of an assessee who has claimed the deduction allowable under section 32AB.".

The above sub-section (8B) was originally inserted by Act 23 of 1986, s. 7(*c*) (w. e. f. 1-4-1987).

29. Sub-section (9) has been omitted by Act 12 of 1990, s. 7(*ii*) (with retrospective effect from 1-4-1976). Prior to its omission, sub-section (9) stood as follows:—

'(9) For the removal of doubts, it is hereby declared that the deduction under sub-section (1) shall 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 Investment Allowance Reserve Account exceeds the amount of the profit of such previous year (as arrived at without making the debit aforesaid), in accordance with the profit and loss account.'.

(*i*) New ships and new aircraft acquired after the 31-3-1976, by taxpayers engaged in the business of operation of ships or aircraft.

For this purpose, second-hand ships will be regarded as new if the conditions specified in the *Explanation* to section 32(1)(*vi*) are fulfilled.

It should be noted that new ships and aircraft will qualify for investment allowance only in the hands of taxpayers carrying on the business of operating ships or aircraft and the allowance will not be available in respect of ships or aircraft acquired by other taxpayers.

(*ii*) New machinery or plant installed after the 31-3-1976, for the purposes of business of generation or distribution of electricity or any other form of power.

For this purpose, as also for the purposes of items (*iii*) and (*iv*) below, reconditioned machinery or plant imported from abroad will be regarded as new if the conditions specified in the *Explanation* to section 32(1)(*vi*) are fulfilled.

(*iii*) New machinery or plant installed for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Ninth Schedule to the Income-tax Act.

The list in the Ninth Schedule has been amended to include the following further items:—

1. Carbon and graphite products.

2. Inorganic heavy chemicals other than soda ash and caustic soda. [Soda ash and caustic soda are already covered by items 12 and 13 of the list].

3. Organic heavy chemicals.

4. Synthetic rubber and rubber chemicals (including carbon black).

5. Industrial explosives.

6. Basic drugs.

7. Industrial sewing machines.

8. Finished leather and leather goods, including footwear made wholly or mainly of leather.

Besides, item 4 in the Ninth Schedule which read as "Steel castings and forgings and malleable iron and steel castings" has been substituted by a new item, namely:—

"Steel castings and forgings and alloys, malleable and S.G. iron castings.".

As a result of this change, alloy and S.G. iron casting will also qualify for investment allowance.

LexisNexis

(*iv*) New machinery or plant installed in a small-scale industrial undertaking for the purposes of business of manufacture or production of any articles or things, including articles or things specified in the Ninth Schedule.

For this purpose, an industrial undertaking will be regarded as a small-scale industrial undertaking if the aggregate value of machinery or plant installed therein, as on the last date of the previous year, does not exceed ₹ 10 lakhs (as against ₹ 7.5 lakhs for the purposes of initial depreciation allowance) and, in computing the value of such machinery for this purpose, the value of tools, jigs, dies and moulds will not be taken into account.

23.3 Development rebate was not admissible in respect of the following assets, namely:—

(*i*) Machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

(*ii*) Office appliances and road transport vehicles.

Investment allowance will be inadmissible not only in respect of the assets referred to in (*i*) and (*ii*) above but also in respect of the following, namely:—

(*a*) Machinery or plant the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the taxable income of any one previous year. Thus, no investment allowance will be admissible in respect of (*i*) any machinery or plant the actual cost whereof, being less than ₹ 750, is allowed to be written off by way of depreciation allowance under the first proviso to section 32(1)(*ii*); (*ii*) any machinery or plant on which depreciation is admissible at the rate of 100 per cent. under the Income-tax Rules, 1962; or (*iii*) any machinery or plant the entire cost of which is allowed as deduction under section 35(2)(*ia*) by way of expenditure of a capital nature on scientific research.

(*b*) Ships, machinery or plant in respect of which the deduction by way of development rebate is admissible under section 33 of the Income-tax Act, namely:—

(*i*) ships acquired before 1-1-1977, if the contract for the purchase thereof had been entered into by the taxpayer with the builder or owner thereof before 1-12-1973 (vide section 16(*a*) of the Finance Act, 1974 (20 of 1974), as amended by section 30 of the Finance Act, 1975 (25 of 1975)), and

(*ii*) any machinery or plant, being coal-fired equipment, or machinery or plant for converting oil-fired equipment into coal-fired equipment, installed by the taxpayer before the 1-6-1977 [*vide* section 16(*b*) of the Finance Act 1974].

23.4 The deduction on account of development rebate was ordinarily admissible in the year in which the ship was acquired or the machinery or plant was installed. Where, however, the ship, machinery or plant was first put to use in the year immediately following the year in which it was acquired or installed, development rebate was allowed in such immediately following year. Further, where the total income (as computed before making any deduction in respect of development rebate under section 33 or development allowance under section 33A or any deduction under Chapter VIA of the Income-tax Act) for the assessment year relevant to the previous year in which the ship was acquired or the machinery or plant was installed, or the immediately following previous year, as the case may be, was nil or less than the full amount of development rebate otherwise admissible for that year, the sum to be allowed by way of development rebate for that assessment year was restricted to such amount as would have been sufficient to reduce the total income so computed to nil. The unabsorbed development rebate was allowed to be carried forward for a period of eight years to be set-off against profits of subsequent years. In view of this position, in a case where the total income computed in the manner referred to above was a loss, no development rebate was admissible for that year and, in a case where such total income was less than the amount of development rebate otherwise admissible, the deduction was limited to such total income. The position in regard to investment allowance is broadly similar. The amount of total income with reference to which the admissibility of investment allowance has to be determined will, however, be the total income as computed after making deduction in respect of development rebate under section 33 and development allowance under section 33A but without making any deduction in respect of investment allowance or any deduction under Chapter VIA of the Income-tax Act. The combined effect of the provisions of sections 32, 32A, 33, 33A and 72 is that in a case where there are allowances in the nature of depreciation allowance, investment allowance, development rebate, development allowance and losses, such allowances and losses would be deductible in the order given below, in cases where the profits are insufficient to absorb all of them:—

(*i*) Current depreciation [Section 32(1)].

(*ii*) Carried forward losses of earlier years [Section 72(1)].

(*iii*) Unabsorbed depreciation of earlier years [Section 32(2)].

(*iv*) Unabsorbed development rebate of earlier years [Section 33(2)(*ii*)].

(*v*) Current development rebate [Section 33(2)(*i*)].

(*vi*) Unabsorbed development allowance of earlier years [Section 33A(2)(*ii*)].

(*vii*) Current development allowance [Section 33A(2)(*i*)].

(*viii*) Unabsorbed investment allowance of earlier years [Section 32A(3)(*ii*)].

(*ix*) Current investment allowance [Section 32A(3)(*i*)].

23.5 Development rebate was admissible if the following conditions were fulfilled:—

(*i*) The prescribed particulars had been furnished by the taxpayer in respect of the ship, machinery or plant.

(*ii*) An amount equal to 75 per cent. (50 per cent. in the case of ships) of the development rebate to be actually allowed was debited to the profit and loss account of the relevant previous year and credited to a special reserve account. The reserve so created was required to be utilised for the purpose of the business of the undertaking for a period of eight years next following the year in which it was created, and during this period could not be used (*a*) for distribution by way of dividends or profit, or (*b*) for remittances outside India as profits or for the creation of any asset outside India. The requirement of creation of reserve did not, however, apply to electricity companies licensed under the Electricity (Supply) Act, 1948 (54 of 1948).

(*iii*) The ship or aircraft could not be sold or otherwise transferred during the period of eight years from the end of the year of acquisition or installation, except to the Government, a local authority, a statutory corporation or a Government company or in connection with amalgamation or succession covered by sub-sections (3) and (4) of section 33.

The condition at (*i*) above regarding furnishing of prescribed particulars has been retained in respect of investment allowance as well.

LexisNexis

The condition at (*ii*) above regarding creation of a special reserve has been slightly modified inasmuch as the amount credited to the "Investment Allowance Reserve Account" will now be required to be utilised for acquiring new ships or new aircraft or new machinery or plant [other than machinery or plant referred to in clauses (*a*), (*b*) and (*d*) of the proviso to section 32A(1)] for the purposes of business of the undertaking during a period of ten previous years next following the previous year in which the ship or aircraft was acquired or the machinery or plant was installed. During the interregnum, the amount credited to the Investment Allowance Reserve Account could be utilised for any purposes of the business of the undertaking other than (*a*) for distribution by way of dividends or profits, or (*b*) for remittances outside India as profits or for the creation of any asset outside India. Further, unlike the development rebate scheme, the requirement of creation of investment allowance reserve will apply even in the case of electricity companies licensed under the Electricity (Supply) Act, 1948 (54 of 1948).

[As explained earlier, in a case where the total income (as computed before making any deduction in respect of development rebate under section 33 or development allowance under section 33A or under Chapter VIA of the Income-tax Act) was a loss, no development rebate was admissible for that year, and in a case where such total income was less than the amount of the development rebate otherwise admissible, the deduction on account of development rebate was limited to such total income. Since the obligation for creation of statutory reserve was limited to 75 per cent. (50 per cent. in the case of ships) of the development rebate actually allowed, there was no obligation to create statutory reserve in a year of loss. There was, however, some doubt regarding the correct legal position in this matter. The position has been clarified in relation to investment allowance in sub-section (4) of section 32A. A taxpayer will not, therefore, be required to create investment allowance reserve during the year of installation of machinery or plant if there is no income in that year and such reserve should be created in the year when there is income.]

The condition at (*iii*) relating to restrictions on sale or transfer of ship, aircraft, machinery or plant has been retained in respect of investment allowance as well.

23.6 In the Board's circular F. No. 10/49/65-IT (AI), dated 14-10-1965, *inter alia*, stated that where there was no deliberate contravention of the provision relating to creation of development rebate reserve, the Income-tax Officer may condone genuine deficiencies subject to the same being made good by the taxpayer through creation of adequate additional reserve in the current year's books in which the assessment is framed. This instruction has been put on a statutory basis in a slightly modified form in relation to investment allowance. It has been specifically provided that any deficiency in the amount transferred to the investment allowance reserve account may be allowed to be made up in cases where the amount transferred by the taxpayer to the Investment Allowance Reserve Account is not less than the amount required to be so transferred on the basis of the amount of investment allowance claimed in the return of income. For this purpose, the Income-tax Officer will be required to give a notice in writing giving the taxpayer an opportunity to transfer further amounts to the Investment Allowance Reserve Account either out of the profits of the previous year in which notice is served or out of the profits of the immediately preceding year if the accounts for that year have not been made up. If the taxpayer transfers the requisite further amount to such account within the time allowed by the Income-tax Officer, the amount so transferred will be regarded as having been transferred to the Investment Allowance Reserve Account of the previous year in which the deduction is admissible. Such transfer will, however, not be taken into account in determining the adequacy of the reserve required to be created by the taxpayer in respect of the previous year in which such further transfer is made. This provision will, however, not apply in a case where the difference in the total income returned by the taxpayer and the total income as proposed to be computed by the Income-tax Officer arises out of the application of the proviso to section 145(1) or section 145(2) or the concealment of income by the taxpayer.

23.7 Where any of the conditions subject to which investment allowance was admissible is contravened, the investment allowance will be withdrawn by amending, under new section 155(4A), the assessment for the year in which the allowance was made. In other words, if the ship, aircraft, machinery or plant is sold or otherwise transferred, before the expiry of a period of eight years in which the ship or aircraft was acquired or the machinery or plant was installed, in violation of the conditions referred to in paragraph 23.5, or if the taxpayer does not utilise the amount transferred to the Investment Allowance Reserve Account within a period of 10 years from the end of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed for the purposes of acquiring a new ship or an aircraft or machinery or plant [other than machinery or plant referred to in clauses (*a*), (*b*) and (*d*) of the proviso to section 32A(1)], or if he utilises, before the expiry of the period of ten years aforesaid, the amount credited to such reserve account for distribution by way of dividends or profits or for making remittances outside India, the investment allowance would be withdrawn by amending, under new section 155(4A), the assessment order under which the investment allowance was granted.

LexisNexis

23.8 The provisions relating to continuance of investment allowance on amalgamation of companies or succession of a firm by a company are broadly on the lines of the scheme of development rebate.

23.9 The aforesaid amendments have come into force with effect from the 1-4-1976, and will accordingly apply in relation to the assessment year 1976-77 and subsequent years. It may be noted that since investment allowance will not be admissible in respect of a ship or an aircraft acquired before the 1-4-1976, or machinery or plant installed before that date, the provision will, in so far as it relates to the assessment year 1976-77, cover cases of acquisition of ships or aircraft or installation of machinery or plant after 31-3-1976, in cases where the previous year relevant for that assessment year expires after that date, *e.g.*, Ramnaumi year, Baisakhi year.'.

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1977.*—By **the Finance (No. 2) Act, 1977** (29 of 1977), the following **amendments** (**w. e. f. 1-4-1978**) have been made—

—**sections 32A(2)(*b*)(*ii*) & (*iii*)** have been **substituted**;

—***Explanation* to section 32A(2)** has been **amended**; and

—**sections 32A(2A), (2B) & (8A)** have been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 229, dated 9-8-1977*, as follows:—

'**13.** *Modification of the provisions relating to investment allowance—section 32A.*—**13.1** The Finance (No. 2) Act, 1977 (29 of 1977), has made a number of important modifications in the scheme of investment allowance contained in section 32A of the Income-tax Act. At present investment allowance is granted in respect of the following assets:—

(*i*) New ships or new aircraft acquired by an assessee engaged in the business of operation of ships or aircraft [*vide* section 32A(2)(*a*)].

(*ii*) New machinery or plant installed for the purposes of business of generation or distribution of electricity or any other form of power [*vide* section 32A(2)(*b*)(*i*)].

(*iii*) New machinery or plant installed for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Ninth Schedule to the Income-tax Act [*vide* section 32A(2)(*b*)(*ii*)].

(*iv*) New machinery or plant installed in a small-scale industrial undertaking for the purposes of business of manufacture or production of any other articles or things [*vide* section 32A(2)(*b*)(*iii*)].

The Finance (No. 2) Act, 1977 (29 of 1977), has substituted sub-clauses (*ii*) and (*iii*) of clause (*b*) of section 32A(2) referred to above by two new sub-clauses. Under the new provisions, investment allowance will be allowed in respect of new machinery or plant installed for the purposes of business of construction, manufacture or production of all articles or things, except certain articles or things of low priority specified in the list in the new Eleventh Schedule inserted in the Income-tax Act by section 28 of the Finance (No. 2) Act, 1977 (29 of 1977). The list of articles or things contained in the new Eleventh Schedule is given in Annexure II[30] to this circular. The disqualification arising from the installation of machinery or plant for the purposes of business of manufacture or production of any article or thing specified in the list in the Eleventh Schedule will, however, not apply in respect of machinery or plant installed in small-scale industrial undertakings, and such machinery or plant will be eligible for investment allowance even though it is used for purposes of business of manufacture or production of any article or thing specified in the said list.

13.2 Under new sub-section (8A) inserted in section 32A, the Central Government has been empowered to delete, by notification in the Official Gazette, any article or thing from the list of articles or things specified in the new Eleventh Schedule, if it considers necessary or expedient so to do.

13.3 Sometimes, a machinery or plant installed and used mainly for the purposes of business of construction, manufacture or production of any article or thing not specified in the list in the new Eleventh Schedule may have been partly used for the purposes of business of manufacture or production of any article or thing specified in the said list. As investment allowance is not intended to be denied in such cases, a new sub-section (2A) has been inserted in section 32A to provide that investment allowance will not be denied by reason only that machinery or plant installed and used mainly for the purposes of business of construction, manufacture or production of any article or thing not specified in the list in the Eleventh Schedule is also used for the purposes of business of manufacture or production of any article or thing specified in the said list.

13.4 It is relevant to note that the benefit of the aforesaid relaxation will not be available unless the machinery or plant is both installed and used mainly for the purposes of business of construction, manufacture or production of an article or thing not specified in the list in the Eleventh Schedule. The question whether any machinery or plant has been used mainly for the purposes of business of construction,

LexisNexis

30. Not printed here.

manufacture or production of an article or thing not specified in the said list will depend upon the extent to which the machinery or plant has been used for the purposes of such business during the previous year. Thus, the question will have to be decided with reference to the number of days or hours for which the machinery or plant has been actually used by the taxpayer for the purposes of such business. The number or quantity of articles or things manufactured or produced for the two businesses may be a fair, but not a conclusive, test of the extent to which the machinery or plant has been used for the two businesses. The question will, therefore, have to be decided on the facts of each case. The burden of proving that the machinery or plant has been installed and used mainly for purposes of business of construction, manufacture or production of an article or thing not falling in the Eleventh Schedule will be on the person claiming the benefit of the provision and necessary evidence in support thereof will have to be adduced by him.

13.5 New sub-section (2B) inserted in section 32A provides for the grant of investment allowance at the higher rate of 35 per cent. in respect of machinery or plant installed after 30-6-1977, but before 1-4-1982, for the purposes of business of manufacture or production of any article or thing in cases where:

(*a*) the article or thing is manufactured or produced by the assessee by using any technology (including any process) or other know-how developed in a laboratory owned or financed by the Government, or a laboratory owned by a public sector company or a university or by an institution recognised in this behalf by the prescribed authority; or

(*b*) the article or thing manufactured or produced by the assessee is an article or thing invented in a laboratory referred to in (*a*) above.

It may be noted that the condition in (*a*) above will not be satisfied unless the technology, etc., is basic to the manufacture or production of the article or thing and not merely peripheral to it.

13.6 Investment allowance at the higher rate of 35 per cent. will be granted in such cases only if the following conditions are fulfilled:

(*i*) The right to use such technology (including any process) or other know-how or to manufacture or produce such article or thing has been acquired by the taxpayer from the owner of the laboratory referred to in (*a*) of paragraph 13.5 above or any person deriving title from such owner.

(*ii*) The taxpayer furnishes, along with the return of income of the assessment year for which the deduction is claimed, a certificate from the prescribed authority to the effect that such article or thing is either manufactured or produced by the taxpayer by using such technology (including any process) or other know-how developed in such laboratory or is an article or thing invented in such laboratory. If the full amount of investment allowance due to the taxpayer is not allowed in the previous year in which the machinery or plant was installed and a part of the unabsorbed allowance is carried forward for being allowed in computing the total income of the following year or years, a certificate from the prescribed authority will have to be furnished by the taxpayer for each of the years for which the unabsorbed investment allowance is claimed as a deduction.

(*iii*) The machinery or plant is not used for the purposes of manufacture or production of any article or thing specified in the list in the Eleventh Schedule. It may be noted that this condition is applicable in the case of both small-scale industrial undertakings and other undertakings.

13.7 The expression "laboratory financed by the Government" has been defined as a laboratory owned by any body including a society registered under the Societies Registration Act, 1860 (21 of 1860), and financed wholly or mainly by the Government. The expression "public sector company" has been defined to mean any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956). The term "Government company" as defined in the said section 617 means any company in which not less than fifty-one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government company as thus defined.

13.8 The aforesaid amendments to section 32A will come into force with effect from 1-4-1978, and will accordingly apply in relation to the assessment year 1978-79 and subsequent year.'.

II. *The Finance Act, 1981.*—By **the Finance Act, 1981** (16 of 1981), ***Explanation (2)*** **below section 32A(2)** has been **amended** (**w. e. f. 1-4-1981**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 308, dated 29-6-1981*, as follows:—

'**8.** *Amendment of the definition of a small-scale industrial undertaking in pursuance of the statement on Industrial Policy.*—**8.1** Under the existing provisions of the Income-tax Act, the following tax concessions are available in the case of small-scale industrial undertakings, namely:—

(*i*) Investment allowance is admissible in respect of any machinery or plant installed in a small-scale industrial undertaking for the purpose of business of manufacture or production of any article or thing *including an article or thing of low priority specified in the list in the Eleventh Schedule to the Income-tax Act.* [*Section 32A(2)(b)(ii)*]

(*ii*) An assessee is entitled to deduction, in the computation of his taxable income, of an amount equal to 20 per cent of the profits and gains derived from a small-scale industrial undertaking set up in a rural area for ten initial assessment years. [*Section 80HHA*]

(*iii*) An assessee owning a small-scale industrial undertaking is entitled to a deduction, in the computation of his taxable income, of an amount equal to 20 per cent of profits and gains (25 per cent in the case of a company) derived from a small-scale industrial undertaking which may be engaged in the manufacture or production of any article or thing, *including an article or thing of low priority specified in the list in the Eleventh Schedule to the Income-tax Act,* for eight initial assessment years (10 years in the case of a co-operative society). [*Section 80-I(2), second proviso*]

8.2 For the purpose of the tax concessions referred to above, a "small-scale industrial undertaking" has been defined as an industrial undertaking in which the aggregate value of the machinery or plant installed as on the last day of the previous year does not exceed ₹ 10 lakhs. In the statement on Industrial Policy made in July, 1980, Government announced its decision to increase the limit of investment in the case of the generality of small-scale industrial undertakings from ₹ 10 lakhs to ₹ 20 lakhs with effect from 1-8-1980, as a measure to boost the development of small-scale industries and to ensure their rapid growth.

8.3 In view of the aforesaid change in the definition of small-scale industrial undertaking, the Finance Act, 1981, has made the following modifications in the relevant provisions as under:—

(*i*) Where any assessee has installed any machinery or plant in a small-scale industrial undertaking in a previous year ending after 31st July, 1980, he will be eligible for investment allowance at the specified rates if the total value of the machinery or plant installed in the industrial undertaking as on the last day of the previous year does not exceed ₹ 20 lakhs. In a case where the previous year ended after 31st July, 1980, and the value of the machinery or plant installed in the industrial undertaking as on the last day of the previous year does not exceed ₹ 20 lakhs, the assessee will be entitled to investment allowance irrespective of whether the machinery is installed before 1st August 1980, or on or after that date.

(*ii*) In regard to the provision for partial exemption of profits and gains derived from a small-scale industrial undertaking in any rural area under section 80HHA of the Income-tax Act, the Finance Act, 1981, provides that where the previous year ends after 31st July, 1980, the industrial undertaking will be regarded as a small-scale industrial undertaking if the total value of the machinery or plant installed therein on the last day of the previous year does not exceed ₹ 20 lakhs. Another amendment made in this section is intended to secure that in a case where an industrial undertaking was not eligible for the tax concession for the reason that the investment in machinery or plant in earlier years exceeded ₹ 10 lakhs, such undertaking would be eligible for the benefit of this tax concession for the unexpired portion of the 10-year period specified in that section provided that the total investment in machinery or plant at the end of the relevant previous year does not exceed ₹ 20 lakhs. For example, where the industrial undertaking was not eligible for the initial three assessment years for the reason that the value of the machinery or plant installed in the said undertaking exceeded ₹ 10 lakhs, such an undertaking would be eligible for the tax concession under section 80HHA for the balance period of 7 assessment years commencing with the assessment year 1981-82, or any subsequent assessment year relevant to the previous year provided that the value of the machinery or plant installed therein as on the last day of the previous year concerned did not exceed ₹ 20 lakhs.

(*iii*) The amended definition of a "small-scale industrial undertaking" in section 80HHA of the Income-tax Act will also apply for the purposes of the tax holiday provision in section 80-I of that Act.

8.4 These provisions have come into force with effect from 1st April, 1981, and are accordingly applicable in relation to the assessment year 1981-82, and subsequent years. [*Sections 5 and 10 of the Finance Act, 1981*]'.

III. *The Finance Act, 1982.*—By **the Finance Act, 1982** (14 of 1982), **section 32A(2B)** has been **amended** (**w. e. f. 1-4-1982**).

IV. *The Finance Act, 1983.*—By **the Finance Act, 1983** (11 of 1983), the following **amendments** have been made—

—**section 32A(2)(*c*)** has been **inserted** (**w. e. f. 1-4-1984**) before the *Explanation*;

—***Explanation* to section 32A(2)** has been **amended** (**w. e. f. 1-6-1983**); and

LexisNexis

—**section 32A(2C)** has been **inserted** (**w. e. f. 1-6-1983**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 372, dated 8-12-1983*, as follows:—

'(*xv*) *Investment allowance for ship repair industry—Section 32A.*—**23.1** Under section 32A of the Income-tax Act, a deduction on account of investment allowance is allowed in the computation of taxable profits at the rate of 25 per cent. of the actual cost of the following:—

(*i*) New ships or new aircraft acquired by taxpayers engaged in the business of operation of ships or aircraft.

(*ii*) New machinery or plant installed for the purposes of business of generation or distribution of electricity or any other form of power.

(*iii*) New machinery or plant installed in a small-scale industrial undertaking for the purposes of business of manufacture or production of any article or thing.

(*iv*) New machinery or plant installed in any other industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule to the Income-tax Act.

23.2 With a view to encouraging ship repair industry, the Finance Act, 1983 (11 of 1983), has amended the provisions relating to investment allowance so as to make the allowance admissible in respect of new machinery and plant installed after 31-3-1983, but before 1-4-1988, for the purposes of the business of carrying on repairs to ocean-going vessels or other powered craft, if the business is carried on by an Indian company and such business is for the time being approved by the Central Government.

23.3 The amendment takes effect from 1-4-1984, and will, accordingly, apply in relation to the assessment year 1984-85, and subsequent years. [*Section 11(a) of the Finance Act*]

(*xvi*) *Investment allowance in respect of machinery and plant for pollution control and protection of environment—Section 32A*(*2C*).—**24.1** The Finance Act, 1983 (11 of 1983), has inserted a new sub-section (2C) in section 32A to provide for investment allowance at the higher rate of 35 per cent. (as against the normal rate of 25 per cent.) of the actual cost of machinery or plant which would assist in control of pollution or protection of environment and which has been notified in this behalf by the Central Government in the Official Gazette. This concession will be allowed only if the machinery or plant is installed by the assessee after 31-5-1983, in any industrial undertaking.

24.2 The amendment takes effect from 1-6-1983. Conformably with the principle that the substantive law applicable as on the 1st April of an assessment year is the law applicable to that assessment year, this provision will apply in relation to the assessment year 1984-85, and subsequent years. [*Section 11(b) of the Finance Act, 1983 (11 of 1983)*]'.

V. *The Finance Act, 1986.*—By **the Finance Act, 1986** (23 of 1986), the following **amendments** have been made—

—**section 32A(2)(*c*)** has been **amended** (**w. e. f. 1-4-1987**);

—**sub-clauses (*i*), (*ii*) & (*iii*) of *Explanation (2)* to section 32A(2)** have been **substituted** (**w. r. e. f. 1-4-1985**) for the then existing ***Explanation (2)(i) & (ii)***;

—**section 32A(8)** has been **amended** (**w. e. f. 1-4-1986**); and

—**section 32A(8B)** has been **inserted** (**w. e. f. 1-4-1987**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 461, dated 9-7-1986*, as follows:—

'(*vi*) *Modification of the definition of "small scale industrial undertaking".*—**15.1** Section 32A(2)(*b*)(*ii*) of the Income-tax Act, 1961 (43 of 1961), provides that investment allowance is admissible in respect of any machinery or plant installed in a small scale industrial undertaking for the purposes of business of manufacture or production of any article or thing, including an article or thing specified in the Eleventh Schedule of the Income-tax Act. An assessee which does not fall under the category of small scale industrial undertaking is denied the benefit of investment allowance if it is engaged in the manufacture or production of an article or thing listed in the Eleventh Schedule. Further, under section 80HHA of the Income-tax Act, an assessee is entitled to a deduction in the computation of his taxable income of an amount equal to 20 per cent. of the profits and gains derived from a small scale industrial undertaking set up in a rural area for ten initial assessment years. Under section 80-I of the Income-tax Act, an assessee owning a small scale industrial undertaking is entitled to a deduction in the computation of his taxable income of an amount equal to 20 per cent. of the profits and gains (25 per cent. in the case of a company) derived from a small scale industrial undertaking which may be engaged in the manufacture or production of any article or thing, including an article or thing of low priority specified in the Eleventh Schedule to the Income-tax Act for eight initial assessment years (10 years in the case of a co-operative society).

15.2 For the purposes of the above mentioned tax concessions, a "small scale industrial undertaking" has been defined as an industrial undertaking in which the aggregate value of the machinery and plant installed, as on the last day of the previous year, does not exceed ₹ 20 lakhs. With a view to promoting the growth of the small scale sector, the limit of investment in a small scale industrial undertaking was increased from ₹ 20 lakhs to ₹ 35 lakhs by the Department of Industrial Development, *vide* their Notification dated 18-3-1985. In view of the increase in the aforesaid qualifying monetary limit, the Finance Act, 1986 (23 of 1986), has amended sections 32A and 80HHA of the Income-tax Act to provide that an industrial undertaking will be regarded as a small scale industrial undertaking if the aggregate value of the machinery and plant (other than tools, jigs, dies and moulds) installed therein, as on the last day of any previous year ending after the 17-3-1985, does not exceed ₹ 35 lakhs. In view of the *Explanation 3* to section 80-I(2), the amended definition will automatically apply for the purposes of that section also.

15.3 This amendment will have retrospective effect and will apply in relation to the assessment year 1985-86 and subsequent years.

(*vii*) *Other amendments to section 32A of the Income-tax Act.*—**16.1** As one of the measures of corporate tax reform announced in the Long-Term Fiscal Policy, the scheme of investment allowance has been replaced by the scheme of investment deposit account. Under the existing provisions of clause (*c*) of sub-section (2) of section 32A of the Income-tax Act, in the case of approved Indian companies any new machinery or plant installed for the purposes of business of repairs to ocean-going vessels or other powered craft, is entitled to investment allowance. As per section 32A(8), the Central Government may by notification in the Official Gazette, direct that the deduction allowable under section 32A of the Act shall not be allowed in respect of any ship or aircraft acquired or any machinery or plant installed after such date, not being earlier than three years from the date of such notification, as may be specified.

16.2 Since the scheme of investment allowance is being replaced by the new scheme of investment deposit account, there has to be a consequential change in the modality of allowing deduction for encouraging investment in new plant and machinery. In order to facilitate the switch over from the old scheme, in section 32A(2)(*c*), for the date 1-4-1988, the date 1-4-1987, has been substituted by the Finance Act, 1986 (23 of 1986). Similarly, section 32A(8) has been amended to secure that the requirement of three years after which the notification for withdrawing the investment allowance shall be effective, is not necessary. The notification in this regard has been made.

16.3 By inserting a new sub-section (8B) in section 32A, it has been provided that no deduction by way of investment allowance shall be allowed in the case of an assessee who has claimed deduction allowable under the new section 32AB (relating to the new scheme of investment deposit account). However, the benefit of set-off of the unabsorbed investment allowance for an earlier year will not be denied. This amendment will apply in relation to the assessment year 1987-88 and subsequent years.'.

LexisNexis

VI. *The Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986.*—By **the Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986** (46 of 1986), ***Explanation (1)*** **to section 32A(2)** has been **substituted**.

VII. *The Finance Act, 1987.*—By **the Finance Act, 1987** (11 of 1987), ***Explanation (b)*** **to section 32A(2B)** has been **omitted** (**w. e. f. 1-4-1987**).

VIII. *The Direct Tax Laws (Amendment) Act, 1987.*—By **the Direct Tax Laws (Amendment) Act, 1987** (4 of 1988), **section 32A(4)** has been **amended** (**w. e. f. 1-4-1988**).

IX. *The Direct Tax Laws (Amendment) Act, 1989.*—By **the Direct Tax Laws (Amendment) Act, 1989** (3 of 1989), the following **amendments** (**w. e. f. 1-4-1989**) have been made—

—a new **1st proviso to section 32A(1)** has been **inserted**;

—***Explanation*** **to section 32A(1)** has been **added** after the provisos;

—**proviso to section 32A(2)(*b*)** has been **inserted**;

—**section 32A(2C)** has been **amended**;

—**section 32A(4)(*ii*)(*a*)** has been **amended**;

—**section 32A(5)(*b*)** has been **amended**; and

—**sections 32A(8B) & (8C)** have been **substituted** for the then existing section 32A(8B).

The scope and effect of all the above amendments have been elaborated in the following portion of the *Departmental Circular No. 559, dated 4-5-1990*, as follows:—

'**6.** *Reintroduction of investment allowance as an option to the existing Investment Deposit Account Scheme.*—**6.1** Amendments to section 32A to revive investment allowance.—It was decided in the year 1986 to discontinue the deduction for investment allowance and substitute it by the new provisions of investment deposit account, where the deduction was linked with the profit of the concern. Accordingly, under the provisions of sub-section (8) of the section, a Notification No. G.S.R. 870(E), dated 12-6-1986, was issued,

which discontinued the deduction for investment allowance in respect of a ship or aircraft acquired or any machinery or plant installed after 31-3-1987. The Finance Act, 1986 (23 of 1986), inserted, with effect from 1-4-1987, a new section 32AB in the Income-tax Act, 1961 (43 of 1961), to allow deduction on account of investment deposit account (*i.e.*, deposit in an account with the Development Bank) subject to a maximum of 20% of the profits of the eligible business or profession. This deduction is allowed in accordance with the Investment Deposit Scheme framed under the said section 32AB and is subject to the fulfilment of the conditions mentioned in that section.

6.2 It was, however, felt that the withdrawal of investment allowance, with effect from 1-4-1987, created an adverse situation for entrepreneurs, who were not able to get the benefit of section 32AB for reasons of absence or inadequacy of profit in the year of investment. The Government, therefore, decided to reintroduce investment allowance in respect of new ship or aircraft acquired or new machinery or plant installed after 31-3-1988. The investment allowance could be claimed as an option to the deduction allowable under the investment deposit account scheme (section 32AB) and was to be allowed on the same lines as was being allowed earlier prior to its withdrawal, with the modification that the admissible deduction would be 20% of the cost of the new asset as against 25% allowed earlier. However, investment allowance in respect of any plant or machinery installed for the purposes of business of repairs to ocean-going vessels or other powered craft, which was earlier allowable under section 32A(2)(*c*), was not to be reintroduced.

6.3 Since the investment allowance had been withdrawn earlier in respect of new ship or aircraft acquired or new machinery or plant installed after 31-3-1987, and it was being revived in respect of such assets acquired or installed after 31-3-1988, the result was that assessees would not have been eligible to claim investment allowance in respect of these assets acquired or installed during the period 1-4-1987, to 31-3-1988. It was felt that the short notice given for withdrawal of investment allowance, *vide Notification, dated 12-6-1986*, had caused hardship in cases where the assessees had taken steps to acquire such assets prior to the date of their notification (*i.e.*, 12-6-1986), but were not able to obtain timely delivery of these assets from the foreign or Indian manufacturers or dealers for reasons beyond their control, so that these could be acquired or installed only after 31-3-1987. These assessees would have been denied the benefit of deduction for no fault of theirs. It was, therefore, decided to make provisions to allow investment allowance to such assessees also.

LexisNexis

6.4 In order to implement the decision for reintroduction of investment allowance, as indicated in paras. 6.2 and 6.3 above, the Amending Act, 1989, has made the following amendments to section 32A:

(I) A new sub-section (8B) has been substituted in the section to provide that, notwithstanding anything contained in sub-section (8) or *Notification No. G.S.R. 870(E), dated 12-6-1986*, issued thereunder, the provisions of the section shall apply in respect of the following assets:

(*a*) (*i*) A new ship or new aircraft acquired after 31-3-1987, but before 1-4-1988, if the assessee furnishes evidence to the satisfaction of the Assessing Officer that he had entered into a contract for the purchase of such ship or aircraft with the builder or manufacturer or owner thereof before 12-6-1986.

(*ii*) Any new machinery or plant installed after 31-3-1987, but before 1-4-1988, if the assessee furnishes evidence to the satisfaction of the Assessing Officer that he had,—

(1) purchased such machinery or plant or had entered into a contract for purchasing such machinery or plant with the manufacturer or owner of or dealer in such machinery or plant before 12-6-1986, or

(2) where such machinery or plant has been manufactured in an undertaking owned by the assessee, taken steps, before 12-6-1986, for the manufacture of such machinery or plant.

In both the situations indicated at (*i*) and (*ii*) above, normally, the investment allowance would have been allowable in the assessment year 1988-89. However, to get over the problems which would have arisen by retrospective revival of investment allowance in respect of assessment year 1988-89, it has been specifically provided that in both these situations the investment allowance can be claimed in the assessment year 1989-90 only.

(*b*) A new ship or new aircraft acquired or any new machinery or plant installed after 31-3-1988, but before such date as the Central Government may specify in a notification in the Official Gazette.

(II) A proviso has been inserted in sub-section (1) of the section to provide that in respect of a ship or an aircraft or machinery or plant specified in sub-section (8B), the deduction for investment allowance shall be allowed at 20% of the actual cost thereof.

(III) Since there would be cases where a portion of the cost of the new asset may be financed by way of withdrawal from the deposits made with the Development Bank under the Investment Deposit Account Scheme, on which deduction under section 32AB has already been claimed by the assessee, it was

necessary to provide that investment allowance would not be allowed again on such portion. An *Explanation* has, therefore, been inserted in sub-section (1) of the section to provide that for the purposes of the investment allowance, "actual cost" shall mean the actual cost of the ship, aircraft, machinery or plant to the assessee as reduced by that part of such cost which has been met out of the amount released to the assessee from the Development Bank in accordance with the provisions of section 32AB(6).

(IV) A proviso has been inserted in sub-section (2) of the section, which specifies the assets on which deduction for investment allowance is allowable, to clarify that the deduction shall not be allowed on a new ship or new aircraft acquired or any new machinery or plant installed after 31-3-1987, but before 1-4-1988, unless such assets are acquired/installed in the circumstances specified in clause (*a*) of sub-section (8B) of the section and the assessee furnishes evidence to the satisfaction of the Assessing Officer as specified in that clause.

(V) Sub-section (2C) of the section allows a special rate of investment allowance, being 35%, in respect of new machinery or plant which would assist in control of pollution or protection of environment and which is installed after 31-5-1983, in any industry specified in sub-section (2) of the section. This sub-section has been amended to provide that investment allowance at the enhanced rate of 35% shall be allowed only in respect of such machinery or plant installed before 1-4-1987. Where such machinery or plant is installed on or after 1-4-1987, it will be entitled to investment allowance at the normal rate of 20% under the amended provisions of sub-sections (1) and (8B) of the section.

(VI) A new sub-section (8C) has been substituted in the section to provide that where a deduction for investment allowance under section 32A has been allowed to the assessee for any assessment year (called as the initial assessment year), no deduction shall be allowed to him in respect of the investment deposit account scheme under section 32AB in the said initial assessment year and a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year. The intention is that the option, once exercised, cannot be changed for five assessment years.

(VII) Amendments of consequential nature have been made in sub-sections (4) and (5) of the section pursuant to the insertion of a proviso in sub-section (1) of the section, as discussed at serial No. (*II*) above.

X. *The Finance Act, 1990.*—By **the Finance Act, 1990** (12 of 1990), the following **amendments** (**w. r. e. f. 1-4-1976**) have been made—

—**section 32A(4)(*ii*) (opening portion)** has been **amended**; and

—**section 32A(9)** has been **omitted**.

The scope and effect of the above amendments, as also of section 34(3)(*a*), have been elaborated in the following portion of the *Departmental Circular No. 572, dated 3-8-1990*, as follows:—

'*Streamlining of tax structure.*—**13.** With the reduction in the rates of taxes in the case of domestic companies, registered firms and co-operative societies and on a review of some of the incentives and concessions available to taxpayers, the following incentives and concessions have been withdrawn or modified:—

(*a*) Under the existing provisions of section 32A of the Income-tax Act, a deduction of an amount equal to twenty per cent of the cost of new ship or aircraft or plant and machinery installed or put to use is allowed in computing the profits and gains from business or profession.

This concession has been withdrawn in relation to new ship or aircraft acquired or new plant or machinery installed after the 31st day of March, 1990. Copy of the notification issued in this regard is at Annexure‡.

* * *

Modification of conditions for grant of development rebate and investment allowance.—**18.** The provisions of section 33 read with section 34 of the Income-tax Act, relating to development rebate, provide for deduction of a percentage of the actual cost of a ship acquired or machinery or plant installed. One of the conditions for the deduction is that an amount equal to seventy-five per cent. of the amount of 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.

18.1 In the context that appropriation to a reserve presupposes existence of sufficient profits and it should suffice if the required amount is so appropriated before the deduction by way of development rebate came to be allowed, the Central Board of Direct Taxes through a circular clarified that the requirement of creation of reserve will be considered to have been satisfied if the accumulated reserves in respect of the said machinery or plant up to the year or years of actual deduction is equal to seventy-five per cent. of the amount of development rebate to be actually allowed. This meant that in a year when profits are insufficient or there are no profits, the creation of reserve was not mandatory.

‡ Not printed here.

LexisNexis

18.2 The Supreme Court in the case of *Shri Shubhlaxmi Mills Ltd.* [(1989) 177 ITR 193 (SC)] has held that in order to claim the deduction on account of development rebate, it is obligatory that the reserve should be created in the year of acquisition/installation of machinery or plant, etc., even in a case where there are no profits. If the decision of the Supreme Court is to be followed, then taxpayers who have been following the Board's circulars for many years would be placed in a very difficult situation as their assessments already completed could be reopened. Apart from this, it may run contrary to accounting principles and the assurance given by the Central Board of Direct Taxes through its circular.

18.3 Though the decision of the Supreme Court has been pronounced only with regard to the provisions relating to development rebate, the underlying principle may apply equally to the grant of investment allowance. Accordingly, sections 32A and 34 have been amended to secure that the condition of reserve even in a year of loss or of insufficiency of profit as laid down by the Supreme Court will not be mandatory in respect of both development rebate and investment allowance. It is now provided that in considering whether the condition regarding creation of reserve is fulfilled or not, the reserve(*s*) created in the year in which the deduction is to be allowed and in any earlier year will be taken into account. Of course, the 'earlier year' will not be a year earlier than the year in which the plant, machinery is installed or put to use or the ship is acquired.

18.4 These amendments will take effect retrospectively from 1-4-1962, in relation to the development rebate and 1-4-1976, in relation to the investment allowance and will, accordingly, apply from assessment years 1962-63 and 1976-77, respectively, and subsequent years. [*Sections 7 and 11 of the Finance Act, 1990 (12 of 1990)*]'.

Introduction.—Development rebate, allowable under section 33 as an incentive, was withdrawn in respect of ships acquired, or machinery or plant installed, after 31-5-1974, except in certain cases specified in section 16 of the Finance Act, 1974 (20 of 1974) (later amended by the Finance Act, 1975 (25 of 1975)). To fill up the gap, an initial depreciation was provided for, in section 32(1)(*vi*), as an allowance in respect of certain assets for and from assessment year 1975-76. This initial depreciation was, however, discontinued in respect of ships or aircraft acquired, or machinery or plant installed, after 31-3-1976. That was because an investment allowance was, by way of similar incentive, provided for in **section 32A** introduced by **the Finance Act, 1976** (66 of 1976).

Relevant rule.—Rule 5AA of the Income-tax Rules, 1962, is relevant to section 32A.

Discontinuance of investment allowance.—The following **notification** has been issued under section 32A(8):—

'In exercise of the powers conferred by **sub-section (8) of section 32A** of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that the deduction allowable under this section shall not be allowed in respect of any ship or aircraft acquired or any machinery or plant installed after the 31-3-1987.' [*Notification No. GSR 870(E), dated 12-6-1986*].

Thus, in consequence to the aforestated notification, deduction of investment allowance has been discontinued in respect of any ship or aircraft acquired or any machinery or plant installed on or after 1-4-1987.

Revival of investment allowance.—Section 32A(8B), **newly introduced** by **the Direct Tax Laws (Amendment) Act, 1989** (3 of 1989) (w. e. f. 1-4-1989), enacts provisions of the overriding nature and revives the deduction of investment allowance for and from assessment year 1989-90 on fulfilment of the conditions laid down in that sub-section.

Investment allowance again discontinued.—As a result of the issuance of the following **notification** under section 32A(8B)(*b*), the investment allowance has again been discontinued, in effect, for and from assessment year 1991-92 (previous year being financial year 1990-91):—

'In exercise of the powers conferred by **clause (*b*) of sub-section (8B) of section 32A** of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that the deduction allowable under this section shall not be allowed in respect of any new ship or new aircraft acquired or any new machinery or plant installed after the 31-3-1990.' [*Notification No. SO 233(E), dated 19-3-1990*].

Bar on deduction under section 32A in certain cases.—It was specifically provided in **section 32A(8B)** (operative between 1-4-1987 and 31-3-1989) that subject to the provisions of section 32A(3)(*ii*), no deduction shall be allowed under section 32A in the case of an assessee who has claimed the deduction allowable under section 32AB (investment deposit account).

Further, it is specifically provided in **section 32AB(10)** (operative from 1-4-1989) that where a deduction has been allowed to an assessee under section 32AB (investment deposit account) in any assessment year, say, 1989-90, no deduction shall be allowed to the assessee under section 32A(1) (investment allowance) in—

—the said assessment year 1989-90 (hereinafter referred to as the initial assessment year) and

LexisNexis

—a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year, *i.e.,* 1990-91 to 1993-94.

A situation converse to section 32AB(10) is taken care of by section 32A(8C).

Bar on deduction under section 32AB in certain cases.—Section 32A(8C), newly introduced (w. e. f. 1-4-1989) by **the Direct Tax Laws (Amendment) Act, 1989** (3 of 1989), takes care of a situation, subject to the provisions of section 32A(3)(*ii*), where a deduction has been allowed to an assessee under section 32A(1) (investment allowance) in any assessment year, say, 1989-90. In such a situation, no deduction shall be allowed to the assessee under section 32AB (investment deposit account) in—

—the said assessment year 1989-90 (hereinafter referred to as the initial assessment year) and

—a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year, *i.e.,* 1990-91 to 1993-94.

A situation converse to section 32A(8C) is taken care of by section 32AB(10).

When investment allowance could not be carried forward.—It is clear that until the investment allowance is quantified and determined in the relevant assessment year after installation of the machinery, there cannot be any question of carrying forward of the investment allowance [*Salem District Co-operative Milk Producers Union Ltd. v. Deputy CIT*, (2005) 274 ITR 150 (Mad)].

Investment allowance when can be withdrawn.—Under section 32A(5)(*c*), before the expiry of 10 years period as stipulated in section 32A(5)(*b*), if the assessee utilizes the amount credited to the reserve account for distribution by way of dividends or profits, etc., the AO becomes entitled to withdraw the investment allowance [*CIT v. Shree Shantinath Silk Mills*, (2008) 303 ITR 58 (Guj)]. Also see, *I.C.I. India Ltd. v. CIT*, (2011) 337 ITR 327 (Cal).

Investment allowance could not be withdrawn, illustrative case.—In *CIT v. Pratik Prints* [(2005) 274 ITR 289 (Guj)], the Tribunal had found that the reserve pertaining to assessment year 1977-78 was utilized for purchase of machinery in the immediately succeeding accounting period when the assessee was in existence; and the reserve relating to assessment year 1978-79 was utilized by the partner, who took over the business for purchasing machinery in the immediately succeeding year hence, the investment allowance could not be withdrawn.

Allowance in respect of which assets.—The investment allowance has been provided to be allowed in respect of—

—new ship or new aircraft acquired between 31-3-1976 and 31-3-1987 by an assessee engaged in the business of operation of ships or aircraft, as the case may be [**s. 32A(2)(*a*)** read with notification under section 32A(8)]. For this purpose, a second-hand ship or aircraft is to be regarded as new ship or aircraft (*i*) which was not previously owned by any person resident in India and (*ii*) which was not previously used by the assessee. The expression 'person resident in India' does not apply to the Government. The Government is not a 'person' and is not capable of having residence either on its own or in terms of section 6. Thus, even where an assessee acquires a ship which was previously used by the Government of India, he would be entitled to investment allowance [*CIT v. Dredging Corporation of India,* (1988) 174 ITR 682, 688-89 (AP)];

—new machinery or plant installed between 31-3-1976 and 31-3-1987 for the purposes of business of generation or distribution of electricity or any other form of power [**s. 32A(2)(*b*)(*i*)** read with notification under section 32A(8)];

—new machinery or plant installed between 31-3-1976 and 31-3-1987,—

—(for assessment years 1976-77 and 1977-78), for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Ninth Schedule[31] to the Act [the then **section 32A(2)(*b*)(*ii*)**];

—(for assessment years 1976-77 and 1977-78), in a small-scale industrial undertaking [as defined in *Explanation* (*2*) to section 32A(2)] for the purposes of business of manufacture or production of any other articles or things [the then **section 32A(2)(*b*)(*iii*)**];

LexisNexis

31. Item No. 14 of the Ninth Schedule specifies "Commercial vehicles". It has been clarified that "public carrier (conveyance) used for the haulage of man and material for commercial consideration may be termed as 'commercial vehicles'" [*vide, CBDT's letter No. F 202/12/75-IT*(*A-II*)*, dated 25th October, 1976, addressed to FICCI*].

Item No. 21 of the Ninth Schedule reads: "Textiles (including those dyed, printed or otherwise processed) made wholly or *mainly* of cotton, including cotton yarn, hosiery and rope". The implication of *"mainly"* in item No. 21 is that "if the weight of the cotton yarn used for the manufacture of a certain fabric is not less than 51 per cent. of the weight of all types of yarn used for the manufacture of that fabric, such fabric can be said to be made mainly of cotton. In cases where the yarn itself is a mixed yarn containing cotton and other fibres, the cotton content of such yarn will also have to be taken into account for determining the total cotton content of the fabric" [*vide, Circular No. 213, dated March 14, 1977*: (1977) 108 ITR (St.) 3-4].

—(for and from assessment year 1978-79), in a small-scale industrial undertaking, for the purposes of business of manufacture or production of any article or thing [**s. 32A(2)(*b*)(*ii*)** read with notification under section 32A(8)];

—(for and from assessment year 1978-79), in any other (than small-scale) industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule to the Act. If, however, the intention was to use the machinery, etc., mainly for construction, manufacture or production of articles other than those listed in the Eleventh Schedule, any later user in part of manufacture, etc., even of an article listed in the Eleventh Schedule, by itself, will not disentitle, as per section 32A(2A), the grant of investment allowance [**s. 32A(2)(*b*)(*iii*)** read with notification under section 32A(8)];

—new machinery or plant installed between 1-4-1983 and 31-3-1987,—

—(for and from assessment year 1984-85), for the purposes of business of re pairs to ocean-going vessels or other powered craft if the business is carried on by an Indian company and the business so carried on is for the time being approved for the purposes of section 32A(2)(*c*) by the Central Government [**s. 32A(2)(*c*)**];

—new ship or new aircraft acquired between 1-4-1987 and 31-3-1988 by an assessee engaged in the business of operation of ships or aircraft, as the case may be,—

—(for assessment year 1989-90), if the assessee furnishes evidence to the satisfaction of the Assessing Officer that he had, before 12-6-1986, entered into a contract for the purchase of such ship or aircraft with the builder or manufacturer or owner thereof, as the case may be [**s. 32A(2)(*a*)** read with s. 32A(8B)(*a*)(*i*)];

—new ship or new aircraft acquired after 31-3-1988 but before 31-3-1990, which is the date as specified by the Central Government under section 32A(8B)(*b*) by an assessee engaged in the business of operation of ships or aircraft, as the case may be, for and from assessment year 1989-90 [**s. 32A(2)(*a*)** read with s. 32A(8B)(*b*)];

—new machinery or plant installed between 1-4-1987 and 31-3-1988,—

—(for assessment year 1989-90), for the purposes of business of generation or distribution of electricity or any other form of power;

—(for assessment year 1989-90), in a small-scale industrial undertaking for the purposes of business of manufacture or production of any article or thing;

—(for assessment year 1989-90), in any other (than small-scale) industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule to the Act [If, however, the intention was to use the machinery, etc., mainly for construction, manufacture or production of articles other than those listed in the Eleventh Schedule, any later user in part for manufacture, etc., even of an article listed in the Eleventh Schedule, by itself, will not disentitle, as per section 32A(2A), the grant of investment allowance],

if the assessee furnishes evidence to the satisfaction of the Assessing Officer that, before 12-6-1986, he—

—had purchased such machinery or plant, or

—had entered into a contract for the purchase of such machinery or plant with the manufacturer or owner of, or a dealer in, such machinery or plant, or

—had, where such machinery or plant has been manufactured in an undertaking owned by the assessee, taken steps for the manufacture of such machinery or plant [s. 32A(2)(*b*) read with s. 32A(8B)(*a*)(*ii*)];

—new machinery or plant installed after 31-3-1988 but before 31-3-1990, which is the date as specified by the Central Government under section 32A(8B)(*b*),—

—(for and from assessment year 1989-90), for the purposes of business of generation or distribution of electricity or any other form of power;

—(for and from assessment year 1989-90), in a small-scale industrial undertaking for the purposes of business of manufacture or production of any article or thing;

—(for and from assessment year 1989-90), in any other (than small-scale) industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing, not being an article or thing specified in the list in the Eleventh Schedule to the Act. If, however, the intention was to use the machinery, etc., mainly for construction, manufacture or

LexisNexis

production of articles other than those listed in the Eleventh Schedule, any later user in part for manufacture, etc., even of an article listed in the Eleventh Schedule, by itself, will not disentitle, as per section 32A(2A), the grant of investment allowance [s. 32A(2)(*b*) read with section 32A(8B)(*b*)].

An industrial undertaking is treated as a "small-scale industrial undertaking", for the purposes of grant of investment allowance, if the aggregate value of the machinery and plant (other than tools, jigs, dies and moulds) installed, as on the last day of the previous year for the purposes of the business of the undertaking does not exceed,—

(*i*) in a case where the previous year ends before the 1-8-1980, Rs. 10 lakhs;

(*ii*) in a case where the previous year ends after the 31-7-1980, but before the 18-3-1985, Rs. 20 lakhs; and

(*iii*) in a case where the previous year ends after the 17-3-1985, Rs. 35 lakhs.

For the above purpose, the value of any machinery or plant shall be,—

—in the case of any machinery or plant owned by the assessee, the actual cost thereof to the assessee; and

—in the case of any machinery or plant hired by the assessee, the actual cost thereof as in the case of the owner of such machinery or plant [**s. 32A(2),** ***Explanation*** **(*2*)**].

For arriving at the aggregate value of plant and machinery, the road transport vehicles are not to be regarded as plant and machinery because the same are not eligible for investment allowance [*CIT v. Travancore Mats & Mattings Co.,* (1998) 229 ITR 93, 98-99 (Ker)].

The assessee-firm, which was running a hospital/nursing home, spent Rs. 4,28,196 on the installation of certain machines. The assessee was held to be a small-scale industrial undertaking, for assessment year 1986-87, because the value of the machinery and plant did not exceed the prescribed limit [*CIT v. Trinity Hospital,* (1997) 225 ITR 178, 190 (Raj)].

In *CIT v. Upasana Hospital,* [(1997) 225 ITR 845, 851-52 (Ker)], the assessee's unit of X-ray machine and accessories was held to be a small-scale industrial undertaking, for assessment year 1981-82, as the cost of plant and machinery of the assessee on the last day of the previous year was only Rs. 6.93 lakhs.

In *Perfect Pottery Co. Ltd. v. CIT* [(1996) 221 ITR 210, 213 (MP)], the unit was held not a small scale industrial unit for the assessment year 1978-79 as the investment in the unit was more than Rs. 10,00,000.

In the context of the provisions contained in *Explanation* (*2*) to section 32A(2), defining the expression 'small-scale industrial undertaking', the definition of the expression 'plant' as contained in section 43(3) cannot have application and, therefore, 'motor cars' cannot be regarded as a 'plant' and the value of the motor cars has to be excluded for computing the aggregate value of the plant and machinery installed in an industrial undertaking so as to treat it as a small-scale industrial undertaking [*Hyderabad Deccan Cigarettes Factory v. CIT,* (1999) 236 ITR 615, 619-20 (AP)]. In the facts of that case, the assessee's undertaking was held to be a small-scale industrial undertaking because the aggregate value of plant and machinery installed excluding the value of motor cars was less than Rs. 20 lakhs and, therefore, it was eligible for investment allowance.

Substitution (w. e. f. 1-4-1978) of clauses (*ii*) and (*iii*) of section 32A(2)(*b*) by Act 29 of 1977 is not retrospective and is operative for and from assessment year 1978-79.—The substitution (w. e. f. 1-4-1978) of clauses (*ii*) and (*iii*) of section 32A(2)(*b*) by the Finance (No. 2) Act, 1977 (29 of 1977), would apply only for and from assessment year 1978-79 and not retrospectively for assessment year 1977-78 or any earlier year. As a result of such substitution, the investment allowance is allowable on articles or things not specified in the Eleventh Schedule instead of the earlier provisions (operative for assessment years 1976-77 and 1977-78) the investment allowance was available only on the manufacture of articles or things specified in the Ninth Schedule. Thus, the scope of the substituted provisions is wider [*CIT v. Century Flour Mills Ltd.,* (1999) 239 ITR 23, 25 (Mad)].

The question whether the Tribunal was legally right in considering the written down value of the plant and machinery for finding out the aggregate value within the meaning of the said *Explanation* (*2*), is one of law [*CIT v. Simbholi Industries* (*P.*) *Ltd.,* (1989) 176 ITR 505 (All)].

New machinery or plant in this context, besides purchase of first-hand machinery, etc., also includes second-hand machinery or plant, which before its installation by the assessee was used outside India by any other person, if the following conditions are fulfilled, namely:—

—such machinery or plant was not previously used in India;

—such machinery or plant is imported into India from a foreign country;

LexisNexis

—no depreciation in respect of such machinery or plant had ever been allowed, or was allowable, under the Indian law.

Notification under section 32A(2)(*c*).—'In exercise of the powers conferred by **clause (c) of sub-section (2) of section 32A** of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby approves the business of repairs to ocean-going vessels carried on by M/s. Nigel Shipyard Company Limited, 1st Floor, Malquides Building, Vasco De Gama, Goa, for the purposes of the said Act.' [*Notification No. S.O. 1521, dated 8-6-1994*].

Requisite conditions for availing investment allowance.—'Investment allowance' is granted under section 32A. Sub-section (1) requires that the machinery or plant (*a*) should be owned by the assessee, (*b*) should be wholly used for the purposes of the business carried on by him, and (*c*) should be the machinery or plant specified in sub-section (2), *i.e.,* it should be new machinery or plant installed in an industrial undertaking for the purposes of the business of manufacture or production of articles or things. [*CIT v. Shaan Finance* (*P.*) *Ltd. : First Leasing Co. of India Ltd.,* (1998) 231 ITR 308, 311-12 (SC)].

Where in the case of an assessee carrying on the business of manufacture and sale of cement, there was nothing on record to suggest that the assessee was in a position to use the quarried limestone as a raw material for the purpose of manufacture of cement and there was no finding that the plant and machinery had been set up, the assessee could not be said to have set up the business of manufacturing cement during the accounting year relevant to assessment year 1983-84 wherein the one and only activity evidently undertaken by the assessee was quarring of limestone [*CIT v. Coromandal Fertilizers Ltd.,* (2003) 261 ITR 408, 416-17, 418-19 (AP), special leave petition dismissed by the Supreme Court : (2004) 265 ITR (St.) 38 (SC)].

Whether a particular activity is the manufacturing activity or not is dependent upon several factors and no strait-jacket formula or general principle can be applied. Though manufacture implies a change, every change is not a manufacture. There must be a transformation of some kind and a new and different article must emerge having distinctive features [*CIT v. S. L. Agarwala & Co.,* (1992) 197 ITR 239, 242 (Ori)]. In that case, the assessee produced small iron pieces by conversion of big iron ingots into small pieces. For such activity, it installed a crane which lifted huge iron ingots with magnetic force and then hit them against another hard material as a result of which small pieces of iron came into existence. On the question of allowability of investment allowance, it was found by the Tribunal that the big iron ingot and the smaller pieces were commercially different. In view of the categorical factual finding recorded by the Tribunal that a different and distinctive commercial commodity came into existence, the assessee was held entitled to investment allowance.

In *CIT v. Poyilakkada Fisheries Pvt. Ltd.* [(1992) 197 ITR 85 (Ker)], the processing of fish was held amounting to production of articles and, therefore, the assessee was held entitled to investment allowance in respect of the diesel generator and transformer.

LexisNexis

In this connection, it is pertinent to note that each and every item is not eligible for investment allowance even though it may be used in the business. The machinery or plant must have a close nexus with the business of construction, manufacture or production of any article or things, not being article or things specified in the 11th Schedule. It cannot be said that fire extinguishers or time-office equipments which are used by the assessee in the business are inextricably connected with the production of the article or things for which investment allowance is available [*CIT v. Machinery Manufacturing Corporation Ltd.,* (1992) 198 ITR 559, 566 (Cal)].

In *Hind Nippon Rural Industries Pvt. Ltd. v. CIT* [(1993) 201 ITR 588 (Karn), special leave petition granted by the Supreme Court : (1992) 197 ITR (St.) 2 (SC)], it has been held that chipping and sizing granite do not amount to manufacturing or processing of goods.

Particularly in view of the legislative history of the relevant provisions and the context, it is not possible to read the word 'construction' in section 32A(2)(*b*)(*iii*) as referring to construction of dams, bridges, buildings, roads or canals. In the former sub-clause (*ii*) and the present sub-clause (*iii*) of section 32A(2)(*b*) as well as in Schedules IX and XI, the words 'articles' and 'things' are used interchangeably. In the scheme and context of the provision, it would not be right to isolate the word 'thing', ascertain its meaning with reference to the law lexicons, and attach to it a meaning which it was never intended to bear. A statute cannot always be construed with the dictionary in one hand and the statute in the other. Regard must be had to the scheme, context and—as in this case—the legislative history of the provision [*CIT v. N. C. Budharaja & Co.,* (1993) 204 ITR 412, 434 (SC), **reversing on different grounds** *Shankar Construction Co. v. CIT,* (1991) 189 ITR 463 (Karn)]. This view has been reiterated in *Builders Association of India v. Union of India* [(1994) 209 ITR 877 (SC)]. Here, the Supreme Court has opined [209 ITR 877, 886-87 (SC)] that the departmental circular explaining the provisions of section 32AB does not have any relevant significance on the interpretation of the provisions of section 32A. It may be noted that in *CIT v. Bhageeratha Engineering Ltd.,* [(1993) 199 ITR 12 (SC), **affirming** *CIT v. Bhageeratha Engineering Ltd.* (1992) 193 ITR 674 (Ker)], the Supreme Court has dismissed a special leave petition by the Department. In that case, the finding of the Tribunal was that the assessee, engaged in the business of construction, was an industrial undertaking. On that basis, the Tribunal concluded that assessee was entitled to investment allowance in respect of the machinery used in the business of construction. The High

Court opined that it was not open to the revenue, in reference proceedings, to contend that the assessee-company was not an industrial undertaking since the finding of fact in that regard entered by the Tribunal has not been expressly challenged by an appropriate question raised in the reference. In that view of the matter, the High Court answered the question by saying that in view of the aforesaid finding of the Tribunal the assessee was entitled to investment allowance. The special leave petition has also been dismissed by the Supreme Court on that basis. In *Builders Association of India v. Union of India* [(1994) 209 ITR 877, 888 (SC)], it has been observed that the Kerala High Court decision [193 ITR 674 (Ker)] clearly shows that the contention of the Revenue was that the assessee was not an 'industrial company' and that the interpretation of the words 'construction, manufacture or production of any article or thing not being an article or thing specified in the list in the Eleventh Schedule' was not really an issue therein. It, therefore, cannot be said that the Supreme Court has taken a different view on the interpretation of the said words in *CIT v. Bhageeratha Engineering Ltd.* [(1993) 199 ITR 12 (SC)].

The investment allowance is permissible only in the case of 'industrial undertakings' and not in the case of 'industrial company' or an assessee which is indulging in construction work. Where the assessee is engaged in construction work, it cannot be said that it is an industrial undertaking as it does not manufacture an article or thing as contemplated by section 32A(2) [*CIT v. Unit Construction Co. Pvt. Ltd.,* (1999) 240 ITR 718, 719 (Cal), **following** *Builders Association of India v. Union of India,* (1994) 209 ITR 877 (SC)].

The photographs or the graphs obtained from X-ray machine, ultra-sound scanner or ultra sonographic machine, etc., which are the result of efforts or activity can be said to be 'things' as used in section 32A. The installation of these machines in a hospital by an assessee can be said to be for the purpose of business of production of things [*CIT v. Trinity Hospital,* (1997) 225 ITR 178, 189 (Raj)]. It cannot be doubted that the photographs of various parts of the body obtained by an X-ray machine are the resultant product of work of activity and they are the end result of efforts and activities carried on with the machine by human endeavour and give a result in black and white regarding the internal position of the parts of the body on the exposed film and this end result is helpful for the proper and efficient diagnosis of the patient. The photographs or the graphs obtained from X-ray machine which are the result of human efforts and activity, therefore, cannot but be a thing produced by the use of X-ray machine [*Natvarlal Ambalal Dave v. CIT,* (1997) 225 ITR 936, 939 (Guj)].

In *CIT v. Mysore Minerals Ltd.* [(1994) 205 ITR 461 (Karn), special leave petition granted by the Supreme Court : (1993) 201 ITR (St.) 59 (SC)], the activity of the assessee in extracting granite from a quarry and cutting the same into various sizes and polishing them, has been held to amount to manufacture or production of an article or thing so as to be eligible for investment allowance. Reference may also be made to *CIT v. Mysore Minerals Ltd.* [SLP (Civil) No. 16416 of 1998 : (1998) 234 ITR (St.) 74-75 (SC) & (1999) 235 ITR (St.) 25 (SC)].

LexisNexis

For the meanings of the words 'thing' and 'article', reference may also be made to *CIT v. Mahalinga Setty & Co.* [(1992) 195 ITR 526, 529 (Karn)].

The expression 'plant installed', used in section 32A, does not necessarily mean something fixed in position, but it should be construed widely in the sense of 'inducted or introduced' [*CIT v. Baker Mercer India P. Ltd.,* (1992) 196 ITR 667, 670 (Bom), **followed in** *CIT v. Bharat Radiators P. Ltd.*, (1999) 239 ITR 608, 610-11 (Bom)]. The word 'installed' would mean to place in position for service or use or to set up for service or use. The books would be installed when they would be placed for use in the premises in question [*CIT v. Thyristors Controls Pvt. Ltd.,* (1994) 207 ITR 317, 319 (Guj)].

The expression 'install' does not mean affixation. The word 'install' has different connotation in different context having regard to the nature and character and specified manner of use of a particular plant or machinery for effective and appropriate utilisation of operation thereof. A locomotive is installed as soon it is put on rail ready for use. A railway siding is installed as soon it is constructed and made ready for use [*CIT v. Birla Jute & Industries Ltd.,* (2003) 260 ITR 55, 65 (Cal)].

It is the manufacture and production of 'office machines and apparatus' used for data processing which is excluded under item 22 in the list in the Eleventh Schedule and not the activity of producing computations and statements after processing data furnished by various parties, which are fed into the computer as inputs [*CIT v. Computerised Accounting & Management Service Pvt. Ltd.,* (1999) 235 ITR 502, 506 (Ker)].

In *Shree Products v. CIT* [(1999) 237 ITR 367, 368, 370-71 (Bom)], it has been held that rubber stoppers did not fall under items 27 and/or 28 of the Eleventh Schedule and, therefore, new machinery for manufacture of rubber stoppers has been held entitled to investment allowance for the assessment years 1978-79 and 1979-80.

In *CIT v. Tamil Nadu Heat Treatment & Fetting Services* (*P.*) *Ltd.* [(1999) 238 ITR 529, 540 (Mad)], it has been held that the activities of the assessee in relation to raw or untreated crank shafts being subjected to heat treatment, etc., is definitely a 'manufacturing activity' entitling it to claim investment allowance under section 32A.

Assessee has been held entitled to investment allowance even where the machinery has been used for trial production [*CIT v. Union Carbide* (*I*) *Ltd.,* (2002) 254 ITR 488, 492 (Cal)].

The assessee cannot claim investment allowance on the machinery with the aid of which the product was manufactured as also on the product so manufactured when it puts that product to use for the manufacture of yet other products [*CIT v. Estee Engineering Co.* (*P.*) *Ltd.,* (2002) 255 ITR 44, 45 (Mad)]. Thus, it has been held, in the facts of that case, that investment allowance is to be granted to the assessee subject to such allowance not having been granted on the machine with the aid of which the tools and dies were manufactured

'Production' has wider connotation than 'manufacture'.—The word 'production' has a wider connotation than the word 'manufacture'. While every manufacture can be characterised as production, every production need not amount to manufacture. The word 'production' or 'produce' when used in juxtaposition with the word 'manufacture' takes in bringing into existence new goods by a process which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products which emerge in the course of manufacture of goods [*CIT v. N.C. Budharaja & Co.,* (1993) 204 ITR 412, 423, 423-24 (SC)]. The activity of winning or excavating the coal from the mines can be aptly described as production activity. The expression 'production of mineral' is used in the allied provisions (such as section 35E) of the Act itself and it is a definite point that Parliament employed the expression 'production' to the minerals extracted from underneath the surface [*CIT v. Singareni Collieries Co. Ltd.,* (1996) 221 ITR 48, 52 (AP)].

Road transport vehicles, connotation of.—'Road transport vehicles' would, in common parlance, mean vehicles which were used for transportation of people at least though in a given set of circumstances they may be involved in transportation of goods. Tractor trailers would fall within the meaning of 'road transport vehicles' [*CIT v. Gujarat Narmada Valley Fertilizer Co. Ltd.*, (2006) 281 ITR 297 (Guj)].

Industrial undertaking, meaning of.—Though the wide definition of industry in the context of employer-employee relation under the various industrial laws may not be applicable to the meaning of industrial undertaking under the Income-tax Act, as the expression is used in the context in which the provisions are set, the meaning of industrial undertaking in the set up of the Income-tax Act takes its colour from the activity for which the new plant or machinery is set up. The activity is of production of any article or thing. Therefore, any activity which primarily concerns the production of any article or thing would fall in the category of industrial undertaking for that purpose; may be that activities carried on by a trader or any person carrying on any business or profession [*Natvarlal Ambalal Dave v. CIT,* (1997) 225 ITR 936, 943 (Guj)].

Article or thing need not be marketable commodity.—It is not the requirement of the provisions of section 32A nor can it be read in the context of these provisions that in order to fulfil the condition that a machinery or plant must have been installed in an industrial undertaking for the purpose of manufacture or production of any article or thing, it must be related to production of such article or thing which is saleable in the open market as a common marketable commodity only. Therefore, it can be said that so far as satisfaction of this condition is concerned the X-ray plant is a machinery or plant through which any article or thing could be produced for sale stands satisfied [*Natvarlal Ambalal Dave v. CIT,* (1997) 225 ITR 936, 940 (Guj)].

Installation need not necessarily be in the year of acquisition.—Section 32A does not require that the machinery or plant should be installed in the year in which it is acquired for the purpose of claiming investment allowance. If the installation of a machinery or plant is spread over more than a year, the relevant year for the grant of investment allowance would be the year in which installation is completed [*CIT v. Surama Tubes* (*P.*) *Ltd.,* (1993) 201 ITR 124, 128 (Cal)]. In that case, it was found by the Income-tax Officer that, out of the machinery valued at Rs. 6,50,050, machinery valued at Rs. 3,79,793 was purchased during 1969-70 to 1974-75 accounting years and the balance of Rs. 2,70,257 was purchased in the previous year relevant to the assessment year 1982-83. The Income-tax Officer, therefore, allowed investment allowance for the assessment year 1982-83 on machinery valued at Rs. 2,70,257 only. It was found by the Tribunal that the machines, although acquired earlier, could not be installed in view of the change of management twice. The machines were lying idle and were kept for installation and the installation was completed in the year under reference. The Tribunal was right in law in concluding that the plant and machinery of the value of Rs. 3,79,793 were new and their installation was completed during the accounting year relevant to the assessment year 1982-83 and the same were eligible for investment allowance.

Clause (*a*) of section 32A(2) contrasted with clause (*b*) thereof.—Section 32A(2) covers all items in respect of which investment allowance can be granted. These items are: ship, aircraft or machinery or plant of certain kinds specified in that section 32A(2). In respect of the new ship or the new aircraft, section 32A(2)(*a*) expressly prescribes that the new ship or the new aircraft should be acquired by an assessee which is itself engaged in the business of operation of ships or aircraft. Under section 32A(2)(*b*), however, any such express requirement that the assessee must himself use the plant or machinery is absent. Section 32A(2)(*b*) merely describes the new plant or machinery which is covered by section 32A. The plant or machinery is described with

reference to its purpose. In other words, section 32A(2)(*b*) refers to the uses to which the machinery can be put. It does not specify that the assessee himself should use the machinery for these purposes. Thus, the benefit of section 32A(2)(*b*) can be availed of by an assessee who is owning the machinery or plant and leasing out the same to other person, who is using such leased out machinery for specified purposes under section 32A(2)(*b*) [*CIT v. Shaan Finance* (*P.*) *Ltd. : First Leasing Co. of India Ltd.,* (1998) 231 ITR 308, 312, 313 (SC)].

Investment allowance held eligible even in respect of leased out machinery.—In the facts of *CIT v. Shaan Finance* (*P.*) *Ltd.* [(1993) 199 ITR 409 (Karn)], the Tribunal was held right in holding that, in respect of machinery owned by the assessee, but leased to third parties and used by them for the manufacture of article or thing, investment allowance was allowable under section 32A. **Affirming** the Karnataka decision [199 ITR 409 (Karn)], the Supreme Court has held that leasing or finance company, which owns machinery and leases the same to the third parties who use such machinery for manufacture or production of articles or things as specified in section 32A(2)(*b*), is entitled to investment allowance in respect of such machinery under section 32A. This is so because where the business of the assessee consists of hiring out machinery and/or where the income derived by the assessee from the hiring out of such machinery is business income, the assessee must be considered as having used the machinery for the purposes of its business [*CIT v. Shaan Finance* (*P.*) *Ltd. : First Leasing Co. of India Ltd.,* (1998) 231 ITR 308, 310, 314, 317 (SC), **affirming** *CIT v. Shaan Finance* (*P.*) *Ltd.,* (1993) 199 ITR 409 (Karn) and *CIT v. First Leasing Co. of India Ltd.,* (1995) 216 ITR 455 (Mad); **approving** *CIT v. Vinod Bhargava,* (1988) 169 ITR 549 (AP) and **distinguishing** *CIT v. Narang Dairy Products,* (1996) 219 ITR 478 (SC)]. Also see, *CIT v. Gautam Chand,* (1994) 123 Taxation 121 (Raj); *CIT v. Span Leasing and Investment Co. Ltd.,* SLP (Civil) No. 4840 of 1994 : (1994) 206 ITR (St.) 283 (SC); *CIT v. Maharashtra Apex Corporation Ltd.,* CC No. 463 of 1998 : (1998) 230 ITR (St.) 89 (SC).

Thus, even in a case where the commercial asset is exploited by letting out the same, the investment allowance cannot be denied [*CIT v. Mercantile Construction Co.,* (1994) 74 Taxman 41, 48 (Cal)].

In *CIT v. Eastern Spinning Mills and Industries Ltd.* [(1994) 74 Taxman 318 (Cal)], it has been held that, in the instant case, the machinery was owned by the assessee. By leasing out the machinery, the assessee was exploiting the commercial assets, *viz.*, the machinery for the purpose of the business. The expression 'wholly' used for the purpose of the business, in the context in which it appears under section 32A(1), means that the asset in its entirety must be used for the purpose of the business. So long as, an asset is used by the assessee for the purpose of the business carried on by the assessee, even though, such assets is allowed to be used by others, that cannot disentitle the assessee from claiming investment allowance.

LexisNexis

In *CIT v. Sivananda Colour Works* [(1997) 223 ITR 180, 181, 184, 186 (Mad)], the assessee was a firm having a factory for bleaching and dyeing. It purchased certain machinery for its business. Since the assessee could not accommodate the newly purchased machinery, for the time being it was let out. On the question of allowability of investment allowance on such leased out machinery, it has been held that inasmuch as the assessee was not doing business in hiring and leasing the machinery and inasmuch as the assessee has not wholly used the machinery for the purpose of the business carried on by it and since the business done by the lessee cannot be considered to be that of the assessee and further even though the lease income is assessable as business income, the assessee is not entitled to ask for investment allowance under section 32A, since the conditions prescribed therein were not satisfied.

In *CIT v. International Clearing & Shipping Agency* [(2000) 242 ITR 426, 427, 428 (Mad)], the Tribunal was held right in holding that even an assessee who carries on the business of leasing machinery owned by it to the others who carried on the business of manufacture or production of articles or things other than those specified in the Eleventh Schedule to the 1961 Act is entitled to investment allowance. Also see, *First Leasing Co. of India Ltd. v. CIT,* (2000) 244 ITR 234, 236 (Mad).

In *CIT v. Smt. S. Devaki* [(2000) 244 ITR 669, 670 (Mad)], the assessee was held entitled to investment allowance on cranes leased out on hire to other concerns by the assessee.

In *CIT v. Andhra Prabha* (*P.*) *Ltd.* [(2000) 244 ITR 776, 780 (Mad)], the assessee was held entitled to investment allowance on the machinery leased out though the assessee was not using the machinery purchased in publishing newspaper.

In *Mercantile Credit Corporation Ltd. v. CIT* [(2000) 245 ITR 245, 251 (Mad)], the assessee was held entitled to investment allowance in respect of new machinery leased out. Thus, a leasing company is entitled to investment allowance even though there was no activity of manufacturing or production of any article by the assessee [*CIT v. Mercantile Credit Corporation Ltd.,* (2001) 252 ITR 87 (Mad)].

In *CIT v. Essan Investments Ltd.* [(2002) 254 ITR 83, 83-84 (Mad)], the assessee was held entitled to investment allowance in respect of earth-moving equipment leased out by it to others.

Where the business of the assessee consists of leasing of machinery, investment allowance cannot be denied to the assessee on the ground that such machinery has not been used by the assessee himself [*CIT v. Maharashtra Apex Corporation Ltd.,* (2002) 254 ITR 98, 98-99 (SC), **affirming** *CIT v. Maharashtra Apex Corporation Ltd.,* (1998) 234 ITR 484 (Karn)]. Thus, a lessor of the machinery is entitled to investment allowance [*CIT v. Shriram Transport Finance Co. Ltd.,* (2002) 254 ITR 558, 559 (Mad)]. Also see, *CIT v. Concert Investment & Leasing Ltd.,* (2002) 123 Taxman 452, 453 (Ker); *CIT v. Investment Trust of India Ltd.,* (2003) 264 ITR 506, 508 (Mad).

Where the business of the assessee was not that of leasing out machineries for the purpose of mining, the lease that it had granted to holder of a mining lease with whom it had arrangements for the purchase of the minerals and was marketing the same, such lease would not be sufficient to entitle the assessee to the benefit of investment allowance [*CIT v. Vijay Granites* (*P.*) *Ltd.,* (2000) 159 CTR (Mad) 425, 427].

Division of manufacturing process does not stand to reason or practicality.—The division of the manufacturing process between the actual manufacturing process and the accessory manufacturing process does not stand to reason or practicality. One may or may not conceive of certain parts or stages of the process as principal process and the rest as accessory process, but that makes no difference to the fact that all processes taken together constitute an indivisible integral process. As a matter of fact, all machinery and equipment that are necessary to make the assessee's manufacturing unit in a state of operational integration pertain to its manufacturing process because there cannot be any manufacture unless this operational integration is achieved after installation of the plant and the plant goes operational. Therefore, any machinery or plant having a link, however minor, in the total process of the operational integration should be taken as machinery or plant pertaining to the manufacturing process [*CIT v. Tribeni Tissues Ltd.,* (1994) 206 ITR 92, 97 (Cal)].

Not allowable in respect of which assets.—No deduction by way of investment allowance is allowable in respect of—

(*i*) any machinery or plant installed in any office premises or any residential accommodation, including a guest house;

(*ii*) any office appliances;

(*iii*) any road transport vehicles;

(*iv*) any ship, machinery or plant in respect of which development rebate was or is allowable; and

(*v*) any machinery or plant, the whole of the actual cost whereof is allowed as a deduction (by way of depreciation, etc.), in computing assessee's taxable income of any one assessment year [*e.g.*, where, for assessment years 1966-67 to 1995-96, the cost was Rs. 5,000 (up to assessment year 1983-84, Rs. 750) or less, or the rate of allowable depreciation is 100%, etc.]. It seems that this clause has been enacted to neutralise the effect of the decisions like that in *CIT v. Swadeshi Cotton Mills Co. Ltd.* [(1979) 117 ITR 321 (All)] which held that even where the full cost of the machinery was, in the initial year, allowed as depreciation, development rebate was still allowable in respect of such machinery.

LexisNexis

In *CIT v. Popular Borewell Service* [(1992) 194 ITR 12, 23 (Mad)], it has been held that the rig and compressor mounted on a lorry and used for drilling borewells cannot be considered as 'road transport vehicle' and, therefore, they are eligible for investment allowance.

In *CIT v. Continental Devices India Ltd.* [(1992) 196 ITR 571, 573 (Del)], it has been held that the question whether investment allowance could be allowed on computers was a question of fact, since there was a finding that the computers were used to help the assessee in the manufacture of its products and was not part of office equipment.

In *CIT v. Shaw Wallace & Co.* [(1993) 201 ITR 17, 24 (Cal)], it has been held that having regard to the nature and function of the computer and the data-processing system, it cannot be said that they are office appliances.

In *CIT v. C.S. Anand* [(1997) 225 ITR 573, 574 (Pat)], it has been held that dumpers are not road transport vehicles and the same were eligible for investment allowance.

In *India Fruits* (*P.*) *Ltd. v. CIT* [(1998) 230 ITR 630, 632-33, 636 (AP)], motor cars have been held to be road transport vehicles and the same are not eligible for investment allowance.

Dumpers used by the assessee in the execution of civil engineering contract work have been held to be 'road transport vehicles', and not eligible for investment allowance under clause (*b*) of the second proviso to section 32A(1) [*CIT v. Shah Construction Co. Ltd.,* (1999) 237 ITR 814, 816 (Bom)].

However, dumpers, which are being used for mining purposes and not merely for carrying goods on the roads, cannot be regarded as road transport vehicles and the same are eligible for investment allowance [*CIT v. Bajrang Enterprises,* (2002) 258 ITR 448, 449 (Mad)].

However, the tippers (which are hydraulically operated and mounted on truck chasis for loading earth, etc., and unloading the same at the project site without the aid of human agency) in the hands of a general works contractor have been held not road transport vehicles but the tools of business of the assessee-contractor and the assessee has been held entitled to get investment allowance on the cost of the tippers [*CIT v. Progressive Engineering Co.,* (1998) 230 ITR 729, 731, 732 (AP)].

In *CIT v. Nandlal Parshuram* [(1999) 239 ITR 497, 499 (Gauh)], it has been held that tractors are not road transport vehicles and the same are eligible for investment allowance. This view has been **followed in** *CIT v. Deha Assam Tea Co.* (*P.*) *Ltd.* [(2000) 241 ITR 555, 556 (Gauh)].

In *CIT v. Elgi Equipments Ltd.* [(2000) 242 ITR 460, 467-68 (Mad)], it has been held that the expression 'office appliance', as employed in clause (*b*) of the second proviso to section 32A(1), must be construed strictly and limited to appliances which are exclusively or permanently used in an office, and not extended to appliances which are capable of being used in an office and are equally capable of being used in a place where the production of articles carried on or elsewhere. In that view of the matter, where the intercom, amplifiers and air-conditioners were all appliances installed in the computer room which was treated as part of the factory, they could not be regarded as office appliances. As these appliances were used as adjuncts to the use of computers, which was eligible for investment allowance, these appliances, *viz.,* intercom, amplifiers and air-conditioners, were qualified for investment allowance.

In *Mehsana District Co-operative Milk Producers Union Ltd. v. CIT* [(2002) 256 ITR 322, 328 (Guj)], it has been held that the wireless equipment installed at factory, chilling centres and vehicles cannot be termed or treated as an office appliance.

In *CIT v. Birla Jute and Industries Ltd.* [(2003) 260 ITR 55, 62-63, 63-64, 66 (Cal)], it has been held that railway biding and locomotive are not 'road transport vehicles' and the same are entitled to investment allowance.

In the absence of a statutory definition of the expression 'road transport vehicles', the meaning of that expression in common parlance has to be adopted. Road transport vehicles would mean vehicles which are used for transportation of goods or passengers on roads. A tractor is not basically used for transportation of goods or passengers on roads. It is machinery used for tilling agricultural land. People can ride on a tractor but that is not its main purpose. Therefore, investment allowance can be claimed on tractors [*CIT v. U.P. Paschim Kshetriya Vikas Nigam Ltd.,* (2003) 264 ITR 273, 275 (All)].

LexisNexis

Illustrative cases.—In the facts of the following cases, **the assessee was held entitled to investment allowance:—**

(1) *CIT v. R. Narayanaswami Naicker & Sons,* (1984) 149 ITR 283 (Mad) [plant and machinery installed in a ginning factory].

(2) *CIT v. Super Drillers,* (1988) 174 ITR 640 (AP) [drilling equipment (rig and compressor) used by the assessee for the purpose of business carried on by it in order to bring to the surface underground water]. This decision [174 ITR 640 (AP)] is **no longer good law on the point** in view of the Supreme Court ruling in *CIT v. N.C. Budharaja & Co.,* (1993) 204 ITR 412 (SC) [*CIT v. Super Drillers,* (1996) 222 ITR 629, 631 (AP)]. In this view of the matter, the decision in *CIT v. Kamdhenu Agencies* [(1997) 223 ITR 376, 379 (MP)], which has **followed** Andhra Pradesh decision [174 ITR 640 (AP)] on the point without noticing a contrary Supreme Court decision [204 ITR 412 (SC)], where the Madhya Pradesh High Court has held that an assessee carrying on business in drilling borewells using rigs and compressors was entitled to investment allowance, **does not represent the correct state of law on the point.** Similarly, the decision in *CIT v. Gangotri Tube Wells* (*P.*) *Ltd.* [(1998) 229 ITR 87, 89 (MP)] **does not represent the correct state of law on the point.**

(3) *CIT v. Kalpana Lamp Components Pvt. Ltd.,* (1989) 178 ITR 330 (MP) [a manufacturer of fluorescent tubes, as the same are not mere 'domestic electric appliances' occurring in item 12 of the Eleventh Schedule].

(4) *CIT v. Elite Sea Foods,* (1989) 179 ITR 85 (Ker) [processing of prawns amounts to production of an article, 'plant freezer' used for the purpose].

(5) *CIT v. Partap Steel Rolling Mills* (*Asr.*) (*P.*) *Ltd.,* (1989) 179 ITR 554 (Punj) [assessee engaged in the manufacture and sale of steel was held eligible for investment allowance in respect of a new oxygen plant installed for its gas division (an intermediate process)].

(6) *CIT v. Jaideep Industries,* (1989) 180 ITR 81 (Punj) [dies and moulds were held to be part of machinery and entire machinery was held eligible for the allowance].

(7) *CIT v. Peerless Consultancy Services* (*Pvt.*) *Ltd.,* (1990) 186 ITR 609, 611-12 (Cal), **affirmed in** *CIT v. Peerless Consultancy & Services* (*P.*) *Ltd.*, (2001) 248 ITR 178, 179 (SC) [the assessee, an industrial company, held entitled to investment allowance in respect of generator installed by it].

(8) *Tribeni Tissues Ltd. v. CIT,* (1991) 190 ITR 487, 492 (Cal) [tube wells and weighing machines used in the production of paper, held eligible for investment allowance].

(9) *CIT v. Electronics Research Industries Pvt. Ltd.,* (1991) 192 ITR 20, 25 (Karn) [the assessee, engaged in the manufacture of electronic equipment, has been held entitled to investment allowance in respect of internal telephone system with about 20 lines].

(10) *CIT v. Mahant Oil Industries Pvt. Ltd.,* (1992) 193 ITR 620 (Karn) [the assessee, carrying on the business of producing oil, was held entitled to investment allowance on the storage tank].

(11) *CIT v. Popular Borewell Service,* (1992) 194 ITR 12 (Mad), special leave petition granted by the Supreme Court : (1993) 201 ITR (St.) 46 (SC) [small scale industry engaged in the sinking of borewells, held entitled to investment allowance in respect of rigs and compressors used for drilling borewells]. But, now, see Supreme Court ruling in 204 ITR 412 (SC). In *CIT v. Sivam & Co.* [(2000) 242 ITR 76, 78-79 (Mad)], it has been held that in view of the Supreme Court ruling [204 ITR 412 (SC)], the Madras decision [194 ITR 12 (Mad)] is **no longer good law**.

(12) *CIT v. General Research & Development Corporation,* (1992) 194 ITR 120 (Karn) [the assessee, a small scale industry carrying on the business of prospecting and drilling for the purpose of rendering consultancy services, held entitled to investment allowance in respect of machinery used for the extraction of iron ore].

(13) *CIT v. Mahalinga Setty & Co.,* (1992) 195 ITR 526 (Karn) [dumpers and tippers used for the purpose of business of construction, *i.e.,* used to lift earth and transport the same, held entitled to investment allowance]. But see, Supreme Court ruling in 204 ITR 412 (SC).

(14) *CIT v. Baker Mercer India P. Ltd.,* (1992) 196 ITR 667 (Bom) [expenditure incurred on acquisition of technical know-how, being a plant, held eligible for investment allowance].

(15) *Chief Commissioner* (*Administration*) *v. Visveswarayya Iron & Steel Ltd.,* (1993) 199 ITR 98 (Karn) [locomotives and railway sidings provided at the place of manufacturing activity for transport of articles out of or into the factory, held eligible for investment allowance].

(16) *CIT v. Shaw Wallace & Co. Ltd.,* (1993) 201 ITR 17, 24 (Cal) [computer division of the assessee has been held to be an industrial undertaking eligible for investment allowance].

(17) *CIT v. Univmine* (*P.*) *Ltd.,* (1993) 202 ITR 825 (Del) [the assessee, who carried on the business of mining of marble, has been held entitled to investment allowance].

(18) *CIT v. Union Carbide India Ltd.,* (1993) 203 ITR 301, 304 (Cal) [the assessee was held entitled to investment allowance in respect of its 'Deep Sea Fishing Division II Unit'].

(19) *CIT v. Yavatmal Co-operative Ginning and Pressing Factory Ltd.,* (1993) 203 ITR 874, 880 (Bom) [machinery installed by the assessee for its ginning factory, held eligible for investment allowance].

(20) *CIT v. Karnataka Power Corporation Ltd.,* (1994) 205 ITR 511 (Karn), special leave petition dismissed by the Supreme Court : (1993) 199 ITR (St.) 81 (SC) [a generating station building has been held to be 'plant' eligible for investment allowance].

(21) *CIT v. Tribeni Tissues Ltd.,* (1994) 206 ITR 92, 97 (Cal) [the assessee, manufacturer of tissue paper, held entitled to investment allowance on motors, electrical installations, underground cables, overhead cables and air-conditioning machines]. Also see, *CIT v. Tribeni Tissues Ltd.,* (1994) 210 ITR 47, 49 (Cal).

(22) *CIT v. Thyristors Controls Pvt. Ltd.,* (1994) 207 ITR 317, 319 (Guj) [investment allowance was held eligible in respect of books containing technical know-how kept in the office where the factory and the office was in the same building].

(23) *CIT v. Needle Roller Bearing Co. Ltd.,* (1992) 106 CTR (Bom) 260 [Tribunal held that loose tools constituted machinery and plant for the purpose of investment allowance; answer to the question was held obvious].

LexisNexis

(24) *CIT v. Best Chem and Limestone Industries Pvt. Ltd.,* (1994) 210 ITR 883, 885 (Raj) [the assessee, engaging in the activity of extracting limestone from mines and converting it in the form of powder and *'rodi'*, held entitled to investment allowance].

(25) *CIT v. Krishna Mohan Constructions,* (1993) 70 Taxman 7, 17 (AP) [the assessee, undertaking contract work mainly of widening the existing roads and providing flexible overlays, held eligible for investment allowance]. But, see, Supreme Court ruling in 204 ITR 412 (SC).

(26) *CIT v. Mercantile Construction Co.,* (1994) 74 Taxman 41, 49 (Cal) [the assessee, who was engaged in removing over-burden and in extraction of coal for collieries, has been held eligible for investment allowance]. Also see, *Khalsa Bros. v. CIT,* (1996) 217 ITR 185 (Cal).

(27) *CIT v. P. Veriah,* (1995) 211 ITR 244, 245 (Ker) [the assessee, running a cinema theatre, was held entitled to investment allowance on generator].

(28) *CIT v. Mysore Minerals Ltd.,* (1994) 122 Taxation 696 (Karn) [the assessee, who was extracting granite from quarry and cutting to various sizes and polishing them, was held entitled to investment allowance on its machinery].

(29) *CIT v. Cochin Refineries Ltd.,* (1995) 212 ITR 664 (Ker) [investment allowance held eligible for the truck which was required to provide quick mobility for the fire-fighting equipment].

(30) *CIT v. Sirdar Carbonic Gas Co. Pvt. Ltd.,* (1995) 216 ITR 1, 5 (Bom) [the assessee manufacturing carbon dioxide, which was nothing but a product of carbon falling within item 25 of the Ninth Schedule to the 1961 Act, held entitled to investment allowance in respect of machinery used in the business of such manufacturing].

(31) *CIT v. First Leasing Co. of India Ltd.,* (1995) 216 ITR 455, 459, 469 (Mad), **affirmed in** *CIT v. First Leasing Co. of India Ltd.,* (1998) 231 ITR 308 (SC) [the assessee was held entitled to investment allowance on items of machinery or plant which have been leased out to others].

(32) *CIT v. Rampur Industries Ltd.,* (1995) 216 ITR 656, 657 (All) [assessee was held entitled to investment allowance in respect of ice factory installed by it]. Also see, *CIT v. Everest Cold Storage,* (1996) 220 ITR 241, 245 (MP).

(33) *CIT v. Fort Gloster Industries Ltd.,* (1996) 219 ITR 223, 224, 225 (Cal) [computer installed in a special cabin constructed within the factory premises and used for processing raw materials, data, straw data, wages and salaries payments, etc., and also for monitoring the details of production, held eligible for investment allowance].

(34) *CIT v. Singareni Colleries Co. Ltd.,* (1996) 221 ITR 48, 52 (AP) [investment allowance is available on the new plant and machinery installed in the assessee's business of extracting coal].

(35) *CIT v. Sibson Construction & Co.,* (1996) 221 ITR 468, 473 (Gauh) [dumper, which can also be said to be machinery because it has got devices to slight down a portion of it for removal of the contents, is eligible for investment allowance].

(36) *CIT v. Kurien Abraham* (*P.*) *Ltd.,* (1996) 221 ITR 745, 748-49 (Ker) [assessee's activity of centrifuging latex amounted to manufacturing activity entitling to the assessee to investment allowance]. Similar view has been taken in *CIT v. Kurian Abraham* [(1999) 154 CTR (Ker) 382, 383].

(37) *CIT v. R.C. Construction,* (1996) 222 ITR 658, 661 (Gauh) [assessee, making chips out of big boulders, held entitled to investment allowance].

(38) *CIT v. Hotel Belle Vue* (*P.*) *Ltd.,* (1997) 223 ITR 675, 683 (Gauh) [the assessee-company being a hotel who prepares foodstuffs or articles for the guests is entitled to get investment allowance]. But, see, serial No. (3), under section 32A, *post*. The Gauhati decision [223 ITR 675 (Gauh)] has been **overruled in** *Indian Hotels Co. Ltd. v. ITO: Hotel & Allied Traders Pvt. Ltd. : Hotel Shashi Pvt. Ltd. v. CIT* [(2000) 245 ITR 538, 546-47 (SC)], holding that when food is prepared or processed, no manufacturing process is involved.

(39) *CIT v. Oswal Data Processors,* (1997) 223 ITR 735, 737-38 (MP) [computer machines held not to constitute office appliances and, therefore, eligible for investment allowance].

(40) *CIT v. Gogte Minerals,* (1997) 225 ITR 60, 61, 63 (Karn) [assessee, engaged in mining operations for excavating iron ore, held entitled to investment allowance on the screening plant and electrical installations used in mining].

(41) *CIT v. Trinity Hospital,* (1997) 225 ITR 178, 190 (Raj) [investment allowance was held allowable on the X-ray machine, ultra-sound scanner, foetal monitor and the air-conditioning equipment installed

LexisNexis

in a hospital]. But, see, *J.M.D. Medicare Ltd. v. Union of India,* (1996) 218 ITR 184 (Cal), decided under section 10(15)(*iv*)(*c*).

(42) *CIT v. Prasad Film Laboratories P. Ltd.,* (1997) 225 ITR 348, 358-59 (AP) [the assessee was held entitled to investment allowance in respect of electrical installations, air-conditioning plant and voltage stabaliser installed in its laboratory on the ground that the assessee was not engaged in the manufacture of cinematograph films as specified in item No. 9 of the Eleventh Schedule to the Act].

(43) *CIT v. C.S. Anand,* (1997) 225 ITR 573, 574 (Pat) [dumpers were held eligible for investment allowance because they were not road transport vehicles].

(44) *CIT v. Upasana Hospital,* (1997) 225 ITR 845, 852 (Ker) [the assessee-firm, running a private hospital, was held entitled to investment allowance in respect of X-ray plant and other accessories such as I.C.C.U. and E.C.G. equipments].

(46) *CIT v. Venkateswara Hatchery Pvt. Ltd.,* (1997) 227 ITR 116, 121, 123-24 (AP) [assessee was held entitled to investment allowance on the plant and machinery installed in the hatchery division].

(47) *Ramdeo Tiles v. CIT,* (1997) 227 ITR 463, 464 (MP) [assessee was held entitled to investment allowance in respect of sheds used for drying tiles manufactured by it].

(48) *CIT v. Kerala Rubber & Reclaims Ltd.,* (1997) 228 ITR 683, 689, 690 (Ker), special leave petition dismissed by the Supreme Court : (1998) 230 ITR (St.) 91 (SC) [assessee, preparing rubber compound (using rubber, carbon black and oils and chemicals as raw material) for utilisation in rubber industries, held eligible for investment allowance].

(49) *CIT v. Steel Tubes of India Ltd.,* (1997) 228 ITR 38, 40 (MP) [computer was not an office appliance and was eligible for investment allowance].

(50) *CIT v. Hardcastle & Waud Mfg. Co. Ltd.,* (1997) 142 CTR (Bom) 168, 172 [machines installed for manufacturing 'power coating', held eligible for investment allowance because power coating was not 'paint' within the meaning of item 26 of the Eleventh Schedule to the Act].

(51) *CIT v. Elemech Industrial Construction,* (1998) 229 ITR 503, 504 (AP) [assessee, who was fabricating steel structures as per specification by using raw materials like steel rods and steel sheets supplied by the contractors, held eligible for investment allowance].

(52) *CIT v. Dr. L.C. Mitra,* (1998) 96 Taxman 568, 570 (Pat) = 234 ITR 805, 807 (Pat) [assessee, a doctor, was held entitled to investment allowance in respect of parts purchased for making additions to the X-ray machines as such parts could be considered as plant].

(53) *CIT v. Hind Filters Pvt. Ltd.,* (1998) 145 CTR (Bom) 459, 461 = 234 ITR 207, 210 (Bom) [assessee was held entitled to investment allowance in respect of plant and machinery used in manufacturing the cigarette filter rod].

(54) *CIT v. Computerised Accounting & Management Service Pvt. Ltd.,* (1998) Tax LR 469, 472 (Ker) = (1999) 235 ITR 502, 506-07 (Ker) [assessee-company was held entitled to investment allowance as it was engaged only in producing the information (by using computers) required by the customers through data processing and not in the manufacture of the 'office machines and apparatus' within the meaning of item 22 in the list in the Eleventh Schedule].

(55) *CIT v. Air Survey Co. of India* (*P.*) *Ltd.,* (1998) 232 ITR 707, 708 (Cal) [the assessee was held entitled to investment allowance on the aircraft radio].

(56) *CIT v. Mahindra Ugine Steel Co. Ltd.,* (1998) 233 ITR 204, 206 (Bom) [the assessee, which was engaged in the manufacture of special alloys, held entitled to investment allowance, under section 32A(2)(*b*)(*iii*), in respect of weighing scale and mobile cranes used by it for manufacture of special alloys].

(57) *CIT v. Himachal Pradesh Mineral & Industrial Development Corporation,* (1998) 234 ITR 509, 511-12, 515, 516 (HP) [the assessee was held entitled to investment allowance on the cost of two transformers installed by it after payment of entire cost and the same were used by it even though the title in them was not transferred to the assessee].

(58) *CIT v. Computerised Accounting & Management Service Pvt. Ltd.,* (1999) 235 ITR 502, 505, 506-07 (Ker) [the assessee-company, which was engaged only in producing the information required by the customers through data processing and not in the manufacture or production of the 'office machines and apparatus', which were used for data processing, has been held eligible for investment allowance]. Also see, *CIT v. Cochin Refineries Ltd.,* (2000) 241 ITR 1, 3 (Ker).

(59) *National Engineering Industries Ltd. v. CIT,* (1999) 236 ITR 577, 580 (Cal) [investment allowance was held eligible on data processing machines because there was no finding that such machines were used only for accounting purposes].

LexisNexis

(60) *Colour Chem Ltd. v. CIT,* (1999) 238 ITR 171, 174-75 (Bom) [the assessee was held entitled to claim investment allowance because the chemicals manufactured by it were 'heavy chemicals' as listed in the Ninth Schedule to the 1961 Act].

(61) *CIT v. M.L. Agarwalla,* (1999) 238 ITR 603, 605, 609-10 (Gauh), notice issued on special leave petition by the Supreme Court: (2000) 244 ITR (St.) 46-47 (SC) [the assessee has been held entitled to investment allowance in respect of ultra-sound medical diagnostic electric equipment, voltage stabilizer and air conditioner because the print which was the outcome of the whole process of the equipment would be covered by the term 'manufacture of article']. Similar view has been taken in *CIT v. Dr. M.L. Agarwalla* [(2002) 258 ITR 102, 103, 106 (Gauh)].

(62) *CIT v. Forbes Ewart & Figgis P. Ltd.,* (1999) 238 ITR 762, 765 (Ker) [the rubber compound manufactured by the assessee has been held to be a final product as far as the assessee was concerned and merely because the above compound was used for the manufacture of tyres, etc., the assessee could not be denied the claim of investment allowance under section 32A].

(63) *CIT v. Bharat Radiators P. Ltd.,* (1999) 239 ITR 608, 610-11 (Bom) [pattern and dies and electrical installations, in the case of an assessee, carrying on the business of manufacture of radiators, has been held eligible for investment allowance for the assessment year 1979-80].

(64) *CIT v. Hindustan Times Ltd.,* (2000) 241 ITR 509 510-11 (Del) [fire fighting equipment held eligible for investment allowance where it formed part of the industrial undertaking for the purpose of business of the assessee, which was printing and publishing of newspapers and magazines].

(65) *CIT v. Dr. S. Surender Reddy,* (2000) 243 ITR 110, 113 (AP) [equipment used for purposes of X-ray, held eligible for investment allowance because when X-ray films are put in the X-ray machine a different article is produced. Further, the assessee was also held entitled to investment allowance on stabilizer, electric fans, scanner and airconditioner used to keep the analytical systems, as they were necessary for purposes of production of an article or a thing].

(66) *CIT v. Aswati Corporation,* (2000) 243 ITR 283, 284 (Karn) [assessee engaged in the business of leasing machinery to manufacturers, held eligible for investment allowance].

(67) *CIT v. Shri Ganapathy Mills Co. Ltd.,* (2000) 243 ITR 879, 880 (Mad) [air-conditioners installed in rooms where computers are kept, held eligible for investment allowance].

(68) *CIT v. Andhra Pradesh Lightings Ltd.,* (2000) 244 ITR 650, 652, 654 (AP) [assessee-company was held entitled to the cost of plant and machinery used for manufacture of electric bulbs because the same did not fall under item 12 of the Eleventh Schedule to the 1961 Act which deals with 'domestic electrical appliances'].

(69) *CIT v. N. Venkataraman,* (2000) 245 ITR 73, 80 (Mad) [air compressor, not falling within the negative list enumerated in the Eleventh Schedule, was held eligible for investment allowance even though it was employed in the intermediate stage of manufacture or production of articles or things by the assessee in using it for sand blasting].

(70) *CIT v. Kwality Ice Creams (P.) Ltd.,* (2000) 245 ITR 252, 253-54 (Cal) [machinery used for manufacture of ice cream has been held eligible for investment allowance because it was not an item of confectionary and did not fall within items specified in the Eleventh Schedule].

(71) *CIT v. Comp-Help Services P. Ltd.,* (2000) 246 ITR 722, 724 (Mad) [assessee engaged in the business of processing data with computers and in the preparation of balance sheets and financial accounts for its customers, held eligible for investment allowance in respect of computers]. Also see, *CIT v. Southern Roadways Ltd.,* (2004) 265 ITR 404, 406-07, 408 (Mad).

(72) *CIT v. Cigfil (P.) Ltd.,* (2000) 246 ITR 734, 735 (Mad) [assessee, manufacturing cigarette filters, held eligible for investment allowance because cigarette filters did not fall within the ambit of item 2 of the Eleventh Schedule to the 1961 Act].

(73) *CIT v. Karnataka Power Corporation,* (2001) 247 ITR 268, 271 (SC) [where the assessee's generating station building was found to be so constructed as to be an integral part of its generating system, such building was held to be a 'plant' and, therefore, eligible for investment allowance].

(74) *CIT v. Prasad Productions (P.) Ltd.,* (2001) 247 ITR 445, 446 (Mad) [the assessee, which was engaged in the business of producing feature films, processing and drying plant, where exposed films in various stages were processed into positive films used for projection in cinema theatre, was held entitled to investment allowance because it was not engaged in the production of cinematograph films mentioned in item 9 of the Eleventh Schedule]. Similar view has been taken in *CIT v. Prasad Productions P. Ltd.* [(2001) 249 ITR 502, 503-04 (Mad)].

(75) *CIT v. J.K.K. Textile Processing Mills,* (2001) 249 ITR 487, 488 (Mad), **following** *S.S.M. Brothers (P.) Ltd. v. CIT,* (2000) 243 ITR 418 (SC) decided in the context of allowability of development rebate [the assessee engaged in the activity of processing unbleached grey cloth by bleaching,

LexisNexis

calendering, dyeing and printing so as to produce printed cloth, held eligible for investment allowance because such activity amounted to manufacture]. Also see, *CIT v. Neelmani Khemka & Sons,* (2001) 161 Taxation 293 (Punj); *CIT v. Kashiram Textiles Mills Pvt. Ltd.,* (2002) 171 Taxation 280, 281 (Guj).

(76) *CIT v. Laxmi Art Studio,* (2001) 249 ITR 710, 712, 715-16 (Raj) [coloured photo processing machine installed by the assessee, which accepted the negatives of the photo-films and after applying chemicals and other things, it delivered colour photographs in different sizes, was held to be used in the manufacturing and production of article or thing known as coloured photographs and was entitled to investment allowance].

(77) *CIT v. Mysore Minerals Ltd.,* (2001) 250 ITR 725, 727 (Karn) [the Tribunal was held right in law in holding that extracting granite from quarry and cutting it to various sizes and polishing should be considered as manufacture or production of any article or thing and the assessee's business activity must be considered as an industrial undertaking for the purpose of granting investment allowance under section 32A]. This view has been **followed in** *CIT v. Mysore Minerals Ltd.* [(2001) 250 ITR 728, 729-30 (Karn), notice issued against the special leave petition by the Supreme Court : (2002) 254 ITR (St.) 273-74 (SC)]. Thus, new machinery employed in such mining activity, such as earth moving equipment, crane, oil engines, pumps and machinery foundations for gang saws have been held to be eligible for investment allowance [*Deputy CIT v. Mysore Minerals Ltd.,* (2001) 250 ITR 730, 731, 734 (Karn), special leave petition dismissed by the Supreme Court : (2002) 254 ITR (St.) 278 (SC)].

In the above Karnataka decision [250 ITR 730, 731, 734 (Karn)], it has been held that the Supreme Court in *CIT v. N.C. Budharaja & Co.* [(1993) 204 ITR 412 (SC)] did not **overrule** the decision in *CIT v. Mysore Minerals Ltd.* [(1994) 205 ITR 461 (Karn)], which has been discussed under section 32A, *ante.*

(78) *CIT v. Jokai India Ltd.,* (2001) 251 ITR 39, 40 (Cal) [leaves carrying basket trailers, which are used only for transporting the green tea leaves to the factory which is situated within the tea garden and are never used for any transportation purpose on the public roads, are such types of tools which are to be treated as part of the plant and machinery for the purpose of manufacturing of tea and such trailers are eligible for investment allowance]. In taking this view, the Calcutta decision [248 ITR 622 (Cal)] discussed at serial No. (33), *post*, under section 32A [discussing the cases in the facts of which the assessee was held not entitled to investment allowance] has been **distinguished**.

(79) *Aspinwall & Co. Ltd. v. CIT,* (2001) 251 ITR 323, 328 (SC), **reversing** 227 ITR 916 (Ker) [the processing of the raw berries into coffee beans ready for consumption would be a manufacturing activity so as to entitle the assessee to investment allowance].

(80) *CIT v. Best & Crompton Engineering Ltd.,* (2001) 251 ITR 706, 706-07 (Mad) [the assessee was mainly engaged in the business of construction, manufacture or production of high tension transmission lines, which were articles not specified in the Eleventh Schedule, was held entitled to investment allowance for the assessment year 1978-79].

(81) *Hyderabad Industries Ltd. v. CIT,* (2001) 252 ITR 401, 403, 406, 407-08 (AP) [data processing machine, which is neither an office appliance nor an article enumerated in the Eleventh Schedule, has been held eligible for investment allowance].

(82) *Mihir Textiles Ltd. v. CIT,* (2001) 252 ITR 686, 691 (Guj) [investment allowance has been held eligible with respect to electrical installation and electrification in mechanical workshop, for the assessment year 1978-79].

(83) *CIT v. Shyam Enterprises* (*P.*) *Ltd.,* (2001) 252 ITR 858, 859 (Mad) [the assessee was held entitled to investment allowance in respect of the machinery installed in the restaurant].

(84) *CIT v. Gemini Arts P. Ltd.,* (2002) 254 ITR 201, 203 (Mad) [new colour film analyser and the new colour film printing machine, held eligible for investment allowance].

(85) *CIT v. Varun Processors* (*P.*) *Ltd.,* (2002) 254 ITR 564, 564-65 (Punj) [assessee engaged in the activities of dyeing, bleaching, printing and embroidering of grey cloth, held eligible for investment allowance because such activities constituted production and manufacture].

(86) *CIT v. G.S. Atwal & Co.,* (2002) 254 ITR 592, 595-96 (Cal) [machinery installed for production of coal, held eligible for investment allowance even though the assessee was also carrying on transport business].

(87) *CIT v. Essar Bulk Carriers Ltd.,* (2002) 256 ITR 251, 251-52 (Mad) [dredgers are ships and hence eligible for investment allowance].

LexisNexis

(88) *Mehsana District Co-operative Milk Producers Union Ltd. v. CIT,* (2002) 256 ITR 322, 324-25, 328 (Guj) [wireless equipment installed at factory, chilling centres and vehicles has been held eligible for investment allowance as the same was not an office appliance].

(89) *CIT v. Oswal Woollen Mills Ltd.,* (2002) 257 ITR 737, 740, 746, 749-50 (Punj) [assessee's refinery units, converting crude oil into refined oil have been held to be industrial undertakings for the purposes of investment allowance]. This view has been **followed in** *CIT v. Oswal Woollen Mills Ltd.* [(2002) 257 ITR 781, 782, 783 (Punj)].

(90) *Sundaram Industries Ltd. v. CIT,* (2002) 258 ITR 38, 39, 41-42 (Mad) [assessee constructed bus bodies on the chassis supplied by its customers, held eligible to investment allowance for the assessment year 1977-78, taking the view that the term 'commercial vehicles' as contained in item 14 of the Ninth Schedule to the 1961 Act is not to be understood as being applicable only to a commercial vehicle, which is complete in all respects. The separation of the activity of manufacture of chassis from that of the manufacture of bus bodies does not disentitle either the manufacturer of the chassis or the manufacturer of the body from claiming investment allowance for the machinery installed by them for the purpose of the manufacturing the chassis or the body, as the case may be].

(91) *CIT v. S.S.M. Processing Mills,* (2002) 258 ITR 256 (Mad) [assessee was held entitled to investment allowance with respect to the additions to plant and machinery on the basis that its business of warping, sizing and bleaching of unbleached cloth amounted to manufacture].

(92) *Mar Gregorious Memorial Muthoot Medical Centre v. CIT,* (2003) 261 ITR 443, 445-46 (Ker) [a hospital cannot be denied investment allowance on ECG machine, X-ray unit and other laboratory equipments].

(93) *CIT v. Tube Investments of* (*India*) *Ltd.,* (2003) 261 ITR 753, 754 (Mad) [investment allowance was held eligible on the ground water tank used for storing water required for pulling of plant and machinery].

(94) *CIT v. Emirates Commercial Bank Ltd.,* (2003) 262 ITR 55, 58-59 (Bom) [investment allowance was held eligible in respect of the computers installed by the assessee-bank in its office premises. This is so because the nature of the services rendered by the bank does involve the work of data processing. It is on the basis of this data processing that the information is provided to its customers by the bank. It is on the basis of this data processing that the balance-sheets are prepared. It is on the basis of this data processing done by the computers that the management information reports come out]. Also see, *CIT v. Indian Rayon & Industries Ltd.,* (2011) 336 ITR 479 (Bom).

(95) *CIT v. Gem Granites,* (2003) 262 ITR 426, 428 (Mad) [where the Tribunal has found as a matter of fact that the machinery in question was engaged in the manufacture of articles, such machinery was held eligible for investment allowance].

(96) *CIT v. Vinay Kumar Sigtia,* (2003) 262 ITR 686, 691 (Ori) [data processing machine, held eligible for investment allowance].

(97) *CIT v. Sesa Goa Ltd. : D.B. Bandodkar & Sons Pvt. Ltd. : Chowgule & Co. Ltd.,* (2004) 266 ITR 126, 134-35 (Bom) [assessee-company, engaged in extraction and processing of iron-ore, held entitled to investment allowance in respect of machinery used in mining activity].

(98) *CIT v. Down Town Hospital Pvt. Ltd.,* (2004) 267 ITR 439, 443 (Gauh) [the assessee, which was running a hospital, has been held entitled to investment allowance for acquisition of medical equipment, air-conditioners, lifts and other office equipment].

(99) *CIT v. Tamil Nadu Magnesite Ltd.,* (1999) 151 CTR (Mad) 152, 155-56 [the assessee-company, which was engaged in mining operation, has been held entitled to investment allowance with regard to welding sets, platform scales and electric motors as all these items have a reasonable nexus with the mining business. However, no investment allowance was eligible on car washers as these cannot be regarded as reasonably necessary for the mining business].

(100) *CIT v. Nagaland Roller Flour Mills Ltd.*, (2010) 329 ITR 631 (Gauh) [it was incumbent upon the AO to determine the investment allowance admissible to the assessee and carry forward the same to be allowed in the year of profit subject to creation of the reserve fund in any assessment year within the period as stipulated by section 32A].

(101) *CIT v. Professional Information Systems & Management*, (2005) 274 ITR 242 (Guj) [the assessee-company which provided computer services to other concerns was an industrial undertaking engaged in the business of manufacture or production and was eligible for investment allowance on the cost of computer].

(102) *CIT v. Sraya Industries P. Ltd.*, (2010) 328 ITR 29 (Del) [as the main activity of the assessee was to manufacture industrial spirit also known as ethyl alcohol and rectified spirit, thus the assessee would be eligible for claiming investment allowance].

LexisNexis

(103) *CIT v. Radico Khaitan Ltd.*, (2005) 274 ITR 354 (All) [telephone exchange installed in the fertilizer unit would be entitled for investment allowance as the telephone exchange would fall under the term 'plant'].

(104) *CIT v. EID Parry* (*India*) *Ltd.*, (2005) 274 ITR 489 (Mad) [the processing of seeds amounts to 'production', as such the machinery deployed in the seed processing unit was entitled to investment allowance for assessment year 1982-83].

(105) *CIT v. Vippy Solvex Products Ltd.*, (2005) 274 ITR 615 (MP) [the only necessary consequence, in the instant case, was that the assessee had to be held entitled to claim the benefit of investment allowance within the meaning of section 32A(8B)].

(106) *CIT v. Advance Construction Co. P. Ltd.*, (2005) 275 ITR 30 (Guj) [since the investment allowance had been granted in the case of the same assessee for assessment year under consideration, the same remained undisturbed thus, it was not possible on the peculiar facts of the case, to take a different view of the matter].

(107) *CIT v. Rampur Distillery & Chemical Co. Ltd.*, (2005) 277 ITR 416 (All) [investment allowance on plant and machinery meant for manufacture of rectified spirit was held admissible].

(108) *CIT v. Raj Vijay Corporation*, (2005) 278 ITR 348 (All) [the generator which was used in the business of manufacture or production of any article or thing by the assessee clearly came within section 32A(2)(*b*)(*ii*) and, hence, investment allowance held admissible].

(109) *CIT v. Starlight Silk Mills P. Ltd.*, (2006) 280 ITR 257 (Guj) [investment allowance is exigible for the electrical installations, transformer and air-conditioning plant].

(110) *CIT v. Gujarat Narmada Valley Fertilizer Co. Ltd.*, (2006) 281 ITR 297 (Guj) [the drainage and sewerage network held entitled to investment allowance].

(111) *CIT v. Sayaji Iron & Engineering P. Ltd.*, (2006) 281 ITR 438 (Guj) [nowadays, the computers are extensively used in various business activities of manufacture or production of machinery or things right from the stage of preparing designs up to the quality control and the said computers are eligible for investment allowance].

(112) *CIT v. Sesa Goa* (*India*) *Ltd.*, (2006) 282 ITR 197 (Bom) [extraction of ore amounts to 'production' for purposes of section 32A thus, entitled to investment allowance].

(113) *CIT v. Sidral Food P. Ltd.*, (2006) 282 ITR 563 (Guj) [since there was 'manufacture' of an article for purposes of section 32A hence investment allowance exigible].

(114) CIT v. *R.M. Malhotra, Proprietor Malhotra Nursing & Maternity Home*, (2006) 283 ITR 181 (All) [investment allowance held exigible on ultra sound machine equipment].

(115) *CIT v. Radla Machinery Export*, (2006) 283 ITR 185 (All) [a computer being a 'plant' would qualify for investment allowance]. Also see, *CIT v. Motor Sales Ltd.,* (2006) 283 ITR 186 (All).

(116) *CIT v. Narayan Glass Works*, (2006) 285 ITR 23 (All) [the assessee was rightly allowed investment allowance on new furnace which had come into existence].

(117) *CIT v. Nathubhai H. Patel*, (2006) 285 ITR 67 (Guj) [investment allowance entitled on the heart monitoring machine and tread mill].

(118) *Associated Bearing Co. Ltd. v. CIT*, (2006) 286 ITR 341 (Bom) [investment allowance entitled on calculators for assessment year 1979-80 and on factory cleaning machines for assessment year 1980-81].

(119) *CIT v. Daljeet Tyres*, (2006) 287 ITR 344 (All) [a tin printing unit being an industry involved in a 'manufacturing process' held entitled to investment allowance].

(120) *General Contracts Co. v. CIT*, (2006) 287 ITR 416 (Guj) [since the plant and machinery specified in section 32A(2) is owned by the assessee and is wholly used for the purposes of business, investment allowance exigible].

(121) *CIT v. Suresh Amin Family Trust*, (2007) 288 ITR 101 (Guj) [a pathological laboratory runned by the assessee-trust as its business venture held eligible for investment allowance on the expenditure incurred for the equipment].

(122) *CIT v. Statronics & Enterprises P. Ltd.*, (2007) 288 ITR 455 (Guj) [investment allowance held eligible on computers and the data processing machines].

(123) *CIT v. Oswal Woollen Mills Ltd.*, (2007) 289 ITR 261 (Punj) [investment allowance held entitled on electric installations such as humidifiers in the wool chambers unit].

(124) *CIT v. Oswal Woollen Mills Ltd.*, (2007) 289 ITR 266 (Punj) [since the outgoing switch boards in the Madras vanaspati unit and the electric machinery worth Rs. 2,22,129 installed in the solvent unit were part and parcel of plant and machinery, the same held exigible for investment allowance].

LexisNexis

(125) *CIT v. Oswal Woollen Mills Ltd.*, (2007) 289 ITR 270 (Punj) [investment allowance held exigible on grain analysers].

(126) *McDowell & Co. v. Asst. CIT*, (2007) 291 ITR 439 (Karn), **affirmed in** *Asst. CIT v. United Spirits Ltd.*, (2016) 386 ITR 718, 719 (SC) [investment allowance eligible on effluent treatment plant at a lower rate of 25 per cent and not 35 per cent].

(127) *CIT v. Avery Cycle Industries P. Ltd.*, (2007) 292 ITR 200 (Punj) [on air-conditioner, water-cooler and weighing bridge, investment allowance held eligible].

(128) *CIT v. Funskool* (*India*) *Ltd.*, (2007) 294 ITR 642 (Mad) [investment allowance held eligible on the additional customs duty paid during the year in respect of machinery imported and installed in an earlier year].

(129) *CIT v. Punjab Wireless System Ltd.*, (2008) 296 ITR 489 (Punj) [wireless sets manufactured by the assessee held entitled to investment allowance].

(130) *T.R.F. Ltd. v. CIT*, (2008) 298 ITR 78 (Jhar) [computers installed in factory premises for the purpose of business of manufacture and production of article held eligible for investment allowance].

(131) *CIT v. Gotan Lime Stone Khanij Udyog* : *A.R. Enterprises P. Ltd.*, (2008) 299 ITR 368 (Raj) [dumpers, tippers and hydraulic excavators being construction equipment vehicles are not road transport vehicles and profit gained by letting them out on hire basis to a cement producer industrial undertaking could not debar them from claiming investment allowance].

(132) *Deputy CIT v. Official Liquidator*, (2008) 305 ITR 418 (Mad) [the additional amount paid being part of the actual cost of the asset in the relevant assessment year held entitled to investment allowance].

(133) *CIT v. Dr. S.K. Ohri, Prop. Ohri Maternity Hospital*, (2009) 310 ITR 209 (Punj) [investment allowance held eligible on the purchase of a scanner machine by a doctor].

(134) *CIT v. Oswal Woollen Mills*, (2009) 311 ITR 230 (Punj) [the refinery units were held as industrial undertakings for availing the benefit of investment allowance].

(135) *CIT v. Sangrur Vanaspati Mills Ltd.*, (2009) 311 ITR 345 (Punj) [the product, washing soap, being manufactured by the assessee being not in the negative list as per the XIth Schedule, the same would be entitled to investment allowance].

(136) *CIT v. India Pistons Ltd.*, (2010) 320 ITR 257 (Mad) [investment allowance held eligible on the additional cost].

(137) *CIT v. Eastern Book Co.*, (2010) 322 ITR 605 (All) [investment allowance held eligible on photo-composing machine as the assessee-firm was engaged in production/manufacturing activity].

(138) *CIT v. Mahavir Spinning Mills Ltd.,* (2007) 293 ITR 492 (Punj) [before deducting investment allowance, the special deduction under section 80HH could not be allowed]. Also see, *Mahavir Spinning Mills Ltd. v. CIT*, (2008) 304 ITR 371 (Punj).

(139) *CIT v. Apollo Hospital Enterprises,* (2011) 338 ITR 68 (Mad) [items of medical equipment are entitled to investment allowance hence, investment allowance in respect of X-ray, ultra sound, angio-graphy, gamma camera, stress analysis equipment held eligible].

(140) *CIT v. Firma Hi-Tech*, (2012) 343 ITR 507 (AP) [investment allowance held exigible in respect of machinery and plant used in job work].

(141) *CIT v. O.R. Distilleries Ltd.*, (2012) 349 ITR 215 (AP) [when the assessee was given licence for the manufacture of rectified or denatured spirit, even if it incidentally under compulsion manufactured arrack to supply to the Government, the assessee held exigible for investment allowance].

(142) *Tamil Nadu Minerals Ltd. v. CIT*, (2012) 349 ITR 695 (SC) [mining granite from quarries and exporting them after cutting, polishing, etc., amounts to 'manufacture' for being eligible for investment allowance under section 32A].

(143) *CIT v. Vizag District Milk Producers Co-op. Union Ltd.*, (2013) 356 ITR 612 (AP) [where the assessee was employing machinery for making milk products like ghee, flavoured milk, butter milk, rose milk and kova and when once the milk was subjected to the process, in its factory, new products emerged which were altogether different from milk itself, hence, the assessee held entitled to investment allowance].

(144) *CIT v. Vijayawada Bottling Co. Ltd. : Sarvaraya Sugars Ltd.*, (2013) 356 ITR 625 (AP) [the assessee held entitled to investment allowance for the assessment years 1981-82, 1982-83, 1985-86 and 1986-87].

LexisNexis

(145) *CIT v. Punjab Anand Industries*, (2013) 359 ITR 300 (Punj) [with regard to the additional liability incurred towards the cost of the plant and machinery on account of fluctuation in foreign exchange rate subsequent to the year in which plant and machinery had been installed, investment allowance held admissible].

(146) *CIT v. Dharamsi Morarji Chemicals Co. Ltd.*, (2015) 373 ITR 545, 553 (Bom) [higher rate of investment allowance of 35% on machinery installed for manufacturing sulfuric acid allowed]

(147) *CIT v. Industrial Credit & Investment Corporation of India Ltd.*, (2017) 393 ITR 298, 301 (Bom) [asseessee, a leasing or financing company, leasing machinery to third parties for manufacture in accordance with section 32A(2)(*b*)(*iii*) held entitled to investment allowance].

Reference may also be made to *Seshasayee Paper and Boards Ltd. v. Deputy CIT* [(2005) 272 ITR 165 (Mad)]; *Simplex Concrete Piles* (*India*) *P. Ltd. v. CIT* [(2006) 286 ITR 470 (Cal)]; *CIT v. Agro Tech* (*India*) *Ltd.* [(2008) 296 ITR 166 (Punj)]; *Deepak Nitrite Ltd. v. CIT* [(2008) 307 ITR 289 (Guj)]; *CIT v. Groz Beckert Saboo Ltd.* [(2009) 308 ITR 397 (Punj)]; *Velan Textiles Pvt. Ltd. v. Deputy CIT* [(2009) 312 ITR 56 (Karn)]; *CIT v. HLS India Ltd.* [(2011) 335 ITR 292 (Del)]; *CIT v. Aicam Engineering P. Ltd.* [(2011) 336 ITR 294 (Mad)]; *CIT v. Deep Awadh Hotels* (*P.*) *Ltd.* [(2013) 350 ITR 185 (All)].

Also see, *Krishna Dyeing and Finishing Mills v. ITO:* SLP (Civil) Nos. 10719-10721 of 1986, (1986) 161 ITR (St.) 133 (SC) (dyeing, bleaching and finishing yarn, whether manufacture); *CIT v. Kiran Tobacco Products P. Ltd.,* SLP (Civil) Nos. 3547-3548 of 1993 : (1993) 201 ITR (St.) 56 (SC); *CIT v. Essma Woollen Mills Ltd.,* SLP (Civil) Nos. 1489-90 of 1995 : (1995) 212 ITR (St.) 61-62 (SC); *CIT v. Raj Lakshmi Dyeing & Printing Mills,* SLP (Civil) No. 4296 of 1995 : (1995) 212 ITR (St.) 62 (SC); *CIT v. Indian Textile Dyers,* SLP (Civil) No. 4297 of 1995 : (1995) 212 ITR (St.) 62 (SC); *CIT v. New India Printing Works,* CC No. 4638 of 1998 : (1998) 233 ITR (St.) 2 (SC); *CIT v. Shri Vishnu Processor,* C.C. No. 4332 of 1998 : (1998) 234 ITR (St.) 30 (SC); *CIT v. Priya Textiles P. Ltd.,* C.A. No. 6251 of 1998 : (1999) 235 ITR (St.) 26-27 (SC); *CIT v. Sharvan Kumar,* CC No. 892 of 1998 : (1999) 237 ITR (St.) 1 (SC); *CIT v. Forbes Ewart & Figgis* (*P.*) *Ltd.,* SLP (C) No. 19407 of 1999 : (2000) 241 ITR (St.) 130 (SC); *CIT v. L.D. Sahoo,* C.C. Nos. 365 and 366 of 2000 : (2000) 241 ITR (St.) 131-32 (SC); *Deputy CIT v. Madhu Silica Pvt. Ltd.,* SLP (C) Nos. 5999-6000 of 2002 : (2002) 255 ITR (St.) 99-100 (SC); *CIT v. Suryakant Gupta,* (2000) 156 Taxation 311 (Bom).

On the other hand, in the facts of the following cases, **the assessee was held not entitled to investment allowance**:—

(1) *S.P.G.C. Metal Industries Pr. Ltd. v. CIT,* (1985) 152 ITR 484 (Mad), special leave petition granted by the Supreme Court : (1991) 187 ITR (St.) 43 (SC) [assessee, a manufacturer of tin containers using iron and steel, was held not a manufacturer of iron and steel (metal) within the meaning of item 1 of the Ninth Schedule].

(2) *Mittal Ice & Cold Storage v. CIT,* (1986) 159 ITR 18 (MP) [machinery of the cold storage plant because no 'manufacture' was involved in operating a cold storage]. Also see, *S.B. Cold Storage Industries Pr. Ltd. v. CIT,* (1987) 166 ITR 646 (Cal). These have been **dissented from in** *CIT v. S. Warriam Singh Cold Stores,* (1989) 178 ITR 585 (Punj). The Madhya Pradesh decision [159 ITR 18 (MP)] has been **followed** and the Punjab decision [178 ITR 585 (Punj)] has been **dissented from in** *CIT v. Nandlal Cold Storage* [(1993) 199 ITR 327 (All)]. Also see, *CIT v. Kothiwala Cold Storage,* (1993) 199 ITR 399 (All); *CIT v. East India Cold Storage* (*P.*) *Ltd.,* (1996) 218 ITR 668 (Cal); *CIT v. Everest Cold Storage,* (1996) 220 ITR 241, 244-45 (MP); *CIT v. Pawansut Cold Storage* (*P.*) *Ltd.,* (1997) 225 ITR 51, 53-54 (Pat). The said Punjab decision [178 ITR 585 (Punj)] has been **overruled** by the Full Bench in *CIT v. Kissan Friends, Ice Factory & Cold Storage* [(1998) 144 CTR (Punj) 48 (FB) = 234 ITR 400 (Punj—FB)]. Similarly, cold storage unit has been held not eligible for investment allowance [*CIT v. Devi Marine Food Exports Pvt. Ltd.,* (2002) 254 ITR 484, 486 (Mad)].

(3) *CIT v. S. P. Jaiswal Estates* (*P.*) *Ltd.,* (1992) 196 ITR 179 (Cal) [the assessee, running a hotel, is not entitled to investment allowance as preparation of food in a hotel does not constitute manufacture or production]. Also see, *S. P. Jaiswal Estates Pvt. Ltd. v. CIT,* (1994) 209 ITR 307, 311 (Cal); *CIT v. S. P. Jaiswal Estates* (*P.*) *Ltd.,* (1995) 214 ITR 448, 451-52 (Cal); *Hotel and Allied Traders P. Ltd. v. CIT,* SLP (Civil) No. 7550 of 1985 : (1992) 195 ITR (St.) 144 (SC). The view taken in Calcutta decision [196 ITR 179 (Cal)] has been **approved in** *Indian Hotels Co. Ltd. v. ITO : Hotel & Allied Traders Pvt. Ltd. : Hotel Shashi Pvt. Ltd. v. CIT* [(2000) 245 ITR 538, 547 (SC)], in deciding a case with reference to similar provisions contained in the then section 80J.

(4) *CIT v. Machinery Manufacturing Corporation Ltd.,* (1992) 198 ITR 559, 567 (Cal) [no investment allowance was held admissible on fire extinguishers and time-office equipments].

LexisNexis

(5) *Peico Electronics and Electricals Ltd. v. CIT,* (1993) 201 ITR 477, 483 (Cal) [equipment used in the canteen, held not eligible for investment allowance]. Also see, *CIT v. Peico Electronics and Electricals Ltd.,* (1994) 73 Taxman 524, 526 (Cal).

(6) *Hind Nippon Rural Industries Pvt. Ltd. v. CIT,* (1993) 201 ITR 588 (Karn), special leave petition granted by the Supreme Court : (1992) 197 ITR (St.) 2 (SC) [mobile crane and air compressor used in the assessee's activity of open-cast mining in chipping and sizing granite, held not eligible for investment allowance].

(7) *CIT v. Hotel Ayodya,* (1993) 201 ITR 1002 (Karn) [machinery installed in a hotel, held not eligible for investment allowance as a hotel cannot be said to be an industrial undertaking]. Also see, *CIT v. Woodlands Hotel Pvt. Ltd.,* (1998) 233 ITR 224, 226 (Karn), which has been **reversed on another point in** *CIT v. Anand Theatres,* (2000) 244 ITR 192 (SC).

(8) *CIT v. N C. Budharaja & Co.,* (1993) 204 ITR 412, 429-34 (SC), **reversing on different grounds** *Shankar Construction Co. v. CIT,* (1991) 189 ITR 463 (Karn) [the assessee, engaging in the construction of dams and canals, held not entitled to investment allowance]. The Supreme Court [204 ITR 412, 435] has also **reversed** *Suresh Malpani & Co. v. CIT* [(1992) 196 ITR 104 (Karn)]. In view of this Supreme Court ruling, the decision in *Mysore Construction Co. v. CIT* [(1992) 196 ITR 105 (Karn)] should be deemed to have been **impliedly overruled** by the Supreme Court. Also see, *CIT v. Shankar Construction Co.,* SLP (Civil) Nos.13630-13633 of 1992 : (1992) 198 ITR (St.) 165-166 (SC); *Asia Foundations & Constructions v. CIT,* SLP (Civil) No. 8315 of 1994 : (1995) 211 ITR (St.) 14 (SC). This Supreme Court ruling [204 ITR 412 (SC)] has been **followed in** *CIT v. K.S. Raman* [(1995) 215 ITR 938, 939 (Mad)]; *CIT v. Sri Ranganathar & Co.* [(1997) 224 ITR 75, 76 (Mad)]; *CIT v. P.D. Agrawal & Co.* [(1997) 226 ITR 924, 926 (MP)]; *CIT v. Bakatawarsing Balkrishan Engineers & Contractors* [(1996) 135 Taxation 143 (MP)]; *CIT v. Michigan Engineers Pvt. Ltd.* [(1997) 138 Taxation 750, 751 (Bom)]; *CIT v. Michigan Engineers Pvt. Ltd.* [(1997) 138 Taxation 568, 569 (Bom)]; *CIT v. Shah Construction Co. Ltd.* [(1998) 230 ITR 51, 53 (Bom)]; *CIT v. Ajaypal Mangal & Co.* [(1997) 141 Taxation 634 (Bom)]; *CIT v. Reliable Constructions Pvt. Ltd.,* [(1997) 141 Taxation 635, 636 (Bom)]; *CIT v. Gannon Dunkerley & Co. Ltd.,* [(1997) 141 Taxation 636, 637 (Bom)]; *CIT v. Cyrus Engineers Pvt. Ltd.* [(1997) 141 Taxation 637, 638 (Bom)]; *CIT v. Anupchand & Co.* [(1999) 239 ITR 466, 468 (MP)]; *CIT v. G. Harishchandra Reddy & Co.* [(1999) 239 ITR 737, 738 (Mad)]; *Hydel Construction Co. (P.) Ltd. v. CIT* [(1999) 102 Taxman 155, 156 (Del)]; *CIT v. Bhasin Construction Co. (P.) Ltd.* [(2002) 177 CTR (All) 507, 508]; *CIT v. Jai Prakash Associates* [(2003) 130 Taxman 610, 611 (All)]; *CIT v. Popular Automobiles Ltd.* [(2003) 131 Taxman 346, 347 (Ker)]; *CIT v. V. Ganesan* [(1999) 154 CTR (Mad) 240, 242-43; *CIT v. Asian Techs Ltd.* [(2004) 187 CTR (Ker) 321, 322-23].

Also see, *Bhagheeratha Engineering Ltd. v. CIT,* (1997) 227 ITR 504, 511 (Ker).

(9) *CIT v. N. C. Budharaja & Co.,* (1993) 204 ITR 412, 435 (SC), **reversing** *CIT v. Buildmet Pvt. Ltd.,* (1993) 200 ITR 160 (Karn) [the assessee-company, doing the execution of civil engineering and structural work on contract basis, held not entitled to investment allowance]. Also see, *CIT v. Buildmet P. Ltd.,* SLP (Civil) Nos. 6150 and 6151 of 1992 : (1992) 195 ITR (St.) 314 (SC); *CIT v. Mysore Construction Co.,* SLP (Civil) No. 12654 of 1992 : (1992) 197 ITR (St.) 407 (SC); *CIT v. Buildmet P. Ltd.,* SLP (Civil) No. 9128 of 1993 : (1993) 204 ITR (St.) 4-5 (SC).

(10) *CIT v. N. C. Budharaja & Co.,* (1993) 204 ITR 412, 435 (SC), **reversing,** *Universal Borewell Agencies v. CIT,* decided by the Karnataka High Court on 4-6-1992 [benefit of investment allowance is not available in respect of new machinery employed in digging borewells]. This view has been **followed in** *CIT v. Sivam & Co.* [(2000) 242 ITR 76, 78-79 (Mad)].

(11) *CIT v. Technico Enterprise Pvt. Ltd.,* (1994) 206 ITR 36 (Cal) [investment allowance not eligible on the computer not forming part of the manufacturing machinery]. But, see, serial No. (16). Also see, *CIT v. Bhilai Engineering Corporation Ltd.,* (1998) 148 CTR (MP) 455, 457-58.

(12) *Fariyas Hotels Pvt. Ltd. v. CIT,* (1995) 211 ITR 390, 393 (Bom), **following** *CIT v. Berry's Hotel P. Ltd.,* (1994) 207 ITR 615 (Bom) [investment allowance not eligible in respect of machinery or plant installed in a hotel business].

(13) *CIT v. Khaders International Constructions Ltd.,* (1995) 213 ITR 869, 871-72 (Ker), **following** *CIT v. N.C. Budharaja & Co.*, (1993) 204 ITR 412 (SC) [plant and machinery used in civil construction works like schools and hospital buildings, held not entitled to investment allowance]. Also see, *CIT v. Geo Tech Foundations & Constructions*, (1998) 146 CTR (Ker) 273, 274.

(14) *CIT v. First Leasing Co. of India Ltd.,* (1995) 216 ITR 455, 467-68, 469 (Mad) [assessee was held not entitled to investment allowance in relation to its hiring of the bulldozer].

LexisNexis

(15) *Khatau Makanji Spinning & Weaving Co. Ltd. v. CIT,* (1996) 222 ITR 472, 474 (Bom) [assessee was held not eligible for investment allowance in respect of additional cost of imported assets].

(16) *CIT v. Damodar Corporation,* (1997) 225 ITR 699, 702-03 (Ker) [the entire hotel complex was held not eligible for investment allowance]. This view has been **overruled** by the Kerala Full Bench in *CIT v. Hotel Luciya* [(1998) 231 ITR 492 (Ker—FB)].

(17) *CIT v. Aspinwall & Co. Ltd.,* (1997) 227 ITR 916, 930 (Ker), **reversed in** *Aspinwall & Co. Ltd. v. CIT*, (2001) 251 ITR 323, 328 (SC) [the assessee, engaged, *inter alia*, in the activity of curing coffee, held not eligible for investment allowance because such activity could not be understood as a manufacturing activity].

(18) *CIT v. Naik Ice & Cold Storage,* (1997) 141 Taxation 618, 619 (Bom) [assessee engaged in the business of beheading and peeling shrimps and preserving the same in cold storage, held not entitled to investment allowance].

(19) *Bhagat Construction Co. Pvt. Ltd. v. CIT,* (1998) 232 ITR 722, 728-29 (Del), **applying,** *CIT v. N.C. Budharaja & Co.,* (1993) 204 ITR 412 (SC) and *CIT v. Minocha Bros.* (*P.*) *Ltd.,* (1986) 160 ITR 134 (Del) [where the assessee, whose main business was to be engaged in executing civil engineering contracts, has engaged itself in quarrying stones to be used in its construction business, the assessee could not be regarded as an industrial undertaking and the machinery purchased for quarrying stones was held not eligible to investment allowance].

(20) *CIT v. Bakhtawarsingh Balkishan Bhilai,* (1998) 234 ITR 652, 653 (MP), **following** (1993) 204 ITR 412 (SC) [assessee was held not entitled to investment allowance in so far as its activity of the construction work was concerned].

(21) *CIT v. V. Ganesan,* (1999) 235 ITR 426, 428-29 (Mad) [assessee, a contractor for construction of buildings, held not eligible for investment allowance because the assessee was not engaged in the manufacture or production of any article or thing specified in section 32A].

(22) *CIT v. Venkateswara Hatcheries* (*P.*) *Ltd.,* (1999) 237 ITR 174, 183, 185 (SC) [the assessee, having the business of hatchery, has been held neither an industrial undertaking nor it was engaged in the business of producing 'articles or things' and, therefore, it was not eligible for investment allowance].

But, see, *Indian Poultry v. STO* [(1999) 9 SCC 162, 164-65], which has been decided in the context of the M.P. General Sales Tax Act, 1958 (2 of 1959), and having regard to the definition of the expression 'manufacture' as contained in section 2(*j*) of that Act.

(23) *CIT v. Shah Construction Co. Ltd.,* (1999) 237 ITR 814, 815-16 (Bom), **following** (1993) 204 ITR 412 (SC) [assessee, engaged in the business of construction, has been held not an industrial undertaking eligible for investment allowance under section 32A(2)(*b*)(*iii*)]. Also see, *CIT v. Ajay Builders,* (2002) 123 Taxman 842, 843 (Guj).

(24) *CIT v. Vrindavan Hotels* (*P.*) *Ltd.,* (1999) 238 ITR 224, 225-26 (Ker) [the assessee which was engaged in the business of running a hotel, has been held not to be an industrial undertaking engaged in the production of an article or thing as contemplated by section 32A and was not entitled to investment allowance under section 32A(2)(*b*)(*iii*) on the building housing the kitchen, store room and the equipment used for producing the food stuffs, as there was no processing or manufacture of food materials in a hotel]. This view has been **followed in** *Hotel & Allied Trades P. Ltd. v. CIT* [(1999) 238 ITR 226, 228 (Ker)]; *CIT v. Abad Hotels India* (*P.*) *Ltd.* [(2000) 241 ITR 15, 16-17 (Ker), **reversed on another point in** *CIT v. Abad Hotels India P. Ltd.,* (2001) 251 ITR 204 (SC)]; *CIT v. Southern Paper Products* (*P.*) *Ltd.* [(1999) 151 Taxation 239, 240 (Ker)]; *Hotel & Allied Trades* (*P.*) *Ltd. v. CIT* [(1998) 149 CTR (Ker) 223, 225]; *CIT v. Hotel & Allied Traders* (*P.*) *Ltd.* [(1998) 149 CTR (Ker) 396, 398].

(25) *CIT v. R. Shroff Consultants P. Ltd.,* (1999) 238 ITR 1018, 1019, 1021-22 (Bom) [the assessee, which was engaged in business of consultancy and as part thereof undertook data processing through computers, was held not an industrial undertaking and was not eligible for investment allowance on computers for the assessment year 1980-81 because the preparation of statements on the basis of the data processing could not amount to manufacture or production of any article or thing].

(26) *CIT v. Poyilakada Fisheries P. Ltd.,* (1999) 240 ITR 445, 446 (Ker) [assessee engaged in the processing and export of shrimps, held not entitled to investment allowance]. Also see, *CIT v. George Maino Exports* (*P.*) *Ltd.,* (2001) 250 ITR 445, 445-46 (Mad); *CIT v. Premier Export International,* (2004) 271 ITR 308, 310 (Ker).

(27) *Adayar Gate Hotels Ltd. v. CIT,* (2000) 241 ITR 279, 284 (Mad) [hotel has been held not to be an industrial undertaking so as to be eligible for investment allowance].

(28) *CIT v. United Bleachers Ltd.,* (2000) 241 ITR 291, 293 (Mad) [investment allowance was held not allowable to the assessee, whose activities consisted of bleaching, dyeing and printing, etc., on cloth given by its customers because such activities did not amount to manufacture of articles or things]. This view has been **followed in** *United Bleachers Ltd. v. CIT* [(2000) 241 ITR 293, 294-95 (Mad)]; *United Bleachers Ltd. v. CIT* [(2000) 241 ITR 295, 296 (Mad)].

(29) *CIT v. Babcock & Wilcox of India Ltd.,* (2000) 241 ITR 583, 588 (Cal) [the assessee engaged in the business of erection of boilers, held not eligible for investment allowance as no manufacturing process involved in erection of boilers]. Also see, *CIT v. Dowel Erectors,* (2000) 243 ITR 832, 835 (Mad).

(30) *CIT v. B.N.B. Enterprises,* (2000) 242 ITR 439, 439-40 (Mad) [the assessee who was engaged in making photostat copies of documents with the aid of xerox machine, held not entitled to investment allowance].

(31) *CIT v. Dr. S. Surender Reddy,* (2000) 243 ITR 110, 113 (AP) [the equipment used for the purpose of conducting pathological tests was held not to qualify for investment allowance].

(32) *CIT v. Bishal Enterprises,* (2001) 247 ITR 484, 485 (Mad), **following** *CIT v. Gomatesh Granites,* (2000) 246 ITR 737 (Mad) decided in the context of the entitlement to deductions under sections 80HH and/or 80J [assessee, carrying out activities for the preparation of granite blocks, held not entitled to investment allowance as such activities did not fall within the ambit of manufacturing activity].

(33) *CIT v. General Fibre Dealers* (*P.*) *Ltd.,* (2001) 248 ITR 622, 624-25 (Cal) [jeeps and motor cycles required to be used in supervising and interdepartmental and intersectional management of the tea estate were held not eligible for investment allowance].

(34) *CIT v. M.D. Pendse,* (2001) 250 ITR 411, 412 (Bom); *CIT v. M.D. Pendse,* (2001) 250 ITR 413, 414 (Bom) [assessee, carrying on poultry farming, was held not entitled to investment allowance on the cost of poultry shed, machinery, cages and other equipment]. Also see, *CIT v. Balakrishna Hatcheries,* (2001) 169 CTR (Karn) 225, 227.

(35) *CIT v. Lake Palace Hotels & Motels* (*P.*) *Ltd.,* (2001) 251 ITR 644, 646, 655 (Raj) [the Tribunal was held **not justified** in holding that hotel business was an industrial undertaking to which section 32A applied and the assessee was entitled to investment allowance by treating the hotel building itself as a plant]. Also see, *CIT v. Lake Palace Hotels & Motels* (*P.*) *Ltd.,* (2002) 172 CTR (Raj) 290, 291-92; *CIT v. Lake Palace Hotel,* (2002) 176 CTR (Raj) 96; *CIT v. Hotel Hiltop,* (2002) 175 CTR (Raj) 600; *CIT v. Indo Continental Hotel & Resorts & Hotel Man Singh,* (2002) 171 Taxation 548, 549 (Raj).

LexisNexis

(36) *CIT v. Poyilakada Fisheries P. Ltd.,* (2001) 252 ITR 661, 662, 663 (Ker) [assessee was held not entitled to investment allowance on the plant and machinery used in its activity of processing fish].

(37) *CIT v. Mewara Construction,* (2002) 253 ITR 58, 60-61 (MP) [as construction of roads does not involve any activity of manufacturing an article or thing, the assessee was held not entitled to investment allowance].

(38) *CIT v. Megaska International* (*India*) (*P.*) *Ltd.,* (2002) 254 ITR 283, 285 (Del) [**following** Supreme Court ruling [204 ITR 412 (SC)], a building contractor held not eligible for investment allowance].

(39) *CIT v. Gujarat State Fertilizer Co.,* (2002) 255 ITR 294, 296 (Guj) [assessee was held not entitled to investment allowance on compound walls and fencing].

(40) *CIT v. Devans Modern Breweries Ltd.,* (2002) 256 ITR 383, 384 (J&K) [investment allowance was held not eligible on transformer used for the purpose of production of alcoholic drinks for the assessment year 1983-84].

(41) *Abirami Theatres Pvt. Ltd. v. IAC,* (2002) 258 ITR 661, 662 (Mad) [assessee was held not entitled to claim investment allowance on the projector as well as airconditioning plant installed in the cinema theatre because the condition as to manufacture or production of an article or a thing is lacking].

(42) *CIT v. Smt. Geeta Devi Purohit,* (2003) 260 ITR 231, 232 (Raj) [a hotel is not entitled to investment allowance on furniture and electric goods installed therein].

(43) *India Cine Agencies v. CIT,* (2003) 261 ITR 491, 493, 498, 499 (Mad) [the assessee, who is importing photographic colour paper in jumbo rolls, cutting the rolls into photographic flats and rolls of desired size in a dark airconditioned humidity controlled dust proof room with the help of a slitting machine, and selling the photographic colour paper in the form of small rolls or cut sizes, has been held not entitled to investment allowance because in the process of slitting bigger rolls into marketable smaller rolls or sizes neither manufacture nor production was involved].

(44) *Insight Diagnostic & Oncological Research Institute Pvt. Ltd. v. Deputy CIT*, (2003) 262 ITR 41, 43-44 (Bom) [where the Tribunal has found on the facts that the C.T. scan machine was a part of the diagnostic centre and the CT scan machine played an ancillary role in the working of the diagnostic centre, the assessee was held not entitled to investment allowance in respect of the CT scan machine because the reports of patients coming out from the CT scan machine did not amount to manufacture or production of article or thing].

(45) *CIT v. Pooshya Exports P. Ltd.,* (2003) 262 ITR 417, 420 (Mad) [activities of the petitioner in quarrying and mining granite blocks did not amount to manufacture and the assessee was not entitled to investment allowance].

(46) *CIT v. Vijay Granites P. Ltd.,* (2004) 267 ITR 606, 612 (Mad) [activities of cutting and polishing granite slabs before exporting them do not involve any process of manufacture or production so as to entitle the assessee to deduction under section 32A].

(47) *Brooke Bond India Ltd. v. CIT,* (2004) 269 ITR 232, 237, 240 (Cal), **following** *Appeejay Pvt. Ltd. v. CIT,* (1994) 206 ITR 367 (Cal) [assessee, blending different types of tea, was held not entitled to investment allowance in respect of machinery used because such blending does not amount to manufacture or production of article].

(48) *CIT v. George Maijo,* (2003) 129 Taxman 234, 235 (Mad) [assessee engaged in processing and export of prawns and allied products, held not entitled to investment allowance in respect of the building used by the assessee in its business treating it as plant and machinery].

(49) *CIT v. D.V. Datey,* (1998) 147 Taxation 297, 298 (Bom) [assessee, engaged in the business of xerox copies, held not eligible to investment allowance on xerox machines].

(50) *CIT v. Lake Palace Hotels & Motels* (*P.*) *Ltd.,* (2004) 186 CTR (Raj) 466, 467 [restaurant attached to a hotel is not eligible to investment allowance as the same cannot be regarded as an industrial undertaking within the meaning of section 32A].

(51) *South India Tourist Home* (*P.*) *Ltd. v. CIT,* (2004) 186 CTR (Mad) 496, 497 [the assessee, engaged in the business of providing boarding and lodging facilities, in other words, a hotel, has been held not entitled to investment allowance in respect of plant and machinery including pipes, sanitary fittings, lifts, A.C. plant and other mechanical, kitchen and heat equipments].

(52) *CIT v. Fiesta Restaurants Ltd.,* (2004) 186 CTR (Mad) 497, 498-99 [the assessee was held not entitled to investment allowance on machineries installed in a restaurant as the preparation of food cannot be regarded as the process of manufacture].

(53) *CIT v. Tamil Nadu Minerals Ltd.,* (2004) 189 CTR (Mad) 72, 72-73 [assessee was held not entitled to investment allowance as its activities, namely, mining granite from quarries and exporting them after cutting, polishing, etc., would not come within the purview of manufacture or production for the purposes of relief under section 32A].

(54) *CIT v. Soft Beverages P. Ltd.*, (2005) 272 ITR 270 (Mad) [despite being engaged in the manufacture of a product which was covered by entry No. 5 of the Eleventh Schedule, the assessee was not entitled to investment allowance].

(55) *CIT v. Ajit Bhawan Hotel*, (2005) 274 ITR 66 (Raj) [building used as hotel and tourist complex not to be considered as a 'plant' and as such the same is not entitled to investment allowance].

(56) *CIT v. Radico Khaitan Ltd.*, (2005) 274 ITR 354 (All) [investment allowance held not admissible in respect of the plant and machinery installed for the purpose of manufacturing any of the items mentioned in the XIth Schedule].

(57) *CIT v. EID Parry* (*India*) *Ltd.*, (2005) 274 ITR 489 (Mad) [processing of fish does not amount to manufacture and as such investment allowance for assessment year 1982-83 not eligible].

(58) *CIT v. Suraj Theatre*, (2005) 274 ITR 558 (Punj) [the generator installed for business by the assessee did not fulfil the conditions specified in section 32A hence, investment allowance not eligible].

(59) *CIT v. Harbhajan Sarbjit Associates*, (2005) 276 ITR 542 (All) [investment allowance held not admissible in respect of the construction of tunnel and minor irrigation projects thus, the question of granting investment allowance on tractor or trollies not arises].

(60) *Jai Prakash Associates P. Ltd. v. CIT*, (2008) 277 ITR 193 (All) [the assessee-company being engaged in the construction of tunnels, bridges and roads, etc., held not entitled to investment allowance]. Also see, *CIT v. Jai Prakash Associates P. Ltd.*, (2006) 281 ITR 419 (All)

(61) *Poompuhar Shipping Corporation Ltd. v. Joint CIT*, (2006) 287 ITR 83 (Mad) [combined reading of sections 32A, 155(4A) and 154 clearly shows that if an assessee fails to utilize the investment allowance reserve created against the purchase of an original ship within a period of 10 years from the

LexisNexis

year of purchase of the original ship in purchase of a new ship, he is liable to lose the benefit of investment allowance originally].

(62) *CIT v. Gujarat Tube Well Co.*, (2007) 288 ITR 301 (Guj) [investment allowance not eligible on the machinery used for construction of road].

(63) *Mrs. P. Kropivnik v. CIT*, (2007) 291 ITR 72 (Punj) [since the assessee had sought to claim the benefit of investment made on the value of plant and machinery installed for transport purposes and not for the purpose of manufacture or production of any article or thing, the assessee held not entitled to investment allowance].

(64) *Biyar Rubber P. Ltd. v. CIT*, (2007) 292 ITR 251 (Karn) [the installation of 'Alfred Herbert Intermix Machine' would not have become functional and ready to yield the product and, as such, for assessment year 1985-86, the assessee was not entitled to investment allowance].

(65) *Motors & Diesels P. Ltd. v. CIT*, (2008) 307 ITR 298 (All) [since the assessee was not engaged in the process of manufacturing, thus claim of investment allowance been rightly denied].

(66) *CIT v. Dr. Yogender Sharma*, (2009) 311 ITR 372 (Del) [the assessee, a practising radiologist, held not exigible for investment allowance on X-ray machine].

(67) *CIT v. Anil Kumar Bishnoi*, (2009) 311 ITR 449 (Del) [investment allowance held not eligible on the dewatering equipment used in the construction work].

(68) *HMM Ltd. v. CIT*, (2009) 313 ITR 401 (Punj) [the work of construction of roads being not covered by section 32A thus, investment allowance not eligible].

(69) *Ram Bagh Palace Hotel P. Ltd. v. CIT*, (2009) 316 ITR 49 (Raj) [hotel business carried on by the assessee was not an industrial undertaking covered under section 32A thus, investment allowance not eligible].

(70) *CIT v. SB Properties & Enterprises Ltd.*, (2014) 362 ITR 483 (Raj) [Being not a plant, hotel building held not exigible for investment allowance].

In *S.P. Jaiswal Estates* (*P.*) *Ltd. v. CIT* [(1995) 216 ITR 145, 152-54 (Cal)], the question whether the Tribunal was justified in holding that preparation of food in the hotel constituted manufacture or production of any article or thing within the meaning of section 32A has been referred to a larger Bench. Such a reference has been necessitated because there was difference in judicial opinion on the point in *CIT v. Sky Room Pvt. Ltd.* [(1992) 195 ITR 763 (Cal)] and *CIT v. S.P. Jaiswal Estates* (*P.*) *Ltd.* [(1992) 196 ITR 179 (Cal)].

In *CIT v. Escorts Employees Ancillaries Ltd.* [(1997) 224 ITR 28, 34 (Punj)], the Tribunal was held justified in directing the Assessing Officer to consider the assessee's claim for allowing, *inter alia*, investment allowance on foreign tour expenses which were treated to be capital expenditure.

Conditions for allowance.—The requisite conditions are:—

(*i*) the eligible asset is owned by the assessee;

(*ii*) the eligible asset is wholly used for the purposes of the assessee's business;

(*iii*) the prescribed particulars as per rule 5AA (operative up to 1-4-1987) have been furnished [**s. 32A(4)(*i*)**];

(*iv*) the assessee has created an "Investment Allowance Reserve" (by that name) equal to 75% [50% in respect of a ship] of the amount of investment allowance to be actually allowed. Such reserve is created by debiting such amount in the profit and loss account of any previous year in respect of which the deduction is to be allowed under section 32A(3) or any earlier previous year not being a previous year earlier than the year in which the ship or aircraft was acquired or the machinery or plant was installed or the ship, aircraft, machinery or plant was first put to use and crediting the same to this reserve account [**s. 32A(4)(*ii*)**];

(*v*) the amount in such reserve must be utilised for the purposes of acquiring, within the next following ten years, a new eligible asset for the purposes of the business of the undertaking itself. Till such acquisition is made, the amount may, however, be used for any other purpose of the business of the undertaking. But no part of the reserve can be utilised for the purpose of distribution by way of dividends or profits, or remittance outside India as profits or for the creation of any asset outside India [**s. 32A(4)(*ii*)**];

(*vi*) the assessee does not sell or otherwise transfer, for a period of at least 8 years, the eligible asset.

Exceptions to this condition, however, are where—

—the asset is sold, etc., to the Government, a local authority, a statutory corporation or a Government company;

—the sale or transfer of the asset is made in connection with the amalgamation or succession, referred to in section 32A(6) or 32A(7) [**s. 32A(5)(*a*) & proviso**].

Where the Tribunal has recorded findings that the assessee has created adequate reserve and has debited the same to the profit and loss account, there is no justification in rejecting the claim of investment allowance [*CIT v. Estee Engineering Co.* (*P.*) *Ltd.,* (2002) 255 ITR 44, 45 (Mad)].

Once the three conditions of owning a machinery, use thereof for the purpose of business of the assessee and the nature of machinery being of the specified category were fulfilled, section 32A would be attracted [*CIT v. Rieta Biscuit Co.* (*P.*) *Ltd.*, (2010) 320 ITR 521 (Punj)].

If the installation of a plant was spread over more than a year, the relevant year for the grant of allowance would be the year in which the installation was completed. In the case of investment allowance, the material date is the date of installation and not the year of acquisition. Therefore, the assessee was entitled to investment allowance in respect of machinery installed in the previous year relevant to the year under consideration [*Janta Sugar Industries v. CIT*, (2007) 295 ITR 448 (All)].

In order to constitute an industrial undertaking, be it under section 32A or under section 80HH, the important criteria to be applied by the AO is to identify the item in question, the process undertaken by it and the resultant output [*Down Town Hospital Ltd. v. CIT*, (2009) 308 ITR 188 (SC)].

Not one-time allowance.—Investment allowance under section 32A is not a one-time allowance. Section 32A itself provides that investment allowance may be availed of during the period of 8 years. If the Legislature intended to exclude one-time allowance, section 43A(2) would become redundant [*Associated Bearing Co. Ltd. v. CIT*, (2006) 286 ITR 341 (Bom)].

Point of time for creation of investment allowance reserve.—In *CIT v. Orient Express Co. P. Ltd.* [(1987) 167 ITR 894 (Del)], the requisite Investment Allowance Reserve was created by holding a second annual general meeting of the members of the company and the accounts were duly amended so as to provide for the reserve before the assessment was completed. It was held that the condition about creation of reserve was satisfied.

In *CIT v. Partap Rosin & Turpentine Factory* [(1989) 179 ITR 414 (Punj)], it has been held that even where the investment allowance reserve is created before the assessment is made, it can be said that the condition for the creation of the reserve has been fully met.

In *Bharatiya Vehicles and Engineering Co. Ltd. v. Union of India* [SLP (Civil) Nos. 11925 and 11926 of 1989: (1990) 181 ITR (St.) 7-8 (SC)], the Supreme Court has, by an order dated 6-11-1989, directed the issue of notice for final disposal at the notice stage itself, in a special leave petition by the assessee against the order dated 27-6-1989 as modified by the order dated 27-8-1989 of the Assistant Commissioner of Income-tax, Special Circle I(*i*), New Delhi. The assessee in this case had suffered loss and, therefore, could not create a reserve and, therefore, investment allowance under section 32A of the Income-tax Act, 1961 (43 of 1961), was not allowed for assessment years 1986-87 and 1987-88 although the plant and machinery were installed and put to use during 1986-87. In 1988-89, the assessee had a profit and created a reserve of 75% of the investment allowance which was allowed in its entirety for that year. Subsequent to the decision of the Supreme Court in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193 (SC)], the entire investment allowance was withdrawn by way of rectification. The assessee came up by way of a special leave petition against the order of rectification contending that (*i*) it would be futile to proceed by way of appeal and reference since the authorities and the High Court would feel bound by 177 ITR 193; (*ii*) that the words "75% of the investment allowance actually allowed" in section 32A(4)(*ii*) meant that the reserve had to be created in the year when the investment allowance was allowed and not in any other year where due to loss the investment allowance was not allowed; and (*iii*) that to this extent the decision in 177 ITR 193 needed reconsideration.

Thereafter, the Supreme Court, by an order dated 19-3-1990, has granted special leave and directed the resultant appeal to be listed before a larger Bench of three judges [see, (1990) 182 ITR (St.) 411 (SC)].

Applying the Supreme Court decision in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193 (SC)], it has been held that the creation of reserve was mandatory and was precondition for claiming the relief. As the assessee had not created the requisite reserve at the material time, the assessee was not entitled to the benefit of deduction under section 32A [*CIT v. Davy Ashmore India Ltd.,* (1992) 108 CTR (Cal) 246, 252]. Also see, *CIT v. Coimbatore Roller Flour Mills Ltd.,* SLP (Civil) No. 7855 of 1984 : (1992) 193 ITR (St.) 13 (SC).

As a result of the amendment made in section 32A(4)(*ii*) by the Finance Act, 1990 (12 of 1990), with retrospective effect from 1-4-1976, and the omission of section 32A(9) by that Act, also with effect from that date, effect of the abovesaid Supreme Court ruling [(1989) 177 ITR 193 (SC)] has statutorily been superseded. The net effect of such amendments is that the condition of creation of investment allowance reserve even in a

LexisNexis

year of loss on the analogy of the principle laid down by the Supreme Court in the abovesaid ruling will not be mandatory retrospectively for and from assessment year 1976-77. As a result of such amendments, the creation of such reserve has been made permissible in—

—any previous year in respect of which the deduction is to be allowed under section 32A(3) or

—any earlier previous year not being a previous year earlier than the year in which the ship or aircraft was acquired or the machinery or plant was installed or the ship, aircraft, machinery or plant was first put to use.

It may be noted that the **above paragraph** has been **reproduced verbatim**, as forming part of the judgment, by the Calcutta High Court in *CIT v. Century Enka Ltd.* [(1992) 196 ITR 447, 453 (Cal)], **without giving reference to the book.**

In *CIT v. M.P. Electricity Board* [(1994) 210 ITR 425, 426-27 (MP)], the Tribunal was held justified in allowing the claim of the assessee for investment allowance for the assessment year 1981-82 in view of the retrospective amendment (w. e. f. 1-4-1976) of section 32A(4) by the Finance Act, 1990 (12 of 1990), even though such claim disallowed by the Assessing Officer was confirmed by the Tribunal by its order dated 21-6-1989.

Result of breach of conditions.—If an assessee does not fulfil any of the conditions at No. (*i*), (*ii*), (*iii*) and (*iv*) above, he will not be entitled to any investment allowance.

But there is a conditional concession in regard to No. (*iv*). Where the amount transferred by the assessee to the Investment Allowance Reserve Account is not less than the amount required to be so transferred on the basis of the amount of investment allowance claimed in the return of income, and the Assessing Officer proposes to make some additions [other than as a result of the invoking of the first proviso to section 145(1), or section 145(2), or any concealment of income] entitling the assessee to a larger than claimed amount of investment allowance, the *Explanation* to section 32A(4) enjoins upon the Assessing Officer to afford an opportunity to the assessee by a notice in writing to make good the deficiency in the Reserve. In such a case, the assessee may make good the deficiency by transferring, in the accounting year the assessee gets the notice (or in the immediately preceding year if the accounts for that year have not been finalised), to the Reserve Account the deficit amount. On so doing, the assessee shall be entitled to get allowance for the larger than claimed allowance. It may be noted that the above portion has been **quoted with approval**, **without giving the reference to this book**, by the Calcutta High Court in *CIT v. Century Enka Ltd.* [(1992) 196 ITR 447, 454 (Cal)]. In the facts of that case, the High Court answered the question by saying that the assessee would be entitled to investment allowance on such sum as may be found to represent any additional liability on the date of actual payment of the loan arising due to fluctuation in the rate of conversion and the Income-tax Officer shall allow the assessee an opportunity of creating a reserve in respect of such additional sums eligible for investment allowance.

LexisNexis

As regards breach of condition (*v*),—(*a*) if the assessee fails to utilise the amount of the reserve in acquiring, within the stipulated period of ten years, a new eligible asset, or (*b*) he utilises the Reserve, within that period, for distribution by way of dividends or profits, or for remittance outside India as profits or for the creation of any asset outside India, or for any other purpose which is not a purpose of the business of the undertaking, the investment allowance already allowed shall be treated as wrongly allowed and the assessment shall be rectified accordingly. Similarly, breach of condition (*vi*) shall result in such withdrawal [**s. 32A(5)**].

In *CIT v. D.K. Trivedi & Sons* [(2001) 250 ITR 561, 564-65 (Raj), **following** *Malabar Fisheries Co. v. CIT,* (1979) 120 ITR 49 (SC)], it has been held that the distribution of assets on the dissolution of a firm amongst its partners does not amount to utilisation of the amount credited to the reserve account in contravention of the provisions of sections 32A(4) and, therefore, the investment allowance allowed could not be withdrawn.

It is pertinent to note that the above Supreme Court decision [120 ITR 49 (SC)] has construed the expression 'transfer' in the context of the analogous provisions of section 34(3)(*b*) and did not concern a case where the assessee-firm had ceased to exist as a result of dissolution [see, *South India Steel Rolling Mills v. CIT,* (1997) 224 ITR 654, 661 (SC)].

However, in *Wilson Industries v. CIT* [(2003) 259 ITR 318, 320 (Mad)], **applying** the Supreme Court decision *South India Steel Rolling Mills v. CIT* [(1997) 224 ITR 654 (SC), which was decided in the context of the analogous provisions contained in section 34(3)(*a*) and 155(5)], it has been held that when the assessee, a firm, ceased to exist as a result of its dissolution within three years of its constitution, which is less than the period of ten years contemplated in section 32A(4) read with section 155(4A)(*b*), it would be impossible to utilise that amount within the period contemplated in that section 32A(4) as that amount had remained unutilised even at the time of dissolution. The withdrawal of the investment allowance as directed by the Tribunal was in accordance with law.

In *CIT v. Nipa Twisting Works* [(2003) 263 ITR 697, 706 (Guj)], on dissolution of the assessee-firm, to which investment allowance has been granted, the assets which were jointly owned, had been distributed amongst the

partners and the investment allowance reserve had also been so distributed. It has been held that as the machinery was otherwise transferred by the assessee-firm to another person before expiry of eight years from the end of the previous year in which it was acquired, the Officer was justified in withdrawing the investment allowance on the ground that the said allowance was wrongly made for the purpose of the Act. Similarly, before the expiry of the ten years period, the assessee had utilised the amount credited to the reserve account under section 32A(4) by distribution to the partners on dissolution of the firm and as there was breach of provisions of section 32A(5)(*c*), the Officer was justified in withdrawing the investment allowance granted to the assessee.

Reference may also be made to *CIT v. Star Steel Pvt. Ltd.* [(2003) 264 ITR 236, 239 (Guj)]; *Meenu Equipments v. CIT* [(2004) 266 ITR 33, 36 (Mad)],

Also see, *Mamta Type Setting Works v. Asst. CIT,* (2004) 267 ITR 623, 626-27 (Guj).

So far as condition (*vi*) is concerned, the intention of the legislature is to withdraw the benefit of investment allowance given to the assessee in respect of certain machineries if such machineries are sold or 'otherwise transferred' by the assessee within the stipulated period. The expression 'otherwise transferred' is very wide expression and takes within its sweep transfer of assets from the assessee to some other person by any means or mode whatsoever. There can be no controversy about the fact that as a result of the sale of the business undertaking of the assessee as a whole as a going concern, the machinery in question also got transferred to the purchaser of the business. That being so the provisions of section 32A(5) read with section 155(4A) are squarely attracted so as to justify withdrawal of investment allowance allowed to the assessee in respect of such machineries [*S.M. Chemicals and Electronics Pvt. Ltd. v. CIT,* (1995) 215 ITR 943, 948-49 (Bom)].

In *CIT v. Baghpat Co-operative Sugar Mills Ltd.* [CC No. 8256 of 1997 : (1997) 228 ITR (St.) 160-61 (SC)] their Lordships of the Supreme Court have, by an order dated 4-11-1997, issued notice to the respondent on the special leave petition filed by the Department against the judgment dated 20-1-1997 of the Allahabad High Court in ITA No. 121 of 1996, whereby the High Court rejected the reference application of the Department on the question whether the Tribunal was justified in deleting the addition of Rs. 7,09,151 accepting the assessee's view, that there was no contravention of the provisions of section 32A read with section 155(4A) of the Income-tax Act, 1961 (43 of 1961).

In *CIT v. Baghpat Co-operative Sugar Mills Ltd.* [SLP (Civil) No. 20736 of 1997 : (1999) 236 ITR (St.) 214 (SC)], their Lordships of the Supreme Court have, by an order dated 8-1-1999, **dismissed** the special leave petition filed by the Department against the order dated 20-1-1997 of the Allahabad High Court in ITA No. 121 of 1997 whereby the High Court had dismissed the Department's reference application on the question whether the Tribunal had rightly deleted the addition of Rs. 7,09,151 accepting the assessee's contention that there was no contravention of the provisions of section 32A read with section 155(4A). The Assessing Officer had, under section 155(4A), withdrawn the investment allowance granted earlier and made the addition in question, on the ground that the assessee had written back the sum of Rs. 7,09,151 to the general reserve account.

Furnishing of prescribed particulars essential.—Up to assessment year 1980-81, the particulars required to be furnished formed part of the prescribed form of return of income. For assessment years 1981-82 to 1987-88, the return form did not contain any such particulars. Instead, **rule 5AA** [**inserted** by **the Income-tax (First Amendment) Rules, 1981**, and **omitted** by **the Income-tax (Third Amendment) Rules, 1987** (w. e. f. 2-4-1987)] prescribed the requisite particulars. Prior to its omission, rule 5AA read as follows:—

"**R. 5AA.** *Prescribed particulars for depreciation and investment allowance.*—(1) For the purposes of the deductions referred to in sub-section (1) or sub-section (1A) of section 32 and sub-section (1) of section 32A, the following particulars shall be furnished in a columnar form, namely:—

(*i*) description of assets (in respect of building, indicate whether the building is taken on lease or is owned by the assessee);

(*ii*) written down value of existing assets;

(*iii*) actual cost of assets acquired during the previous year;

(*iv*) capital expenditure on additions or alterations;

(*v*) period of user (only where return relates to assessment year 1969-70 or any earlier year);

(*vi*) amount of moneys payable and scrap value in respect of assets sold, discarded, demolished or destroyed;

(*vii*) amount on which depreciation is allowable [total of items (*ii*) to (*iv*) exclusive of amounts relating to assets referred to in item (*vi*)];

(*viii*) rate of depreciation;

(*ix*) total number of days worked (to be furnished only if extra shift allowance is claimed);

(*x*) total number of days worked—

double shift and triple shift (to be furnished only if extra shift allowance is claimed);

(*xi*) depreciation claimed—

(*a*) initial depreciation;

(*b*) normal depreciation (including extra depreciation for approved hotels);

(*c*) additional depreciation;

(*d*) extra shift allowance—double shift and triple shift;

(*xii*) total depreciation;

(*xiii*) investment allowance claimed (also indicate rate);

(*xiv*) remarks (indicate the amount of initial depreciation, investment allowance or development rebate allowed in respect of the asset in an earlier year).

(2) Where the depreciation in respect of any asset is not admissible as a deduction under clause (*ii*) of sub-section (4) of section 37 or sub-clause (*ii*) of clause (*c*) of section 40 or sub-clause (*ii*) of clause (*a*) of sub-section (5) of section 40A, such depreciation shall be excluded for the purposes of sub-rule (1).".

Rate of investment allowance.—The uniform rate originally prescribed for such allowance is 25% of the actual cost of the eligible asset [**s. 32A(1)**]. However, for and from assessment year 1978-79, a higher rate of 35% has been prescribed [s. 32A(2B)] in respect of machinery or plant installed, after 30-6-1977 but before 1-4-1987, for the manufacture or production of any article or thing which is manufactured or produced by using any technology or other know-how developed in, or which is invented by, a laboratory owned or financed by the Government, or owned by a public sector company or a University, etc., subject to the conditions specified in section 32A(2B).

Where the petitioners for the purposes of their business of manufacture or production of writing, printing and craft papers have used the technology including the process and know-how developed by the Forest Research Institute which is wholly owned and financed by the Government, the petitioners are held entitled to be issued with a certificate as provided for to enable them to get the benefit of higher rate of investment allowance under the provisions of section 32A(2B) [*Amrit Banaspati Co. Ltd. v. Union of India,* (1996) 218 ITR 375, 384 (Del)].

Similarly, for and from assessment year 1984-85, a higher rate of 35 per cent. has been prescribed [s. 32A(2C)] in respect of machinery or plant which would assist in control of pollution or protection of environment and which has been notified[32] in this behalf by the Central Government in the Official Gazette. For availing such higher rate, the machinery or plant is required to be installed after 31-5-1983 but before 1-4-1987 in any industrial undertaking referred to in section 32A(2)(*b*)(*i*) or 32A(2)(*b*)(*ii*) or 32A(2)(*b*)(*iii*).

Under the **newly inserted** (w. e. f. 1-4-1989) **first proviso to section 32A(1)** by **the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986** (46 of 1986), it is provided that in respect of a ship or an aircraft or machinery or plant specified in section 32A(8B), deduction in respect of investment allowance shall

---

32. The following notification has been issued under section 32A(2C):—

'In exercise of the powers conferred by sub-section (2C) of section 32A of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies the following machinery and plant for the purposes of that sub-section, namely:—

A. Air pollution control equipments, being—

(*i*) Electrostatic precipitation systems,

(*ii*) Felt-filter systems,

(*iii*) Dust collector systems,

(*iv*) Scrubber-counter current/venturi/packed-bed/cyclonic scrubbers.

B. Water pollution control equipments, being—

(*i*) Mechanical screen systems,

(*ii*) Aerated detritus chambers (including air compressor),

(*iii*) Mechanically skimmed oil and grease removal systems,

(*iv*) Chemical feed systems and flash mixing equipment,

(*v*) Mechanical flocculators and mechanical reactors,

(*vi*) Diffused air/mechanically aerated activated sludge systems,

(*vii*) Aerated lagoon systems,

(*viii*) Biofilters,

(*ix*) Methane-recovery anaerobic digestor system,

(*x*) Air floatation systems,

(*xi*) Air/steam stripping systems,

(*xii*) Urea hydrolysis systems,

(*xiii*) Marine outfall systems,

(*xiv*) Centrifuge for dewatering sludge,

(*xv*) Rotating biological contractor or bio disc.

C. Solid waste control equipments, being—

Caustic/lime/chrome/mineral/cryolite recovery system.' [*Notification No. SO 555(E), dated 1st August, 1984*].

be allowed, for and from assessment year 1989-90, at a rate of 20 per cent. of the actual cost thereof. It is clarified in the newly inserted *Explanation* that for the purposes of investment allowance, the actual cost shall mean the actual cost of the ship, aircraft, machinery or plant to the assessee as reduced by any amount which has been met out of the amount released to the assessee from the Development Bank in accordance with section 32AB(6).

In the facts of *CIT v. Windsor Foods Ltd.* [(1998) 146 CTR (Guj) 207, 211, 221-22 = (1999) 235 ITR 249, 252, 263-64 (Guj)], the assessee was held not entitled to investment allowance on the amount of Rs. 80,414 being the additional liability arising due to fluctuation in foreign exchange rate in respect of the payment of outstanding instalments of machinery. This is so because given its full play, the provision of section 43A(1), notwithstanding the specific provision regarding development rebate made in section 43A(2), will not have any impact on the full amount of the investment allowance already quantified on the basis of the actual cost in the relevant previous year which was much prior to the year in which the additional liability arose due to fluctuation in the exchange rate.

In *Amrit Banaspati Co. Ltd. v. Union of India,* [SLP (Civil) No. 6377 of 1987 : (1989) 177 ITR (St.) 16-17 (SC)], the Supreme Court has, by an order dated 13-3-1989, granted special leave to the assessee against the judgment dated 4-2-1987, of the Delhi High Court in W.P. No. 815 of 1956. The assessee in this case had obtained technology from the Forest Research Institute, Delhi, for the manufacture of paper from agricultural waste and had set up a plant and the Forest Research Institute had inspected the plant and certified as to the use of the technology. The Department of Science and Technology however refused a certificate under section 32A(2B) of the Income-tax Act, 1961 (43 of 1961), and the assessee's writ petition in the High Court was dismissed by a non-speaking order. The Supreme Court, while granting special leave, remanded the matter back to the High Court for fresh dismissal giving a reasoned judgment.

Furnishing of the certificate as required under section 32A(2B)(*ii*) in the course of assessment proceedings fulfils the condition.—The furnishing of the certificate from the prescribed authority as contemplated by section 32A(2B)(*ii*) is mandatory. But the requirement of furnishing the certificate along with the return of income is directory. If the assessee furnishes the same to the Assessing Officer before the completion of the assessment and offers a satisfactory explanation for his failure to furnish the same alongwith his return of income, the Assessing Officer may consider the same and allow the claim of the assessee for investment allowance at higher rate under section 32A(2B) [*CIT v. I.A. & I.C. Pvt. Ltd.,* (1999) 239 ITR 1, 7 (Bom), **applying** *CIT v. Shivanand Electronics,* (1994) 209 ITR 63 (Bom) decided in the context of the then section 80J(6A)]. Therefore, in that case, the Tribunal was held justified in directing the Officer to consider the claim of the assessee for investment allowance at a higher rate under section 32A(2B) on the basis of the certificate filed in the course of assessment proceedings.

Year of allowance.—Like development rebate, investment allowance is ordinarily admissible in respect of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed. If, however, the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, the investment allowance is to be allowed in such succeeding previous year. It is allowable only once [**s. 32A(1)**].

Ceiling and unabsorbed investment allowance.—Where the total income [as computed after deduction of development rebate under section 33 and development allowance under section 33A, but without making any deduction for investment allowance, or any deduction under Chapter VI-A (sections 80A to 80U)] for the relevant assessment year is *nil* or is less than the full amount of investment allowance otherwise admissible for that year, the sum to be allowed by way of investment allowance for that assessment year is to be restricted to such amount as would be sufficient to reduce the so-computed total income to nil. In other words, the ceiling for this allowance for a particular year is the so-computed total income.

The unabsorbed investment allowance shall be carried forward, upto a period of eight years, to be set-off against so computed total income of subsequent year or years. Where there is an amount of current as well as unabsorbed investment allowance in a particular year, the unabsorbed allowance shall have precedence over the current allowance. Similarly, where, in a particular year, there are more than one unabsorbed allowances outstanding, the earlier one shall have precedence over the later one [**s. 32A(3)**].

It may be noted that the order of precedence in case of more than one type of allowances under sections 32, 32A, 33 and 33A shall be as follows:—

1. Current year's depreciation [s. 32(1)].
2. Unabsorbed carried forward allowable losses of earlier years [ss. 72(1), 72(2), 2.73(3)].
3. Unabsorbed depreciation of earlier years [s. 32(2)].
4. Unabsorbed development rebate of earlier (upto eight) years [s. 33(2)(*ii*)].
5. Current year's development rebate [s. 33(2)(*i*)].
6. Unabsorbed development allowance of earlier (upto eight) years [s. 33A(2)(*ii*)].

LexisNexis

7. Current year's development allowance [s. 33A(2)(*i*)].
8. Unabsorbed investment allowance of earlier (up to eight) years [s. 32A(3)(*ii*)].
9. Current year's investment allowance [s. 32A(3)(*i*)].

The order of precedence has also been discussed in *Monogram Mills Co. Ltd. v. CIT* [(1982) 135 ITR 122 (Guj)].

Succeeding Officer is bound to carry forward unabsorbed investment allowance for set off in a subsequent year without sitting in judgment over the order passed by the predecessor Officer granting investment allowance.—Under section 32A(3), the assessee is entitled to carry forward the amount of investment allowance to the following assessment year and in that subsequent year, the investment allowance can be set off against the income of the subsequent year and the balance remaining can be carried forward to the subsequent assessment year. That provision makes it clear that the succeeding Officer has to carry forward the investment allowance earlier granted by the preceding Officer and it is not his duty once again to go into the question whether the order passed by the preceding Officer granting investment allowance was correct or not. The order passed by the preceding Officer is a statutory order and has legal consequences and one such legal effect is to grant the statutory benefit of carrying forward of the unabsorbed investment allowances of the earlier year. Therefore, it is not permissible or open to the succeeding Officer to sit in judgment over the order passed by the preceding Officer and once again determine the question whether the investment allowance granted by the preceding Officer was correct or not [*CIT v. Century Flour Mills Ltd.,* (1999) 239 ITR 23, 26 (Mad)]. In the facts of that case, the Officer while completing the assessment for the assessment year 1977-78, though initially rejected the claim of the assessee for investment allowance, by an order of rectification subsequently allowed the claim of the assessee for investment allowance by invoking the provisions of substituted (w. e. f. 1-4-1978) clauses (*ii*) and (*iii*) of section 32A(2)(*b*) by the Finance (No. 2) Act, 1977 (29 of 1977), which were legally not applicable to assessment year 1977-78. Such an order for the assessment year 1977-78 became final and the assessee claimed benefit of carry forward and set off under section 32A(3) for the assessment year 1978-79. Such a claim was rejected by the succeeding Officer in charge of the assessment for assessment year 1978-79. The High Court has held (pp. 25-26) that the refusal by the succeeding Officer in charge of the assessment of income for the subsequent assessment year 1978-79 was quite incompatible with and contrary to the earlier order for assessment year 1977-78 of the preceding Officer granting the relief and allowing it to be carried forward.

Transfer of the unit within eight years—no entitlement to carry forward and set off.—Where the unit, which is eligible for, *inter alia,* investment allowance has been transferred within eight years from the date of purchase and installation of assets, the assessee is not entitled to carry forward and set off of unabsorbed investment allowance. This is so in view of the clear statutory provisions of sections 32A(4)(*a*), 32A(5) and 155(4A) [*CIT v. Fabriquip P. Ltd.,* (2003) 260 ITR 207, 211 (Guj)].

The *Explanation* to section 32A(4) contemplates that an opportunity shall be allowed to the assessee to create investment allowance reserve account by the requisite amount [*CIT v. Seshasayee Paper & Boards Ltd.*, (2006) 283 ITR 200 (Mad)].

Failure on the part of the assessee to debit the investment allowance claimed to the profit and loss account, and to credit 75 per cent thereof to the investment allowance reserve account, would disentitle it from claiming the benefit of investment allowance, or to be subsequently granted an opportunity to create such a reserve, within the meaning of the *Explanation* to section 32A(4) in the year in which the said machines were purchased **[***CIT v. Sarvaraya Textiles Ltd*., (2011) 332 ITR 553 (AP)].

In *CIT v. Sir Shadilal Enterprises Ltd.* [(2005) 276 ITR 302 (All)], the Tribunal had recorded a categorical finding that there had been addition to the extent of Rs. 57,93,122 in the fixed assets under the head 'Plant and machinery' during assessment year 1988-89 which exceeded the amount standing in the investment allowance reserve. Thus, the amount in the investment allowance had been used for purchase of plant and machinery and the provisions of section 32A(5) were not attracted.

The conditions to apply section 32A(5) are : (1) the allowance in respect of the plant and machinery must have been enjoyed by an assessee in his income-tax assessment, (2) the self-same plant and machinery must have been sold or otherwise transferred by the assessee to any other person, and (3) such 'sale' or 'otherwise transfer' must have taken place before the expiry of eight years from the end of the previous year in which it was acquired or installed [*I.C.I. India Ltd. v. CIT*, (2011) 337 ITR 327 (Cal)].

Amalgamation and succession.—The provisions in **sections 32A(6) and 32A(7)** relate to continuance of investment allowance on amalgamation of companies or succession of a firm by a company (where all the shareholders of the company were partners of the firm immediately before the succession) without any break due to such amalgamation or succession.

Power to discontinue.—Section 32A(8) empowers the Central Government to discontinue the investment allowance, whenever it considers necessary or expedient so to do, by a notification issued, *at least three years*

prior to the intended date of discontinuance, in that behalf. The Finance Act, 1986 (23 of 1986), has omitted the words, etc., ', not being earlier than three years from the date of such notification,' from section 32A(8) with effect from 1-4-1986. As a result of such amendment, the power to discontinue can be exercised at any time.

As a matter of fact, in exercise of the power conferred by section 32A(8), the Central Government has directed that the deduction allowable under section 32A shall not be allowed in respect of any ship or aircraft acquired or any machinery or plant installed after 31-3-1987 [*vide Notification No. 870(E), dated 12-6-1986*]. But, see, section 32A(8B).

Power to amend Schedule XI.—Section 32A(8A) (operative from 1-4-1978) empowers the Central Government to omit any article or thing from the list of articles or things specified in Eleventh Schedule. Such power can be exercised by issuing a notification in the Official Gazette if the Central Government considers necessary or expedient so to do.

Principal points of distinction between development rebate allowance and investment allowance.—It is often said that the provisions for investment allowance *vis-a-vis* development rebate allowance are old wine in a new bottle. But it is not wholly true. It will, therefore, be of interest to note the principal points of distinction between the two allowances. They are as follows:—

(1) Aircraft has also been made eligible for grant of investment allowance. That was not so for development rebate allowance.

(2) While development rebate was allowable at varying rates [see, under section 33, *post.*] in respect of ships and machinery or plant in all industries, investment allowance is allowable at a uniform rate of 25% only in respect of certain specified industries [35% in connection with certain industries in respect of machinery and plant installed between 1-7-1977 and 31-3-1987 as also installed between 1-6-1983 and 31-3-1987].

(3) While conditions No. (*i*), (*ii*), (*iii*) and (*vi*) recorded under section 32A, *ante,* are equally applicable for both types of allowances, there are certain points of distinction with regard to conditions No. (*iv*) and (*v*) as above stated for the grant of investment allowance.

(4) With respect to condition No. (*iv*), it has been made clear in section 32A(4) that an assessee will not be required to create an investment allowance reserve during the year of installation of machinery or plant, etc., if there is no sufficient income in that year. The reserve may be created in the year thereafter when there is sufficient income.

(5) In case of breach of condition No. (*iv*), so far as investment allowance is concerned, there is a conditional concession as discussed under the heading *"Result of breach of conditions"*. In case of development rebate, there was no such statutory provision. However, the Board, in circular F. No. 10/49-65-IT(AI), dated 14-10-1965, provided for such concession in a modified form, which has again been reiterated in circular No. 189, dated 30-1-1976 [reproduced under section 34(3), *post.*].

(6) As regards condition No. (*v*), the important point of distinction is that the amount credited to the Investment Allowance Reserve Account is necessarily required to be ploughed back and utilised for acquiring, before the expiry of the period of ten years next following, another eligible asset. There was no such condition in respect of development rebate reserve which could have been distributed by way of profits or dividends after the expiry of eight years next following.

Questions of law.—(1) Whether the Tribunal was right in holding that the assessee-company was entitled to investment allowance [*CIT v. Hans Raj Gupta & Co.* (*P.*) *Ltd.,* (1990) 183 ITR 72 (Del)].

(2) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in upholding the order of the Commissioner of Income-tax (Appeals) who directed the Income-tax Officer to grant investment allowance without deducting the subsidy received from the Government from the cost of the assets [*CIT v. V. M. Salgaocar and Bros.* (*P.*) *Ltd.,* (1990) 185 ITR 469, 470-71 (Karn)].

(3) Whether, on the facts and in the circumstances of the case and in law, the subsidy of Rs. 57,956 sanctioned/received during the year in respect of machinery/generator installed in earlier years could be deducted from the cost of another machinery/generator of the value of Rs. 4,00,190 purchased and installed during the year for the purposes of allowance of investment allowance and whether short allowance of investment allowance was not illegal [*Saru Smelting Pvt. Ltd. v. CIT,* (1990) 185 ITR 621, 624 (All)].

(4) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the hotel run by the assessee was 'plant' entitled to depreciation at 15% and investment allowance [*CIT v. Damodar Corporation,* (1992) 193 ITR 272, 273 (Ker)].

LexisNexis

(5) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in allowing investment allowance of Rs. 35.83 lakhs on the ground that it had allowed the claim for the assessment year 1977-78 [*CIT v. Rajasthan Spinning and Wvg. Mills Ltd.,* (1993) 202 ITR 1012 (Raj)].

(6) Whether, on the facts and in the circumstances of the case, the assessee is entitled to investment allowance under section 32A [*CIT v. Popular Automobiles Ltd.,* (1995) 212 ITR 611, 613 (Ker)].

(7) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the investment allowance of Rs. 3,72,700 was wrongly disallowed by the ITO under section 32A [*CIT v. Modipon Ltd.,* (1995) 212 ITR 656, 659, 663 (Del)].

(8) Was the Tribunal right in holding that the assessee carrying on a hotel business was entitled to investment allowance under section 32A [*CIT v. Comfort Living Hotel* (*P.*) *Ltd.,* (1995) 216 ITR 72, 76 (Del)].

(9) Whether the Tribunal did not err in facts as well as in law in holding that the tractors are not road transport vehicles and also in allowing investment allowance on the tractors [*CIT v. Nandalal Parshuram,* (1995) 216 ITR 393, 394 (Gauh)]. Also see, *CIT v. Prakash Khandsari Udyog,* (1987) 163 ITR 710 (All).

(10) Whether in the circumstances of the case, the Tribunal was legally correct to hold that the assessee, who was running business of letting out on hire Kolhus, Karoos, was entitled to investment allowance [*CIT v. Jagat Narain Chandu Lal,* (1996) 217 ITR 491 (All)].

(11) Whether, on the facts and in the circumstances of the case, the assessee engaged in the processing and export of shrimps, is entitled to the benefit of investment allowance in respect of computer and ice plant [*CIT v. Poyilakada Fisheries* (*P.*) *Ltd.,* (1996) 221 ITR 692, 693 (Ker)].

(12) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee, engaged in mastication of rubber, was entitled to the claim of investment allowance and deduction under section 80-I [*CIT v. Midas Rubber* (*P.*) *Ltd.,* (1996) 222 ITR 314, 315 (Ker)].

(13) Whether, on the facts and in the circumstances of the case, the assessee is entitled for investment allowance when its activity is construction of roads [*CIT v. Mewara Construction,* (1997) 226 ITR 152, 154 (MP)]. In deciding such a question the Supreme Court ruling in *CIT v. N.C. Budharaja & Co.* [(1993) 204 ITR 412 (SC)] is apposite.

(14) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was eligible for investment allowance under section 32A and to the deduction under section 80-I in regard to its new industrial unit set up at Chandigarh, *i.e.,* spirit bottling plant [*CIT v. Mount Shivalik Breweries Ltd.,* (1997) 228 ITR 414, 417 (Punj)].

(15) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that assessee was entitled for investment allowance under section 32A(8B) amounting to Rs. 36,18,035 on the new solvent extraction plant for assessment year 1989-90 [*CIT v. Vippy Solvex Products Ltd.,* (1997) 139 Taxation 520, 523 (MP)].

Also see, *CIT v. National Asphalt Products & Construction Co.,* (1992) 107 CTR (Bom) 112.

However, in *CIT v. Continental Devices India Ltd.* [(1992) 196 ITR 571, 573 (Del)], it has been held that the question whether the air-conditioning plant was entitled to investment allowance was a question of fact, since, for the subsequent assessment year, the Assessing Officer had accepted that investment allowance was allowable on the air-conditioning plant used in the factory.

For **questions of law**, reference may also be made to: (1) *CIT v. Mahaveer Drilling Co.* [(2000) 241 ITR 733, 734 (MP)]; (2) *CIT v. Bhooratnam & Co.* [(2000) 245 ITR 5, 6 (SC), **reversing** *CIT v. Bhooratnam & Co.,* (1999) 238 ITR 674 (AP)]; (3) *CIT v. Modinagar Paper Mills Ltd.* [(2000) 245 ITR 652, 656 (All)]; (4) *CIT v. Venkateswara Hatcheries* (*P.*) *Ltd.* [(2001) 247 ITR 273, 274 (SC)]; (5) *CIT v. Mysore Minerals Ltd.* [(2001) 247 ITR 301, 302 (SC)]; (6) *CIT v. E. Merck Service & Agencies* [(2001) 248 ITR 10, 11, 12 (SC)].

The question whether the Tribunal was correct in law in holding that a diagnostic centre is an industrial undertaking and, therefore, entitled to investment allowance and deduction under section 80-I, has been held to be a question of law [*CIT v. Radhika Sanghi,* (2004) 187 CTR (Del) 559, 560].

Where the Tribunal has merely remanded the matter without recording any finding whether the claim of the assessee for investment allowance was allowable or not, no question of law made out for reference [*CIT v. Hansa Cine Equipments,* (2000) 245 ITR 676, 677 (Mad)].

Remand to the AO.—Where the matter has not been examined with reference to the question whether the plant or machinery installed for which the investment allowance had been claimed were used in the manufacture of other goods or articles, the matter has been remanded to the Assessing Officer for fresh consideration and examination of the assessee's claim after giving due opportunity to the assessee and after scrutinising the material produced [*CIT v. K.S. Venkataraman & Co.,* (2000) 243 ITR 377, 382 (Mad)].

Where the Assessing Officer has disallowed a part of the investment allowance without allowing any opportunity to the assessee to create further reserve so as to make up the deficiency, the Tribunal was held justified in remitting the matter back to the AO to afford the opportunity to the assessee as provided in the *Explanation* to section 32A(4) [*CIT v. G.N.B Motors Ltd.,* (1999) 156 CTR (Cal) 280, 281-82].

In *CIT v. Tamil Nadu Minerals Ltd.* [(2005) 274 ITR 482 (Mad)], in the absence of any factual finding on the question, *viz.*, the activities of the assessee, the question could not be answered. If the assessee had done something more then the assessee had to establish the same before the Tribunal and for such reason, matter been remitted for deciding the same afresh.

What was required was that the industrial undertaking must be engaged in bringing into existence articles or things by a process of manufacture, and if these tests are met, an industrial undertaking can be recognised as being in existence. As in the instant case, the same had not been examined with reference to the question as to whether the plant or machinery installed for which the investment allowance had been claimed was used in the manufacture of other goods or articles, it was only proper that the matter be remitted to the AO for fresh consideration [*CIT v. Aicam Engineering P. Ltd.*, (2005) 274 ITR 521 (Mad)].

The matter has been remanded to the Assessing Officer to give opportunity to the assessee to produce relevant evidence since the assessee had not led evidence before the Assessing Officer as to the exact nature of activities undertaken by it in the course of mining, polishing and export of granites [*Vijay Granites P. Ltd. v. CIT*, (2012) 349 ITR 350 (SC)]. Also see, *CIT v. Vijay Granites Pvt. Ltd.*, (2013) 351 ITR 247 (Mad).

Reference may also be made to *CIT v. Tamil Nadu Minerals Ltd.* [(2005) 274 ITR 482 (Mad)]; *Titanium Equipment & Anode Manufacturing Co. Ltd. v. Deputy CIT* [(2005) 278 ITR 565 (Mad)]; *Deputy CIT v. Surat Electricity Co. Ltd.* [(2011) 337 ITR 271 (Guj)].

Remand to the Tribunal.—In *CIT v. Machinery Manufacturing Corporation Ltd.* [(1992) 198 ITR 559, 567 (Cal)], on the question whether electrification machinery is plant within the meaning of section 32A and whether such machinery is eligible for investment allowance, the matter was remanded to the Tribunal for decision whether, having regard to the nature and function of the electrification machinery installed, such machinery could be termed as plant.

In the facts of *CIT v. Black Diamond Beverages Ltd.* [(1993) 201 ITR 48, 52 (Cal)], the matter was remanded to the Tribunal to go into the nature of the assessee's product to ascertain whether by 'manufacture out of the synthetics' means that the product involved the use of synthetic essences. It was further held that the *Explanation* below item No. 5 of the Eleventh Schedule to the 1961 Act, though inserted by the Finance Act, 1987 (11 of 1987), with effect from 1-4-1988, has to be taken to be only clarificatory in nature and should be referable for the purpose of resolving any doubt arising over the meaning and import of item No. 5 in the Eleventh Schedule, for assessment year 1981-82.

In the facts of *CIT v. Polyclinic P. Ltd.* [(1994) 207 ITR 185 (Ker)], the Tribunal, without considering the specific provisions of law, took the view that X-ray plant was eligible for investment allowance following a decision of the Special Bench of the Tribunal in another case decided with reference to the provisions of section 32A(2)(*b*)(*ii*) whereas the question referred in the instant case made reference to section 32A(2)(*b*)(*iii*). In these circumstances, the matter was remanded to the Tribunal to decide the same afresh by pointedly referring to the particular provision of law applicable in the instant case and decide whether and to what extent the decision of the Special Bench is applicable.

In the facts of *CIT v. Aspinwall & Co. Ltd.* [(1994) 207 ITR 353, 363 (Ker)], it has been held that the Tribunal simply followed the decision of the Bangalore Bench of the Tribunal without going into the details as to whether any manufacturing process or activity was involved in the assessee's activity of curing coffee and without entering a finding on that aspect. Therefore, the matter was remanded to the Tribunal to be decided in accordance with law.

In the facts of *CIT v. Western Bengal Coal Fields Ltd.* [(1994) 208 ITR 981, 984-85 (Cal)], the Tribunal directed allowance of investment allowance in respect of machinery used for boring operations, **following** Andhra Pradesh decision in *CIT v. Super Drillers* [(1988) 174 ITR 640 (AP)], without looking into the purpose of extracting water. The matter was remanded to the Tribunal with the direction to ascertain the purpose of boring and drawing water from underground after allowing the parties to lead evidence if they so desire.

In the facts of *Union Carbide India Ltd. v. CIT* [(1995) 80 Taxman 197, 207 (Cal)], the matter has been remanded to the Tribunal as the Tribunal has not given a specific finding as to the correctness of the argument that the internal telephone system has been installed in the factory premises of the assessee-company substantially and essentially for efficient organisation of manufacturing process.

Where the assessee is engaged in building activity of civil construction as well as industrial establishment of industries for production and manufacture but the questions have been referred without making any distinction in that regard, the matter has been remanded to the Tribunal to be disposed of in the light of the Supreme Court

LexisNexis

ruling in *CIT v. N.C. Budharaja & Co.,* (1993) 204 ITR 412 (SC) [*CIT v. Bakhtawar Singh,* (1997) 228 ITR 614, 616 (MP)].

In the following cases, the **matter has been remanded to the Tribunal**:

(1) *CIT v. Universal Electrics Ltd.,* (1998) 232 ITR 79, 80 (Cal) [with a direction to ascertain the purpose of boring and drawing water from underground and also to allow the parties to lead evidence in deciding the question afresh].

(2) *CIT v. Rensult Investment & Finance P. Ltd.,* (1998) 233 ITR 172, 177-78 (Bom) [where there was nothing to show the nature of financing and leasing—whether it was a case of hiring simpliciter or leasing simpliciter or hire purchase or any other form of transfer, the remand has been made to the Tribunal to decide the controversy afresh in the light of the Supreme Court decision in *CIT v. Shaan Finance* (*P.*) *Ltd.* : (1998) 231 ITR 308 (SC)].

(3) *CIT v. Bakhtawarsingh Balkishan Bhilai,* (1998) 234 ITR 652, 653 (MP) [for considering whether the activities, other than construction work, amounted to manufacturing activity or not]. Also see, *CIT v. Bhagat Construction Co.,* (2002) 253 ITR 177, 179 (Del).

(4) *CIT v. Harisons Malayalam Ltd.,* (2000) 245 ITR 126, 128-29 (Ker) [where the Tribunal has disposed of the matter without discussing the factual aspect of the case, the matter has been remanded to the Tribunal for examining the factual aspect and recording its conclusion about the entitlement or otherwise of the assessee].

(5) *CIT v. Prudential Management & Services Pvt. Ltd.,* (2001) 250 ITR 136, 137-38 (Bom) [the matter has been remanded to the Tribunal to consider the same in the light of *CIT v. R. Shroff Consultants P. Ltd.* : (1999) 238 ITR 1018 (Bom) so as to ascertain whether the assessee-company which was in the business of data processing could be said to have been engaged in the manufacture of articles or things with the help of the computer].

(6) *M.S. Kold Hold Industries Pvt. Ltd. v. CIT,* (2002) 255 ITR 96, 97 (Del) [where the Tribunal has rejected the claim of the assessee as to investment allowance by a non-speaking order that the activity of deboning the meat and selling it as keema, etc., does not entitle the assessee to claim investment allowance, the matter has been remanded to the Tribunal for considering the basic issue whether there was any manufacturing or processing involved in the conversion of carcass into commercially marketable meat].

(7) *CIT v. Oswal Woollen Mills Ltd.,* (2002) 257 ITR 737, 745-46 (Punj) [where the Tribunal has neither recorded any findings as to the details of the electrical installation nor a finding that such items were not to hit by the exceptions enacted in the second proviso to section 32A(1), the matter has been remanded to the Tribunal for a fresh adjudication in the light of the observations made in this judgment]. A similar course has been adopted in *CIT v. Oswal Woollen Mills Ltd.* [(2002) 257 ITR 781, 783 (Punj)].

(8) *CIT v. Coromandel Engineering Co. Ltd.,* (2002) 257 ITR 792, 795 (Mad) [where there was no finding on the question whether the assessee, engaged in construction business, was using material manufactured by it, the matter has been remanded to the Tribunal to decide the same on merits]. Similar course has been adopted in *CIT v. Hydle Constructions Pvt. Ltd.* [(2003) 259 ITR 344, 373 (Del)].

(9) *CIT v. Tarapore & Co.,* (2003) 264 ITR 61, 64 (Mad) [as there was nothing in the order of the Tribunal to show the basis on which the Tribunal came to the conclusion that the assessee, who employed plant and machinery in construction work, was entitled to investment allowance].

(10) *CIT v. R.G. Ispat Ltd.,* (2004) 266 ITR 327, 329 (Raj)

(11) *CIT v. R.G. Ispat Ltd.*, (2005) 272 ITR 383, 384 (Raj) [the High Court remitted back the matter to the Tribunal with the direction to give required finding for the purpose of investment allowance whether the entire building or part of building is eligible for investment allowance]

Reference may also be made to *CIT v. Gujarat Siddhi Cement Ltd.* [(2008) 307 ITR 393 (SC)].

Departmental circulars.—The following departmental circulars are relevant to section 32A:—

I. *'Investment allowance—Creation of reserve—Clarifications regarding—Section 32A of the Income-tax Act.*—**1.** Attention is invited to Board's Circular No. 259, dated July 11, 1979, regarding the creation of statutory reserve under section 34(3)(*a*) in connection with the claim of development rebate under section 33 of the Income-tax Act. It was stated in the circular referred to above that the condition for creation of the requisite

LexisNexis

reserve would stand satisfied if the sum total of the reserves created either in the year of installation or use or in the subsequent year or years is equal to the requisite amount of 75 per cent. of the actual allowances of development rebate in any subsequent year or years.

2. The Board have since received representations that similar instructions may be issued in regard to the reserve required to be created in respect of claims of investment allowance under section 32A which has been substituted for development rebate allowance with effect from April 1, 1976.

3. Investment allowance is admissible in accordance with the provisions of section 32A in respect of the year of installation of the machinery or plant or in the immediately succeeding year if the machinery or plant is put to use in that year. The allowance is, however, granted subject to the creation of a reserve equal to 75 per cent. of the amount actually to be allowed which should be debited to the profit and loss account of the year[33]. It has further been provided in section 32A(3) that only so much of the investment allowance is to be allowed in any year as is sufficient to reduce the total income to nil and the balance of investment allowance has to be carried forward to the following assessment year and so on up to eight assessment years. Thus, in so far as the above matters are concerned, the provisions relating to the grant of investment allowance are in *pari materia* with the provisions governing the grant of development rebate. In view of the legal position stated above, it has been decided by the Board that the contents of Circular No. 259, dated July 11, 1979, referred to above may be followed while considering the adequacy of the reserve created in respect of the grant of investment allowance also.

4. Attention is also invited to the provisions of sub-section (9)[34] of section 32A which is reproduced below and which is quite relevant for the purpose of determining the amount of reserve to be created as it gives the assessee an option to create reserve for the full amount admissible under section 32A:

> "(9) For the removal of doubts, it is hereby declared that the deduction under sub-section (1) shall 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 investment allowance reserve account exceeds the amount of the profit of such previous year (as arrived at without making the debit aforesaid), in accordance with the profit and loss account.".

5. The above instructions may please be brought to the notice of all the officers working in your charge.' [*Circular No. 305, dated June 12, 1981*].

II. *'Depreciation—Initial depreciation under section 32(1)(vi) and investment allowance under section 32A of the Income-tax Act, 1961—Definition of "small scale industrial undertaking"—Clarification regarding.—* Section 32A was introduced by the Finance Act, 1976, to allow investment allowance, inter alia, in respect of new machinery or plant installed after the 31st March, 1976, in a "small scale industrial undertaking" for the purposes of business of manufacture or production of any article or thing.

2. The term "small scale industrial undertaking" has been defined[35] in *Explanation (2)* to section 32A(2) as an industrial undertaking, the aggregate value of whose machinery and plant (other than tools, jigs, dies and moulds) installed as on the last day of the previous year does not exceed Rs. 10 lakhs (in cases where the previous year ends after 31-7-1980—Rs. 20 lakhs). A question has been raised whether the term "machinery & plant" used in this *Explanation* includes all machinery and plant to arrive at the monetary ceiling or whether the ceiling should be determined according to the norms laid down by the Department of Industries in this regard. According to the Department of Industries, the cost of generating sets and of extra transformers, etc., which have to be installed by the assessee as required by the State Electricity Boards will be excluded.

3. The question has been considered in consultation with the Ministry of Law. There is no express or implied legislative intendment disclosed in *Explanation (2)* to section 32A(2) read with section 43(3) of the Income-tax Act, which would permit exclusion of any items other than tools, jigs, dies and moulds from the value of plant and machinery. The norms laid down by the Department of Industries, unless legally incorporated in the Income-tax Act, cannot be invoked for the purpose of excluding additional items like generating sets, transformers, etc. All items of plant and machinery as on the last day of the relevant previous year other than tools, jigs, dies and moulds are, therefore, to be taken into consideration and their aggregate value will be computed for the purpose of ascertaining whether the assessee is a "small scale industrial undertaking".

4. The above clarification will apply, mutatis mutandis, in the case of "initial depreciation" under section 32(1)(*vi*)[36]. However, the definition of "small scale industrial undertaking" for the purpose of initial depreciation given in *Explanation (3)* to section 32(1)(*vi*) is slightly different from that given for the purpose of investment

---

33. Now, reference may be made to the amendment made by the Finance Act, 1990, with retrospective effect from 1st April, 1976.

34. Section 32A(9) corresponds to the *Explanation* to section 34(3)(*a*). Now, section 32A(9) omitted by the Finance Act, 1990, with retrospective effect from 1st April, 1976.

35. *Explanation (2)* has subsequently been amended by the Finance Act, 1986, with retrospective effect from 1-4-1985.

36. Section 32(1) (*vi*) has subsequently been omitted by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), with effect from 1-4- 1988.

allowance inasmuch as the cost of tools, jigs, dies and moulds is not to be excluded in arriving at the monetary ceiling of the value of plant and machinery.

5. The above instructions may please be brought to the notice of all the Income-tax Officers working in your charge.' [*Circular No. 314, dated 17th September, 1981*].

III. *'Investment allowance under section 32A—Tea companies—Creation of reserve.*—Attention is invited to the provisions of section 32A of the Income-tax Act, 1961, which provide for the grant of investment allowance in respect of new machinery and plant installed, *inter alia*, for the purposes of construction, manufacture or production of articles or things not included in Schedule XI to the Income-tax Act. The allowance which is equal to 25 per cent. of the cost of the machinery and plant is permissible in the year of installation or the immediately succeeding year, if put to use in that year, if certain conditions are fulfilled. One such condition prescribed under section 32A(4)(*ii*) is that an amount equal to 75 per cent. of the amount to be actually allowed as investment allowance is debited to the profit and loss account of the previous year in respect of which deduction is to be allowed[37], and credited to a reserve account.

2. A clarification has been sought form the Board regarding the manner in which the amount to be credited to the investment allowance reserve account should be determined in the case of tea companies in whose cases only 40 per cent. of the income is liable to income-tax. A similar question was examined by the Board in the past with regard to the quantum of reserve to be created for the grant of development rebate in respect of new machinery and plant installed by tea companies. It was clarified by the Board's Circular letter F. No. 1(8)-58-PL, dated 1st November, 1958, that in the case of a tea company, it would be sufficient compliance if the tea company created a reserve equal to 75 per cent. of the amount of development rebate actually allowed in the assessment of the tea company.

3. Since the conditions regarding the creation of reserve for the grant of investment allowance under section 32A are identical to those prescribed with regard to the creation of reserve for claiming the grant of development rebate, it is clarified that the reserve required to be created for claiming investment allowance should be calculated at 75 per cent. of the amount which is actually allowed by way of investment allowance, *i.e.,* 75 per cent. of 40 per cent. of the investment allowance debited to the profit and loss account.

4. This clarification may please be brought to the notice of all officers in your charge.' [*Circular No. 324, dated 3rd February, 1982*].

LexisNexis

37. Now, reference may be made to the amendment made by the Finance Act, 1990, with retrospective effect from 1st April, 1976.

Omitted/Phased-out provisions of section 32AB of the 1961 Act

[1][**S. 32AB. Investment deposit account.—**](1) Subject to the other provisions of this section, where an assessee, whose total income includes income chargeable to tax under the head "Profits and gains of business or profession", has, out of such income,—

(*a*) deposited any amount in an account (hereafter in this section referred to as deposit account) maintained by him with the Development Bank before the expiry of six months from the end of the previous year or before furnishing the return of his income, whichever is earlier; or

(*b*) utilised any amount during the previous year for the purchase of any new ship, new aircraft, new machinery or plant, without depositing any amount in the deposit account under clause (*a*),

in accordance with, and for the purposes specified in, a scheme (hereafter in this section referred to as the scheme) to be framed by the Central Government, or if the assessee is carrying on the business of growing and manufacturing tea in India, to be approved in this behalf by the Tea Board, the assessee shall be allowed a [2][deduction (such deduction being allowed before the loss, if any, brought forward from earlier years is set off under section 72) of]—

(*i*) a sum equal to the amount, or the aggregate of the amounts, so deposited and any amount so utilised; or

(*ii*) a sum equal to twenty per cent of the profits of [3][*] business or profession as computed in the accounts of the assessee audited in accordance with sub-section (5),

whichever is less:

[4][*Provided* that where such assessee is a firm, or any association of persons or any body of individuals, the deduction under this section shall not be allowed in the computation of the income of any partner, or as the case may be, any member of such firm, association of persons or body of individuals:]

[5][*Provided further* that no such deduction shall be allowed in relation to the assessment year commencing on the 1st day of April, 1991, or any subsequent assessment year.]

(2) For the purposes of this section,—

[6][(*i*) * * * * ;]

[7][(*ii*) "new ship" or "new aircraft" includes a ship or aircraft which before the date of acquisition by the assessee was used by any other person, if it was not at any time previous to the date of such acquisition owned by any person resident in India;

(*iii*) "new machinery or plant" includes machinery or plant which before its installation by the assessee was used outside India by any other person, if the following conditions are fulfilled, namely:—

(*a*) such machinery or plant was not, at any time previous to the date of such installation by the assessee, used in India;

(*b*) such machinery or plant is imported into India from any country outside India; and

(*c*) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under this Act in computing the total income of any

LexisNexis

---

1. Section 32AB has been inserted by the Finance Act, 1986 (23 of 1986), s. 8 (w. e. f. 1-4-1987).

2. Subs., for "deduction of", by the Finance Act, 1987 (11 of 1987), s. 7(*a*)(*i*) (w. e. f. 1-4-1987).

3. The word "eligible" has been omitted by the Finance Act, 1989 (13 of 1989), s. 7(*a*) (w. e. f. 1-4-1991).

4. Ins. by Act 11 of 1987, s. 7(*a*)(*ii*) (w. e. f. 1-4-1987).

5. Ins. by the Finance Act, 1990 (12 of 1990), s. 8 (w. e. f. 1-4-1990).

6. Clause (*i*) of section 32AB(2) has been omitted by Act 13 of 1989, s. 7(*b*) (w. e. f. 1-4-1991). Prior to its omission, clause (*i*) stood as follows:—

'(*i*) "eligible business or profession" shall mean business or profession, other than—

(*a*) the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule carried on by an industrial undertaking, which is not a small-scale industrial undertaking as defined in section 80HHA;

(*b*) the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small-scale industrial undertaking as defined in section 80HHA, engaged in the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule;'.

7. Clauses (*ii*), (*iii*) and (*iv*) have been substituted by Act 11 of 1987, s. 7(*b*) (w. e. f. 1-4-1987), for the following:—

'(*ii*) "new ship" or "new aircraft" or "new machinery or plant" shall have the same meanings as in the *Explanation* to clause (*vi*) of sub-section (1) of section 32.'.

person for any period prior to the date of the installation of the machinery or plant by the assessee;

(*iv*) "Tea Board" means the Tea Board established under section 4 of the Tea Act, 1953 (29 of 1953).]

(3) [8][The profits of business or profession of an assessee for the purposes of sub-section (1) shall be an amount arrived at after deducting an amount equal to the depreciation computed in accordance with the provisions of sub-section (1) of section 32 from the amounts of profits computed in accordance with the requirements of Parts II and III of the [9][Schedule VI] to the Companies Act, 1956 (1 of 1956)[10] (1 of 1956), [11][as increased by the aggregate of—

(*i*) the amount of depreciation;

(*ii*) the amount of income-tax paid or payable, and provision therefor;

(*iii*) the amount of surtax paid or payable under the Companies (Profits) Surtax Act, 1964 (7 of 1964);

(*iv*) the amounts carried to any reserves, by whatever name called;

(*v*) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities;

(*vi*) the amount by way of provision for losses of subsidiary companies; and

(*vii*) the amount or amounts of dividends paid or proposed,

if any debited to the profit and loss account; and as reduced by any amount or amounts withdrawn from reserves or provisions, if such amounts are credited to the profit and loss account; [12][*]]

[13][(*b*) * * * *]

(4) No deduction under sub-section (1) shall be allowed in respect of any amount utilised for the purchase of—

(*a*) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;

(*b*) any office appliances (not being computers);

(*c*) any road transport vehicles;

(*d*) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year;

[14][(*e*) any new machinery or plant to be installed in an industrial undertaking, other than a small-scale industrial undertaking, as defined in section 80HHA, for the purposes of business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.]

(5) The deduction under sub-section (1) shall not be admissible unless the accounts of the business or profession of the assessee for the previous year relevant to the assessment year for which the deduction is claimed have been audited by an accountant as defined in the *Explanation* below sub-section (2) of section 288 [15][before the specified date referred to in section 44AB and the assessee furnishes by that date] the report of such audit in the prescribed form duly signed and verified by such accountant:

Provided that in a case where the assessee is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this sub-section if such assessee gets the accounts of such

LexisNexis

---

8. Subs. by Act 13 of 1989, s. 7(*c*)(*i*) (w. e. f. 1-4-1991), for the following:—
"The profits of eligible business or profession of an assessee for the purposes of sub-section (1) shall,—
(*a*) in a case where separate accounts in respect of such eligible business or profession are maintained,".

9. Subs., for "Sixth Schedule", by Act 13 of 1989, s. 7(*c*)(*ii*)(1) (w. e. f. 1-4-1991).

10. Repealed and replaced by Act 18 of 2013.

11. Subs., for "as increased by an amount equal to the depreciation, if any, debited in the audited profit and loss account; and", by Act 11 of 1987, s. 7(*c*) (w. e. f. 1-4-1987).

12. The word "and" has been omitted by Act, 13 of 1989, s. 7(*c*)(*ii*)(2) (w. e. f. 1-4-1991).

13. Omitted by Act 13 of 1989, s. 7(*c*)(*iii*) (w. e. f. 1-4-1991). Prior to its omission, clause (*b*) stood as follows:—
'(*b*) in a case where such separate accounts are not maintained or are not available, be such amount which bears to the total profits of the business or profession of the assessee after allowing depreciation in accordance with the provisions of sub-section (1) of section 32, the same proportion as the total sales, turnover or gross receipts of the eligible business or profession bear to the total sales, turnover or gross receipts of the business or profession carried on by the assessee.'.

14. Ins. by Act 13 of 1989, s. 7(*d*) (w. e. f. 1-4-1991).

15. Subs., for "and the assessee furnishes, along with his return of income,", by the Finance Act, 2020 (12 of 2020), s. 14 (w. e. f. 1-4-2020).

business or profession audited under such law and furnishes the report of the audit as required under such other law and a further report in the form prescribed under this sub-section.

[16][(5A) Any amount standing to the credit of the assessee in the deposit account shall not be allowed to be withdrawn before the expiry of a period of five years from the date of deposit except for the purposes specified in the [17][scheme or] in the circumstances specified below:—

(*a*) closure of business;

(*b*) death of an assessee;

(*c*) partition of a Hindu undivided family;

(*d*) dissolution of a firm;

(*e*) liquidation of a company.]

[18][*Explanation.*—For the removal of doubts, it is hereby declared that nothing contained in this sub-section shall affect the operation of the provisions of sub-section (5AA) or sub-section (6) in relation to any withdrawals made from the deposit account either before or after the expiry of a period of five years from the date of deposit.]

[19][(5AA) Where any amount, standing to the credit of the assessee in the deposit account, is withdrawn during any previous year by the assessee in the circumstance specified in clause (*a*) or clause (*d*) of sub-section (5A), the whole of such amount shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year, as if the business had not closed or, as the case may be, the firm had not been dissolved.]

[20][(5B) Where any amount standing to the credit of the assessee in the deposit account is utilised by the assessee for the purposes of any expenditure in connection with the [21][*] business or profession in accordance with the scheme, such expenditure shall not be allowed in computing the income chargeable under the head "Profits and gains of business or profession".]

(6) Where any amount, standing to the credit of the assessee in the deposits account, released during any previous year by the Development Bank for being utilised by the assessee for the purposes specified in the scheme or at the closure of the account [22][[in circumstances other than the circumstances specified in clauses (*b*), (*c*) and (*e*) of sub-section (5A)]], [23][is not utilised in accordance with, and within the time specified in, the scheme], either wholly or in part, [24][* * * *] the whole of such amount or, as the case may be, part thereof which is not so utilised shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(7) Where any asset acquired in accordance with the scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired, such part of the cost of such asset as is relatable to the deductions allowed under sub-section (1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year:

Provided that nothing in this sub-section shall apply—

(*i*) where the asset is sold or otherwise transferred by the assessee to Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[25]; or

(*ii*) where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme continues to apply to the company in the manner applicable to the firm.

Explanation.—The provisions of clause (*ii*) of the proviso shall apply only where—

---

16. Sub-section (5A) has been inserted by Act 11 of 1987, s. 7(*d*) (w. e. f. 1-4-1987).
17. Subs., for "scheme and", by Act 13 of 1989, s. 7(*e*)(*i*) (with retrospective effect from 1-4-1987).
18. Ins. by Act 13 of 1989, s. 7(*e*)(*ii*) (with retrospective effect from 1-4-1987).
19. Sub-section (5AA) has been inserted by Act 13 of 1989, s. 7(*f*) (with retrospective effect from 1-4-1987).
20. Sub-section (5B) has been inserted by Act 11 of 1987, s. 7(*d*) (w. e. f. 1-4-1987).
21. The word "eligible" has been omitted by Act 13 of 1989, s. 7(*g*) (w. e. f. 1-4-1991).
22. Ins. by Act 13 of 1989, s. 7(*h*) (with retrospective effect from 1-4-1987).
23. Subs., for "is not utilised in accordance with the scheme", by Act 11 of 1987, s. 7(*e*)(*i*) (w. e. f. 1-4-1987).
24. The words "within that previous year," have been omitted by Act 11 of 1987, s. 7(*e*)(*ii*) (w. e. f. 1-4-1987).
25. Repealed and replaced by Act 18 of 2013.

LexisNexis

(*i*) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;

(*ii*) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

(*iii*) all the shareholders of the company were partners of the firm immediately before the succession.

(8) The Central Government may, if it considers it necessary or expedient so to do, by notification in the Official Gazette, omit any article or thing from the list of articles or things specified in the Eleventh Schedule.

(9) The Central Government may, after making such inquiry as it may think fit, direct, by notification in the Official Gazette, that the provisions of this section shall not apply to any class of assessees, with effect from such date as it may specify in the notification.

[26][(10) Where a deduction has been allowed to an assessee under this section in any assessment year, no deduction shall be allowed to the assessee under sub-section (1) of section 32A in the said assessment year (hereinafter referred to as the initial assessment year) and a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year.]

Explanation.—In this section,—

(*a*) "computers" does not include calculating machines and calculating devices;

(*b*) "Development Bank" means—

(*i*) in the case of an assessee carrying on business of growing and manufacturing tea in India, the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agricultural and Rural Development Act, 1981 (61 of 1981);

(*ii*) in the case of other assessees, the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964), and includes such bank or institution as may be specified in the scheme in this behalf.]

LexisNexis

Introduction under 1961 Act.—*The Finance Act, 1986*.—By **the Finance Act, 1986** (23 of 1986), **section 32AB** has been **inserted** (**w. e. f. 1-4-1987**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 461, dated 9-7-1986*, as follows:—

'(*viii*) *Substitution of the provisions relating to investment allowance by an investment deposit account scheme.*—**17.1** The 1985-86 Budget had initiated a process of reform of the corporation tax. It had been announced that the scope for further reform would be examined, along two alternative lines as follows:—

(*i*) A further reduction in the rate of tax by 5 per cent. for the next year and withdrawal of surcharge and surtax in the third year along with withdrawal of the investment allowance in the phased manner; or

(*ii*) retention of the investment allowance with no further cut in rates.

17.2 An open debate was invited on the relative merits of these alternatives before taking any decision. On a consideration of the related issues, the surcharge on the companies has been abolished with immediate effect and it has not been postponed to the third year, as envisaged earlier as per para. 5.12 of the LTFP. Keeping in view the interest of revenue, the surtax has been discontinued with effect from the assessment year 1988-89. The scheme of investment allowance has been replaced by a new scheme of investment deposit account.

17.3 One of the reasons for our having a high capital output ratio in the industry is that the tax concessions have so far favoured investment in assets per se rather than output generated from those assets. By the new scheme relating to investment deposit account along with the proposed high depreciation rates announced by the Finance Minister, the retained earnings and internal resources generation of the companies would improve. As mentioned in paras. 5.12 to 5.18 of the LTFP, the investment allowance had tended to favour the larger and more established enterprises, partly because such concerns could set off investment allowance against profits of old established units without waiting for profits from fresh investments. The new scheme of investment deposit account will be neutral as between small and large companies and will also insulate the timing of investment decisions from tax considerations. This measure should help to reduce the premium on spending which taxation of business profit inevitably creates, and thus curb the conspicuous extravagance in

---

26. Subs. by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989), s. 7 (w. e. f. 1-4-1989), for the following:—
'(10) No deduction shall be allowed under this section in the case of an assessee who has claimed the deduction allowable under section 33AB.'.

the corporate sector. The new scheme should also help to neutralise the bias in favour of borrowing and needless capacity creation.

The new scheme differs from the existing provisions of investment allowance as follows:—

(*a*) The existing provisions of the investment allowance apply to only those assessee—

(*i*) who purchase a ship or aircraft, which is first put to use in the business of the assessee; or

(*ii*) who install new machinery or plant in an industrial undertaking for the purposes only of business of construction, manufacture or production of any article or thing not specified in the Eleventh Schedule to the Income-tax Act.

In the case of small scale industrial undertaking, this benefit is not denied even if such an undertaking produces a non-priority item listed in the Eleventh Schedule, like alcoholic spirits, tobacco preparations, cosmetics, etc.

The new scheme is applicable to all existing types of assessees as also to the professionals and the leasing companies which have not leased out machinery to those industrial undertakings, other than a small scale industrial undertaking, engaged in the manufacture or production of articles or things listed in the Eleventh Schedule to the Income-tax Act. In other words, the deduction is admissible to all the assessees who carry on "eligible business or profession", which as per section 32AB(2) means business or profession other than the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule (in case it is not a small scale industrial undertaking) and the business of leasing or hiring of machinery or plant to an industrial undertaking other than a small scale industrial undertaking engaged in the business of low priority items as specified in the list in the Eleventh Schedule. It may be clarified that the business of construction is an eligible business for the purposes of this provision.

(*b*) In order to encourage a more productive use of capital leading to a low-cost economy, the benefits under the new investment deposit scheme shall be available only if there are profits in the eligible business or profession whereas the benefit of investment allowance is available even if there is no such profit, because the deduction is linked merely to the cost of the plant and machinery.

(*c*) The acquisition of a ship or an aircraft or installation of plant and machinery, as the case may be, during the previous year is a condition precedent for availing of the benefit of the existing investment allowance, whereas the deduction under the new provisions can be availed of even before the ship or aircraft is acquired or the plant or machinery has been installed by making a deposit with the designated Development Bank.

(*d*) The investment allowance is allowed at 25 per cent. of the actual cost of the plant, machinery, ship or aircraft to the assessee. As against this, under the new scheme, the entire cost of the ship or aircraft or plant or machinery will qualify for deduction, if the same is up to 20 per cent. of the profits of the eligible business or profession.

(*e*) Under the new provisions, the deduction is not admissible unless the accounts of the business or profession of the assessee, other than a company or a co-operative society, have been audited by an accountant and the assessee furnishes along with the return of his income, the report of such audit in the prescribed form, duly signed and verified by such an accountant. No such audit is required as a condition for availing of the benefit of the existing investment allowance.

(*f*) Subject to the fulfilment of the required conditions, the benefit of investment allowance continues to be available if the sale or transfer of a ship or an aircraft or plant or machinery is made as per a scheme of amalgamation. Such deduction is not provided in the new scheme, because in the Indian context, amalgamations usually arise infrequently and that too only to take care of losing concerns or as a device for tax planning.

17.4 The other salient features of the scheme of the investment deposit account are as follows:

(*a*) Under section 32AB(1), it has been provided that deposits with the Development Bank or the purchase of a new ship, new aircraft, new machinery or plant should be out of income chargeable to tax under the head "Profits and gains of business or profession". However, for arriving at the book profit, a uniform system of accounting is yet to be enforced even in the organised sector. Hence, the term "profit of eligible business or profession" has been defined as per section 32AB(3) in order to ensure uniformity in determining the profits qualifying for deduction, as also to reduce uncertainty about the interpretation of this term. In terms of section 32AB(3)(*a*), it has been provided that the profits of eligible business or profession for the purposes of deduction under these provisions will mean, in a case where separate accounts in respect of such business or profession are maintained, an amount arrived at after deducting an amount equal to the depreciation computed in accordance with the provision of section 32(1) of the Income-tax Act from the amount of profits computed in

LexisNexis

accordance with the requirements of Parts II and III of the Sixth Schedule to the Companies Act, 1956 (1 of 1956), [as increased by an amount equal to the depreciation, if any, debited in the audited profit and loss account]. This implies that the profit has to be computed, taking into account only the depreciation for the current year, as admissible under the Income-tax Act. Further, Part II of the Sixth Schedule to the Companies Act lays down the requirements as to profit and loss account. These requirements, as per the provisions of section 32AB(3) of the Income-tax Act, will be applicable in the cases of corporate as well as non-corporate assessees.

17.5 The requirements as per Part II of the Sixth Schedule to the Companies Act, include the following:—

(*i*) The profit and loss account shall be so made out as clearly to disclose the result of the working of the company during the period covered by the account and shall disclose every material feature, including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of exceptional nature.

(*ii*) The profit and loss account shall set out the various items relating to the income and expenditure under the most convenient heads; and in particular shall disclose the turnover, giving the amount of sales in respect of each class of goods dealt with by the company and indicating the quantities of such sales for each class separately.

(*iii*) The commission, brokerage and discount on sales paid will be indicated.

(*iv*) In the case of a manufacturing concern, the value of the raw material consumed, giving item-wise break-up and indicating the quantities thereof are to be indicated. The important basic raw material consumed, giving item-wise break-up and indicating the quantities thereof are to be indicated. The important basic raw materials should be shown as separate items as far as possible. The intermediates or components procured from other manufacturers may, if their list is too large to be included in the break-up, be grouped under suitable headings, without mentioning the quantities, provided all those items which in value individually account for 10 per cent. or more of the total value of raw material consumed, shall be shown as separate and distinct items with quantities thereof in the break-up.

(*v*) The quantity and other particulars of green tea produced and processed by such companies separately should be disclosed together with the opening the closing stock thereof. If such tea is purchased from outside source, the value also of the tea purchased will be disclosed in addition to the quantity and other particulars.

LexisNexis

(*vi*) The opening and closing stock of goods produced or purchased may be given, disclosing the break-up in respect of each class of good and indicating the quantities thereof.

(*vii*) In the case of all concerns having work-in-progress, the amounts for which such works have been completed at the commencement and at the end of accounting year should be given.

(*viii*) The amount provided for depreciation, renewals or diminution in the value of fixed assets should also be given. If such provision is not made by means of depreciation charge, the method adopted for such provision may be disclosed. If no provision is made for depreciation, this fact may be stated. The quantum of arrears of depreciation computed should be disclosed by way of a note.

(*ix*) The amount of interest on debentures and other fixed loans, the charge for income-tax and other Indian taxation on profits, etc., should be disclosed.

(*x*) The expenditure incurred on consumption of stores and spare parts, power and fuel, rent, repairs, salaries, wages and bonus, contribution to provident fund, etc., may be shown separately for each item.

17.6 The definitions as per Part III of the Sixth Schedule to the Companies Act are as follows:—

(1) The term "provision" means any amount written off or retained by way of providing for depreciation, renewals or diminution in value of asset or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

(2) The expression "reserve" shall not include any amount written off or retained by way of providing for depreciation, renewal or diminution in value of the assets or retained by way of providing for any known liability.

(3) The expression "capital reserve" shall not include any amount regarded as free for distribution through the profit and loss account.

(4) The expression "revenue reserve" shall mean any reserve other than the capital reserve.

(5) (*a*) The expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

(*b*) In case where in respect of eligible business or profession, no separate accounts are maintained or available, the profits of the eligible business or profession shall be such amount which bears to the total profits of the business or profession of the assessee after allowing depreciation under section 32(1), the same proportion as the total sales, turnover or gross receipts of the eligible business or profession bear to the total sales, turnover or gross receipts of the business or profession carried on by the assessee. For example, if the gross receipts of business are ₹ 100 which includes gross receipts of eligible business at ₹ 40 then, in case, the total profit is ₹ 10, the profits of eligible business qualifying for deduction will be ₹ 4.

(*c*) To avail of the deduction under this provision, the deposit has to be made in a Development Bank before the expiry of six months from the end of the previous year or before furnishing the return of income, whichever is earlier.

(*d*) The Development Bank in the case of an assessee carrying on the business of growing and manufacturing tea in India means the National Bank for Agriculture and Rural Development. In the case of other assessees, Development Bank means the Industrial Development Bank of India and includes such bank or institution as may be specified in the scheme in this behalf.

(*e*) The purpose of withdrawal from the Development Bank may be the purchase of any new ship, new aircraft, new machinery or plant or the repayment of "term loans" (as per scheme) utilised for such purchases.

(*f*) No deduction shall be allowed in respect of any amount utilised or the purchase of (*i*) any machinery or plant to be installed in any office premises or residential accommodation including any accommodation in the nature of a guest house; (*ii*) any office appliances (not being computer); (*iii*) any road transport vehicle; and (*iv*) any machinery or plant the whole of the actual cost of which is allowed as a deduction whether by way of depreciation or otherwise in computing the income from business or profession of any one previous year. Computer, for this purpose, is not a plant or a machinery. Hence in respect of any amount utilised for the purchase of a computer installed even in office premises, deduction will be admissible.

(*g*) The term "computer" does not include calculation machines and calculating devices.

(*h*) For getting the benefit under this provision, the deposit in the Development Bank or the purchase of any new ship, plant, etc., should be out of income from the eligible business or profession. There is an underlying reason for this pre-condition. As mentioned in the Long-Term Fiscal Policy (Para 5.14) since the benefit of investment allowance is related to the cost of plant and machinery irrespective of how it is financed, such a benefit had created a distortion in the profitability of companies depending on the extent to which they were able to find the resources internally or through borrowings to acquire the new ship, plant, etc. That being so, under the Investment Deposit Scheme, deduction will be admissible only if the deposit is made or the ship, plant, etc., is acquired out of income chargeable to tax under the head "Profits and gains of business or profession".

17.7 As provided in section 32AB(10), no deduction shall be allowed under section 32AB(1) in the case of an assessee carrying on business of growing and manufacturing tea in India who has claimed the deduction under section 33AB relating to the tea development account. However, any excess deposit made by such an assessee under section 33AB(2) may not be treated as a bar to deposit further amount under section 32AB for the assessment year 1987-88, so long as the overall ceiling of 20 per cent. of eligible profits is not exceeded. As this problem is limited to only one year, no enabling provision in law is considered necessary for this purpose.

17.8 Consequential amendments have been made in section 80VVA and in the Eleventh Schedule to the Income-tax Act.

17.9 The new section will apply in relation to the assessment year 1987-88 and subsequent years.

17.10 A notification relating to the Investment Deposit Account Scheme, 1986, is being published separately in the Gazette. The Scheme shall provide that a depositor may utilise the amount deposited under the Scheme for the purposes of purchase of new ship or new aircraft or new machinery or plant for the purposes of his business or profession, or for the purpose of purchase of new computers or for repayment of principal amount of term loans contracted after 31-3-1986, and taken for a period of 3 years or more from certain financial institutions or from scheduled banks or from other specified institutions. The Scheme shall also lay down the manner of deposit as well as the manner of withdrawals by the depositors.'.

LexisNexis

Legislative amendments under 1961 Act.—I. *The Finance Act, 1987.*—By **the Finance Act, 1987** (11 of 1987), the following **amendments** (**w. e. f. 1-4-1987**) have been made—

—**section 32AB(1)** has been **amended**;

—**proviso to section 32AB(1)** has been **inserted**;

—**sections 32AB(2)(*ii*), (*iii*) & (*iv*)** have been **substituted** for the then existing section 32AB(2)(*ii*);

—**section 32AB(3)(*a*)** has been **amended**;

—**sections 32AB(5A) & (5B)** have been **inserted**; and

—**section 32AB(6)** has been **amended** at two places.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 495, dated 22-9-1987*, as follows:—

'**20.** *Modification of provisions relating to investment deposit account.*—**20.1** The Finance Act, 1986 (23 of 1986), introduced section 32AB relating to Investment Deposit Account. The provisions apply in relation to assessment year 1987-88 and subsequent years. Under these provisions, an assessee is entitled to a deduction of an amount up to 20% of the profits of "eligible business or profession", if the said amount is either deposited with the Development Bank within the period up to six months from the end of the previous year or before furnishing the return, whichever is earlier, or is utilised during the previous year for the purchase of a new ship, new aircraft, or new machinery or plant.

20.2 Under the provisions introduced by the Finance Act, 1986 (23 of 1986), the deduction under section 32AB is allowed after setting off business loss, if any, brought forward from earlier years. To remove hardship in cases where the assessee may not be able to avail of this benefit because of brought forward losses from earlier years, the Finance Act, 1987 (11 of 1987), now provides that the deduction will be allowed before setting off of brought forward losses.

20.3 The existing provisions could conceivably lead to an interpretation that the deduction is allowable both in the case of the firm and also in the case of the partners in respect of income derived from business carried on by a firm. This was never the intention of the provisions. It has, therefore, been clarified by the Finance Act, 1987 (11 of 1987), that the deduction under section 32AB shall be allowed in the hands of the firm and not in the hands of the partners in respect of income derived from the business of the firm.

20.4 Under the existing provisions, as introduced by Finance Act, 1986 (23 of 1986), profits of eligible business or profession, where separate accounts are maintained in respect of such eligible business or profession, means profits as computed in accordance with the Sixth Schedule to the Companies Act, 1956 (1 of 1956), as reduced by depreciation computed under the provisions of section 32(1) and as increased by the depreciation, debited in the audited profit and loss account. The Finance Act, 1987 (11 of 1987), has introduced certain further adjustments for arriving at the amount of "profits of eligible business or profession". The amount arrived at above will have to be increased by provision for taxation and reserves, etc., and decreased by amounts withdrawn form provisions or reserves if such amounts are credited to the profit and loss account.

20.5 By inserting a new sub-section (5A), the Finance Act, 1987 (11 of 1987), also provides that the amount deposited with the Development Bank in accordance with the Scheme shall not be permitted to be withdrawn before the expiry of a period of 5 years from the date of deposit, except for the purposes specified in the Scheme and in the following circumstances:

(*a*) closure of business;

(*b*) death of the taxpayer;

(*c*) partition of a Hindu undivided family;

(*d*) dissolution of a firm;

(*e*) liquidation of a company.

20.6 The Investment Deposit Account Scheme permits withdrawals for some purposes which are even otherwise deductible under the Income-tax Act. In order to secure that such assessees are not allowed deduction twice in respect of the same expenditure, the Finance Act, 1987 (11 of 1987), clarifies that where any expenditure is made wholly or partly by utilising the amount credited to the taxpayer in the deposit account, in respect of which deduction is allowed under section 32AB(1), then such expenditure shall not be reduced under the other provisions of the Act.

20.7 Section 32AB(6) lays down that any amount withdrawn by an assessee from his account with the Development Bank but not utilized in accordance with the scheme during the previous year will be treated as income of the year during which the withdrawal was made. There may be a situation where an assessee withdraws the amount and utilizes the same in accordance with the scheme for specified purposes within the period permitted by the scheme but a part of such period may fall in the next accounting year. In such cases,

the effect of the existing provisions is that though an assessee has utilized the amount in accordance with the scheme, the amount will be added to the assessee's income in the year in which the withdrawal is made. To remove this anomaly, the Finance Act, 1987 (11 of 1987), has clarified [section 32AB(6)] that in a case where the amount withdrawn has been utilized for the specified purpose within the period specified in the scheme, such amount would not form part of the income of the assessee in the previous year in which the amount has been withdrawn.

20.8 The utilization of the amount withdrawn is permitted in accordance with the provisions of section 32AB and the Scheme framed thereunder for the purpose of purchasing a "new ship" or "new aircraft" or "new machinery or plant". These expressions have been defined in the *Explanation* to section 32(1)(*vi*) of the Income-tax Act which has been deleted by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), with effect from 1-4-1988. As a consequence, the Finance Act, 1987 (11 of 1987), has amended section 32AB by including the definition of the expressions "new ship", "new aircraft" and "new machinery or plant" in the section itself.

20.9 These amendments will come into force with effect from 1-4-1987, and will, accordingly, apply to assessment year 1987-88 and subsequent years.'.

II. *The Direct Tax Laws (Amendment) Act, 1989.*—By **the Direct Tax Laws (Amendment) Act, 1989** (3 of 1989), **section 32AB(10)** has been **substituted** (**w. e. f. 1-4-1989**).

The scope and effect of the above substitution have been elaborated in the following portion of the *Departmental Circular No. 559, dated 4-5-1990*, as follows:—

'6.5 *Amendment of section 32AB relating to deduction under the investment deposit account scheme.*—The old provisions of sub-section (10) of section 32AB provided that no deduction shall be allowed under this section in the case of an assessee who had claimed deduction allowable under section 33AB in respect of the tea development account. Since the Finance Act, 1987 (11 of 1987), had amended section 33AB to provide that deduction under that section would be allowable only for the assessment years 1986-87 and 1987-88, the said provisions of sub-section (10) of section 32AB were no longer necessary and were to be deleted.

6.6 Further, since the Amending Act, 1989, has amended section 32A to reintroduce investment allowance, as discussed in the preceding paras, and has substituted a new sub-section (8C) in that section to provide that deduction for investment allowance will be an option to the deduction for investment deposit account scheme under section 32AB and the option, once exercised, would be valid for five assessment years, it was necessary that a corresponding provision should be made in section 32AB also. Therefore, the old sub-section (10) has been substituted by a new sub-section, which now contains provisions similar to those of sub-section (8C) of section 32A. The new sub-section (10) provides that where a deduction under the investment deposit account scheme under section 32AB has been allowed to the assessee for any assessment year (called as the initial assessment year), no deduction shall be allowed to him in respect of investment allowance under section 32A in the said initial assessment year and a block of further period of four years beginning with the assessment year immediately succeeding the initial assessment year.

6.7 *Combined effect of the provisions of section 32A*(*8C*) *and section 32AB*(*10*).—Since the investment allowance (section 32A) has been reintroduced as an alternative to the investment deposit account scheme (section 32AB), the combined effect of the provisions of sub-section (8C) of section 32A and sub-section (10) of section 32AB is that if the assessee exercises option to claim either of them in an assessment year (called as the initial assessment year), he will have to stick to that allowance for the said initial assessment year and a block of four subsequent assessment years. Thus, once the assessee avails of the claim under section 32A in the assessment year 1989-90 (which will become the initial assessment year for claim under section 32A), he will have to continue claiming the same allowance in the block of next four assessment years, *i.e.,* assessment years 1990-91 to 1993-94. During these five assessment years (*i.e.,* assessment years 1989-90 to 1993-94) he cannot claim deduction under section 32AB, for which he can opt only in the assessment year 1994-95. If the assessee opts for the deduction under section 32AB in the assessment year 1994-95, that will become the initial assessment year for claim under section 32AB and then the assessee would have to stick to this claim in the block of next four years, *i.e.,* assessment years 1995-96 to 1998-99. During these five assessment years (*i.e.*, assessment years 1994-95 to 1998-99) he cannot claim deduction under section 32A, for which he can opt again only in the assessment year 1999-2000 and so on.

6.8 It may be clarified that the period of five assessment years (including the initial assessment year) during which the assessee is debarred from switching over to the other option is counted from the initial assessment year only and not from any assessment year comprised in the block of four assessment years immediately succeeding the initial assessment year. Thus, in the example given in the preceding para, the assessee can switch over to deduction under section 32AB in the assessment year 1994-95 (counting the block for claim under section 32A from the initial assessment year 1989-90) notwithstanding that the assessee had claimed deduction under section 32A up to assessment year 1993-94. In case of an option for claiming deduction under section 32A is exercised by the assessee for the first time during the assessment

LexisNexis

year 1990-91, that will become the initial assessment year for claim under section 32A and in that case the assessee would be able to switch over to the claim under section 32AB from the assessment year 1995-96, notwithstanding that the assessee had claimed deduction under section 32A upto assessment year 1994-95.

6.9 *The first initial assessment year for the purposes of exercising the option between sections 32A and 32AB.*—Doubts have been raised as to which will be the first initial assessment year for the purposes of exercising the option between the investment allowance (section 32A) and investment deposit account scheme (section 32AB) and in view of the fact that section 32AB has been in force since the assessment year 1987-88, whether an assessee, who had claimed deduction under section 32AB during the assessment year 1987-88 or assessment year 1988-89, could exercise an option to claim deduction under section 32A in the assessment year 1989-90. In this connection, it may be clarified that since investment allowance (section 32A) has been reintroduced with effect from the assessment year 1989-90 and an option between section 32A and section 32AB has been made available for the first time from the assessment year 1989-90 only, the assessment year 1989-90 shall be the first initial assessment year for the purposes of exercising the option between the two sections. Thus, an assessee, who had claimed deduction under section 32AB during the assessment year 1987-88 or assessment year 1988-89, can exercise the option for claiming deduction either under section 32A or under section 32AB in the assessment year 1989-90. Where any such option is exercised in the assessment year 1989-90, that will be the initial assessment year for the claim for which option is exercised.'.

III. *The Finance Act, 1989.*—By **the Finance Act, 1989** (13 of 1989), the following **amendments** have been made—

—**section 32AB(1)(*ii*)** has been **amended** (**w. e. f. 1-4-1991**);

—**section 32AB(2)(*i*)** has been **omitted** (**w. e. f. 1-4-1991**);

—**section 32AB(3)** has been **amended** (**w. e. f. 1-4-1991**) at four places;

—**section 32AB(4)(*e*)** has been **inserted** (**w. e. f. 1-4-1991**);

—**section 32AB(5A)** has been **amended** (**w. r. e. f. 1-4-1987**);

—***Explanation* to section 32AB(5A)** has been **inserted** (**w. r. e. f. 1-4-1987**);

—**section 32AB(5AA)** has been **inserted** (**w. r. e. f. 1-4-1987**);

—**section 32AB(5B)** has been **amended** (**w. e. f. 1-4-1991**); and

—**section 32AB(6)** has been **amended** (**w. r. e. f. 1-4-1987**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 550, dated 1-1-1990*, as follows:—

'**14.** *Modification of provisions relating to investment deposit account.*—**14.1** Under the existing provisions of section 32AB of the Income-tax Act, a deduction of 20 per cent. of the profits is allowed only to those assessees who carry on "eligible business or profession", which means (*i*) business or profession other than the business of construction, manufacture or production of any article or thing specified in the List in the Eleventh Schedule (in case it is not a small scale industrial undertaking), and (*ii*) the business of leasing or hiring of machinery or plant to a small scale industrial undertaking, or an industrial undertaking engaged in the business of construction, manufacture or production of any article or thing not specified in the List in the Eleventh Schedule. The provisions relating to investment deposit account were enacted as a substitute to investment allowance, which was available to every assessee who purchased a new ship or a new aircraft or installed new machinery or plant in an industrial undertaking, for the purposes of business of construction, manufacture or production of any article or thing not specified in the Eleventh Schedule to the Income-tax Act. The emphasis for availing the benefit of investment allowance was on actual investment in plant and machinery installed to produce or manufacture items of high priority and not on the person who made the investment. However, under the investment deposit account, a person can avail of the benefit even if the investment is made for low priority items. This is not in keeping with the object of development and growth of the priority sector.

14.2 To remove this anomaly, by amending section 32AB of the Income-tax Act, it has been provided that the benefit under this section shall be available to any assessee, deriving income from business or profession, who acquires new machinery or plant or deposits and utilises the deposit for the purchase of new machinery or plant to be used in the manufacture or production of priority items, *i.e.,* items not specified in the Eleventh Schedule. For this purpose, reference to and the concept of eligible business or profession has been deleted. Further, as a consequence, the provisions for the mode of computation of profits of "eligible business or profession" have also been amended and the amended sub-section (3) prescribes the mode for computation of profits of business or profession of an assessee for the purposes of sub-section (1).

14.3 In order to give adequate notice to the taxpayers, these amendments have been made effective from 1-4-1991, and will, accordingly, apply in relation to the assessment year 1991-92 and subsequent years.

14.4 Sub-section (5A) of section 32AB of the Income-tax Act provides that the amounts deposited with the Development Bank in accordance with the Scheme shall not be permitted to be withdrawn before the expiry of a period of five years from the date of deposit except in the case of (*a*) closure of business, (*b*) death of the taxpayer, (*c*) partition of Hindu undivided family, (*d*) dissolution of the firm, (*e*) liquidation of the company, and (*f*) in such other circumstances as may be specified in the Scheme. This sub-section is being interpreted in a manner that in a case withdrawal is made by a taxpayer of any amount standing to his credit in the deposit account after a period of five years from the date of deposit, the condition regarding the purposes for which a withdrawal can be made as specified in the Scheme do not have to be complied with, and no tax will be levied on the amount of withdrawal. Such an interpretation is against the legislative intent and may lead to protracted litigation.

14.5 With a view to clarify the correct legislative intention in this regard, an amendment has been made in section 32AB, so as to provide that where any amount is released by the Development Bank even after a period of five years from the date of deposit and the same is not utilised in accordance with and within the time specified in the Scheme, the same shall be deemed to be the profits and gains of business or profession of the previous year in which such withdrawal is made and shall, accordingly, be chargeable to tax.

14.6 Further, as the circumstances mentioned at clauses (*a*) and (*b*) of sub-section (5A) may be used for tax avoidance purposes, it has been provided by inserting sub-section (5AA) that the money withdrawn or obtained consequent to the closure of the account because of closure of business or dissolution of firm will be subjected to tax in the year of withdrawal or closure of account and shall be assessed in the hands of the same business or firm as if the business was not closed or the firm was not dissolved.

14.7 These amendments will take effect retrospectively from 1-4-1987, and will, accordingly, apply in relation to the assessment year 1987-88 and subsequent years [*Section 7 of the Finance Act, 1989 (13 of 1989)*]'.

IV. *The Finance Act, 1990.*—By **the Finance Act, 1990** (12 of 1990), **2nd proviso to section 32AB(1)** has been **inserted** (**w. e. f. 1-4-1990**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 572, dated 3-8-1990*, as follows:—

'*Streamlining of tax structure.*—**13.** With the reduction in the rates of taxes in the case of domestic companies, registered firms and co-operative societies and on a review of some of the incentives and concessions available to taxpayers, the following incentives and concessions have been withdrawn or modified:—

* * *

(*b*) Under the existing provisions of section 32AB of the Income-tax Act, deduction is allowed in respect of deposit with the IDBI/NABARD or amount utilized for the purchase of any new ship, new aircraft or new machinery or plant. This deduction is allowed in computing the taxable profits or gains of business or profession and is equal to the amount deposited/utilised for the purchase of the new ship or aircraft or machinery or plant or 20 per cent of the profits of business or profession, whichever is less.

No deduction will be allowed under this section in relation to any assessment year commencing on or after the 1st day of April, 1991. [*Section 8 of the Finance Act, 1990*]'.

V. *The Finance Act, 2020.*—By **the Finance Act, 2020** (12 of 2020), **section 32AB(5)** has been **amended** (**w. e. f. 1-4-2020**).

For the explanation of the above amendment, refer the portion of the Memorandum explaining the provisions in the Finance Bill, 2020 (Bill No. 26 of 2020).

Relevant rule and form.—Rule 5AB of the Income-tax Rules, 1962, and **Form No. 3AA** appended to those Rules are relevant to section 32AB. The said **Form No. 3AA** has become (w. e. f. 1-4-2003) **Form No. 3AAA** as a result of the **amendment** made by **the Income-tax (Fourteenth Amendment) Rules, 2002**.

Operative for assessment years 1987-88 to 1990-91.—The deduction under section 32AB is allowable only for assessment years 1987-88 to 1990-91. No deduction under that section shall be allowable for and from assessment year 1991-92.

Eligible assessees.—Every assessee, whose total income includes income chargeable to tax under the head "Profits and gains of business or profession" is an eligible assessee (with certain exceptions), for and from assessment year 1987-88, for the benefit of section 32AB subject to the fulfilment of the conditions otherwise prescribed [s. 32AB(1)]. But, where such an eligible assessee is a firm or any association of persons or any body of individuals, any partner, or as the case may be, any member of such firm, association of persons or body of individuals is not an eligible assessee [s. 32AB(1), proviso]. This provision, in a sense, places a ban on double deduction.

LexisNexis

However, for assessment years 1987-88 to 1990-91, an assessee—

—who is engaged in the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI to the 1961 Act carried on by an industrial undertaking, which is not a small-scale industrial undertaking as defined in clause (*b*) of the *Explanation* to section 80HHA;

—who is carrying on the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small-scale industrial undertaking as defined in clause (*b*) of the *Explanation* to section 80HHA, engaged in the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI to the 1961 Act,

is *not* an eligible assessee [s. 32AB(1) read with s. 32AB(2)(*i*)]. But, for and from assessment year 1991-92, even such an assessee will become an eligible assessee.

In a nutshell for assessment years 1987-88 to 1990-91, the eligible assessees are—

—small-scale industrial undertakings, whether they manufacture any article or thing specified in Schedule XI or note;

—industrial undertakings, other than small scale industrial undertakings, not engaged in the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI;

—leasing companies which have not leased out machinery to those industrial undertakings, other than a small scale industrial undertaking, engaged in the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI; and

—professionals [s. 32AB(1) read with section 32AB(2)(*i*)].

For and from assessment year 1991-92, all assessees, whose total income includes business income and who utilise the amount for the purchase of any new ship, new aircraft, new machinery or plant to be installed in an industrial undertaking, other than a small-scale industrial undertaking, for the purposes of the business of construction, manufacture or production of any article or thing not specified in the list in Schedule XI [s. 32AB(1) read with section 32AB(4)(*e*)], are eligible assessees.

However, for and from assessment year 1987-88, where a firm or an association of persons or a body of individuals is an eligible assessee, its partner or member, as the case may be, is not an eligible assessee.

It is pertinent to note that as a result of the insertion of the second proviso to section 32AB(1) by the Finance Act, 1990 (12 of 1990)**, with effect from 1-4-1990, no deduction under that section shall be allowed in relation to assessment year 1991-92 or any subsequent assessment year.**

In the facts of *CIT v. Sudarshan Plywood Ltd.* [(1995) 80 Taxman 326, 328, 330 (Gauh)], the Tribunal held that the assessee was entitled to the benefit of section 32AB in respect of agricultural income from sale of Eucalyptus wood as the same was business income and although exempt from tax was to be considered as a part of business profit and loss account for computing the deduction allowable under section 32AB. On these facts, the Tribunal was held justified in refusing to refer the question inasmuch as there was no referable question of law arising out of its order.

Sections 10 and 32AB are mutually exclusive of each other—deduction under section 32AB not to be allowed out of exempted income.—A bare perusal of the language of section 32AB(1) shows that it is subject to the other provisions of that section and relates to an assessee whose total income includes income chargeable to tax under the head 'Profits and gains of business or profession'. It is out of such income that deductions are admissible under different sub-sections including section 32AB(3). It may be noted that the total income would not include income exempt, *inter alia,* under section 10(1), hence on the face of it section 32AB would not be applicable to an income exempt under section 10(1). It may be indicated that section 10(1) and section 32AB are mutually exclusive of each other for the purposes of 'total income' and section 5 is rendered neutral, being subject to the provisions of the Act. There cannot be a situation where both the provisions can be applied as section 10(1) provides for non-inclusion of agricultural income in computing the total income, whereas section 32AB applies where the total income includes income chargeable to tax under the head 'Profits and gains of business or profession' [*CIT v. Sudarshan Plywood Industries Ltd.,* (2000) 245 ITR 751, 755 (Gauh)]. In the facts of that case, the Tribunal was held (p. 757) not justified in directing the AO to allow the benefit of section 32AB to the assessee after holding that the income is agricultural income, which is exempt from income-tax under section 10(1).

Requisite conditions.—The conditions requisite for attracting the provisions of **section 32AB**, relating to investment deposit account, are as under:—

(1) (*a*) the eligible assessee must, out of business income, deposit any amount in a deposit account maintained by him with the Development Bank [as defined] before—

—the expiry of 6 months from the end of the previous year or

—furnishing the return of his income,

whichever is earlier [**s. 32AB(1)(*a*)**]; or

(*b*) the eligible assessee must, out of business income, utilise any amount during the previous year for the purchase of any new ship, new aircraft, new machinery or plant [not covered by section 32AB(4)], without depositing any amount in the deposit account as stated above [s. **32AB(1)(*b*)**];

(2) the deposit as stated above in (1)(*a*) must be in accordance with and for the purposes specified in the Investment Deposit Account Scheme, 1986 (hereinafter referred to as the IDA Scheme). In case of an assessee carrying on the business of growing or manufacturing tea in India, such Scheme must be approved by the Tea Board established under section 4 of the Tea Act, 1953 (29 of 1953) [**s. 32AB(1)**]. It is pertinent to note that the IDA Scheme is applicable to all the eligible assessees other than the assessees carrying on the business of growing and manufacturing tea in India [paragraph 1(2) of the IDA Scheme];

(3) the accounts of the eligible assessee for the relevant previous year must be audited by an accountant as defined in the *Explanation* below section 288(2) [(upto 31-3-2020) and the eligible assessee must furnish, along with his return of income,] [(w. e. f. 1-4-2020) before the specified date referred to in section 44AB and the eligible assessee furnishes by that date] the report of such audit in Form No. 3AA duly signed and verified by such accountant [**s. 32AB(5)**, main section]. However, the **proviso to section 32AB(5)** takes care of a situation where the eligible assessee is required by or under any other law to get his accounts audited. In such a situation, the assessee is required—

—to get the accounts of such business or profession audited under such other law and

—to furnish the report of the audit as required under such other law and

—to furnish a further report in Form No. 3AA under section 32AB(5).

It is pertinent to note that the said **Form No. 3AA** has become (w. e. f. 1-4-2003) **Form No. 3AAA** as a result of the amendment made by **the Income-tax (Fourteenth Amendment) Rules, 2002**.

In *CIT v. Dinjoye Tea Estate* (*P.*) *Ltd.* [(1997) 224 ITR 263, 265, 266 (Gauh)], it has been held that in order to invoke the provisions of section 32AB, the relevant income, such as interest and dividend, must be out of the income of the assessee under the head "Profits and gains of business or profession". In that view of the matter, where the interest and dividend do not come from the profits and gains of business or profession, such interest and dividend cannot be included in the income for the purpose of deduction under section 32AB. Thus, the assessee has been held not entitled to deduction under section 32AB in respect of dividend income received from shares held in investment portfolio [*CIT v. Warren Tea Ltd.,* (2001) 251 ITR 382, 383 (Cal)].

Section 32AB(1)(*b*) merely requires that the assessee has, out of its business income, utilised any amount during the previous year for the purchase of, *inter alia,* any new machinery or plant. There are no additional words in the said provision requiring further that the assessee utilise or install the said machinery also, so as to qualify for getting the deduction [*CIT v. Tribeni Tissues Ltd.,* (2002) 258 ITR 393, 393-94 (Cal)].

Under section 32AB(1), one does not find any restriction that the amount should be spent only from the current year's profits. Section 32AB(1) only stipulates that the amount should be spent out of income which is chargeable to tax [*CIT v. International Data Management Ltd.,* (2003) 261 ITR 177, 182 (Bom)].

In *CIT v. Cadila Antibiotics Ltd.* [(2001) 252 ITR 197, 199 (Guj), special leave petition dismissed by the Supreme Court : (2000) 242 ITR (St.) 204 (SC)], the Tribunal has held that the assessee is entitled to deduction under section 32AB on the basis of a receipt obtained by the assessee from the IDBI. In reference proceedings under section 256(2) an oral statement has been made by the Revenue before the High Court that the assessee had by following a dubious method managed to obtain a receipt from the IDBI. The High Court held such mere statement was not sufficient to interfere with the findings of the Tribunal. If it was pleaded before the first appellate authority or the Tribunal or even before the High Court that the assessee had by following dubious method managed to obtain a receipt from the IDBI, the matter would have been quite different.

Section 32AB does not require the profit for the purpose of section 32AB(1) to be calculated in accordance with the provisions of the Income-tax Act. All that it provides is that the calculations should first be made in accordance with the Companies Act and the requirements more specifically required of Parts II and III of Schedule VI to the Companies Act, 1956 (1 of 1956)[27] [*CIT v. Macmillan India Ltd.*, (2007) 295 ITR 67 (Mad)].

The proviso to section 32AB makes it very clear that in respect of profits of exigible business or profession of a firm, the deduction can be claimed and granted only in the hands of the firm and not in those of the individual partners [*CIT v. Janatha Steel Mills P. Ltd.*, (2007) 294 ITR 668 (Ker)].

27. Repealed and replaced by Act 18 of 2013.

The deduction under section 32AB have to be made first while computing the 'gross total income' for the purpose of section 80-I [*CIT v. Kothari Products Ltd.*, (2007) 295 ITR 223 (All)].

A plain reading of section 32AB would go to show that in order to claim deductions under section 32AB only the profits and gains of business or profession earned by the assessee are required to be taken into consideration. Any profit earned by sale of fixed assets by the assessee cannot be regarded and/or construed to be in the nature of profits and gains earned from business [*CIT v. D&H Secheron Electrodes Ltd.*, (2008) 298 ITR 101 (MP)].

In *CIT v. Trichy Distilleries Chemicals Ltd.* [(2005) 272 ITR 227 (Mad)], it has been held that the Tribunal was right in law in holding that the interest received on temporary deposits with scheduled banks, interest received on deposit for allotment of Maruti car and dividend received from the company were to be excluded while computing the income from eligible business under section 32AB.

In *CIT v. Kil Kothagiri Tea & Coffee Estate Co. Ltd.* [(2005) 273 ITR 278 (Ker)], it has been held that the profits of eligible business computed in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act, 1956 (1 of 1956)[28], should not be reduced by income from investments, interest and rent for the purpose of computing the deduction allowable under section 32AB(*b*)(*ii*). Also see, *CIT v. Kelvinator of India Ltd*., (2011) 332 ITR 231 (Del).

The assessee held not entitled to include rent income, interest income and sundry receipts such as receipts from sale of coffee and areca nut and subsidy from the Tea Board, as profits of eligible business or profession for computing the deduction under section 32AB [*Parry Agro Industries Ltd. v. CIT*, (2006) 285 ITR 440 (Ker—FB)].

In *CIT v. Tata Yodogawa Ltd.* [(2013) 351 ITR 379 (Jharkhand)], it has been held that the provision of excise duty written back amounting to Rs. 95.25 lakhs should be held as profit from business for the purpose of deduction under section 32AB.

Benefit under section 32AB can be allowed to an assessee making an advance for purchase of new machinery.—Section 32AB was introduced to replace investment allowance under section 32A by a new scheme of investment deposit account. The benefit of investment allowance under section 32A was related to cost of plant and machinery irrespective of how it is financed. This created a distortion in the profitability of companies. Therefore, under the investment deposit account scheme envisaged by section 32AB, deduction is admissible only if the deposit is made or plant and machinery is acquired out of income chargeable to tax under the head 'Profits and gains of business.' Therefore, to get the benefit under section 32AB, the purchase should be out of income from eligible business or profession. If the difference between sections 32A and 32AB is kept in mind, it is clear that under section 32AB it is not necessary that the assessee should become the owner of specified machinery or that the machinery should be installed or put to use during the previous year. If the assessee has placed an order for purchase and has given an advance to the supplier then the amount has been utilised for the purchase of the machinery. The delivery of the machinery may be taken in a subsequent year. The advance is required to have a nexus with the income of the current year. If an assessee gives an advance for purchase of machinery from the current year's income, he cannot be denied the benefit of section 32AB on the ground that the advance is not utilisation because in the year in which the advance is effected, the assessee will be denied deduction on the ground that it is non-utilisation and if the balance amount is paid in the subsequent year, the assessee will be denied deduction on the ground that it has not come out of the income of the current year. Similarly, if in a given case, under the contract, the assessee is required to pay the purchase price in instalments it could still be utilisation. It cannot be said that because the consideration has been paid in instalments, there was no utilisation. On the other hand, if payment by instalments under the terms of contract constitutes utilisation then, equally, payment of the advance would also constitute utilisation for the purposes of section 32AB. Hence, the concept of utilisation of the amount for purchase has to be understood with reference to actual payment made to the supplier from time to time and not with reference to the liability created for the purchase. It is for this reason that the Legislature has used the word 'purchase' in section 32AB as against the word 'acquired' in section 32A. The two words have different connotations. An asset can be acquired by purchasing raw materials followed by fabrication of the asset whereas, the term 'purchase' implies purchase of an asset. Use of an asset purchased is not necessary for claiming deduction under section 32AB. This position has been clarified *vide* para. 17.3 of the Board's Circular dated 9-7-1986, in which it has been once again clarified that acquisition of ships, or installation of plant or machinery during the previous year is a condition precedent for availing of the benefit of investment allowance whereas, deduction under section 32AB can be availed of even before the ship is acquired or plant and machinery is installed. Therefore, one cannot see as to how the benefit under section 32AB would not be allowed to an assessee who sends an advance for purchase of new machinery [*CIT v. Antifriction Bearings Corporation Ltd.,* (2000) 246 ITR 295, 298, 298-99 (Bom)].

Section 32AB read with section 32A(8B).—On a plain reading of section 32A(8B), it is clear that the benefit of investment allowance has been extended to the plant and machinery installed after 31-3-1987 but

28. Repealed and replaced by Act 18 of 2013.

LexisNexis

before 1-4-1988, subject to the condition that such plant and machinery should have been purchased or a contract for purchase of such plant and machinery should have been entered into before 12-6-1986. Section 32A(8B) does not say that in a case where the benefit of section 32AB has been claimed in the previous year, the assessee shall not be entitled to the benefit thereof. The scope of the provisions has been elaborated in the Explanatory Circular No. 559, dated 4-5-1990. According to the circular, the combined effect of section 32A(8C) and 32AB(10) is that if the assessee exercises option to claim the benefit under either of them in the AY (called the initial AY), assessee will have to stick to that allowance for the initial AY and a block of 4 subsequent AYs. An assessee can have the benefit of either of the provisions but not both. Having regard to the fact that an assessee cannot claim the benefit of both investment allowance and investment deposit account in the same assessment year, the question of double deduction would not arise [*CIT v. Indian Petrochemicals Corporation Ltd.*, (2015) 372 ITR 568, 581 (Guj) = 281 CTR (Guj) 223].

Even a manufacturer of a machine transferring the same to its business at cost is eligible for deduction under section 32AB.—If an assessee manufactures a machine itself and transfers the same at cost to its business of manufacture and claims that it has purchased the machinery, it is certainly entitled to relief under section 32AB(1)(*b*). If an assessee, by making necessary arrangements for purchase from outside, is entitled to claim deduction under section 32AB, then one fails to understand why an assessee who manufactures the machine itself and transfers the same at cost to its business of manufacture cannot claim the same relief. In that view of the matter, if the assessee, by capitalising machinery manufactured by itself, transfers the same at cost to its business of manufacture, then the assessee would be entitled to relief under section 32AB(1)(*b*) [*CIT v. International Data Management Ltd.,* (2003) 261 ITR 177, 181, 182 (Bom)].

Assessee-firm eligible for deduction under section 32AB—partners not eligible for such deduction.— Where the assessee-firm has been allowed deduction under section 32AB as it was carrying on the eligible business, the claim for deduction under section 32AB once again by the partners of the assessee-firm for their respective shares cannot be granted [*Dr. R. Jayachandran v. CIT,* (2003) 262 ITR 683, 684 (Mad)].

Extent of the deduction.—On fulfilment of requisite conditions, the eligible assessee is entitled to obtain a deduction [such deduction is to be allowed before the loss, if any, brought forward from earlier years is set off under section 72] of—

—a sum equal to the amount, or the aggregate of the amounts, deposited under section 32AB(1)(*a*) and any amount utilised under section 32AB(1)(*b*); or

—a sum equal to 20% of the profits of—

—(for assessment years 1987-88 to 1990-91) eligible business or profession

—(for and from assessment year 1991-92) business or profession

as computed in the accounts of the assessee audited in accordance with section 32AB(5),

whichever is less [s. 32AB(1)(*i*) and (*ii*)].

LexisNexis

It is pertinent to note that the profits of the eligible assessee for the purposes of section 32AB(1) are to be determined as per the provisions of section 32AB(3).

Deduction under section 32AB to be allowed before allowing set-off under section 72 and unabsorbed investment allowance of earlier years.—See, *Sundaram Finance Ltd. v. Deputy CIT*, (2016) 387 ITR 155, 161 (Mad).

Deduction under section 32AB to be allowed before allowing deductions under Chapter VI-A in relation to certain sections having concern with 'gross total income'.—See, *CIT v. Rajaram Maize Products*, (1998) 234 ITR 667, 673 (MP), **reversed on another point in** *CIT v. Rajaram Maize Products*, (2001) 251 ITR 427 (SC).

Where no claim under section 32AB is made before AO, Tribunal may be justified in rejecting additional ground for such claim.—Where the assessee had not made a claim for deduction under section 32AB before the Assessing Officer, it is open to the Tribunal to reject an additional ground raised by the assessee for claim of such deduction [*T.V. Sundaram Iyengar & Sons Ltd. v. CIT*, (2000) 241 ITR 420, 423 (Mad)].

Illustrative cases wherein deduction under section 32AB held entitled.—(1) The eligibility to deduction is not confined only to a particular income derived from a particular head but on the income under all heads derived from the eligible business and, as such, the assessee held exigible for allowance under section 32AB(3) [*J. Thomas & Co.* (*P.*) *Ltd. v. CIT*, (2005) 275 ITR 467 (Cal)].

(2) Income from interest, rent, dividend and profit on sale of toothpaste should be included in the eligible profits for working out deduction under section 32AB [*CIT v. Parle Biscuits Ltd.*, (2006) 282 ITR 547 (Del)].

(3) The assessee held not engaged in the manufacture of any item under the prohibited entry 10 of Schedule XI, *viz.*, photographic apparatus and goods and he was eligible for relief under section 32AB [*CIT v. Computer Graphics Ltd.*, (2006) 285 ITR 84 (Mad)].

(4) While computing the deduction available to the assessee under section 32AB, interest income and dividend income are includible in the profits of the eligible business income [*Williamson Financial Services Ltd. v. CIT*, (2007) 290 ITR 385 (Gauh)].

(5) Since the assessee was maintaining its accounts on the mercantile system, in view of section 43(2) was entitled to the benefits under section 32AB [*CIT v. J.M. Agarwal Tobacco Co.*, (2008) 300 ITR 364 (All)].

(6) No error been committed by the Tribunal in so far as it had come to the conclusion that the CIT(A) had rightly upheld the claim for deduction under section 32AB on the basis of the revised return of income in lieu of deduction claimed under section 32A in the original return of income [*Deepak Nitrite Ltd. v. CIT*, (2008) 307 ITR 289 (Guj)].

(7) Interest and dividend income credited in the profit and loss account will form part of the eligible business income under section 32AB [*Deputy CIT v. United Nilgiris Tea Estate Co. Ltd.,* (2005) 273 ITR 470 (Mad)]. Also see, *CIT v. Tirupattur Co-op. Sugar Mills Ltd.,* (2009) 310 ITR 360 (Mad).

Reference may also be made to *Protos Engineering Co. P. Ltd. v. Deputy CIT*, (2006) 282 ITR 550 (Bom); *India Cine Agencies* : *Computer Graphics Ltd. v. CIT*, (2009) 308 ITR 98 (SC)]; *CIT v. Tirupattur Co-op. Sugar Mills Ltd.* [(2009) 310 ITR 360 (Mad)]; *Harsiddh Specific Family Trust v. Asst. CIT* [(2017) 395 ITR 312, 324 (Guj)].

Illustrative cases wherein deduction under section 32AB held not entitled.—(1) The assessee-company being engaged in the business of execution and completion of building contracts been denied the allowance under section 32AB on the ground that no manufacturing activity had been carried out [*S.A. Builders Ltd. v. CIT*(*A*), (2007) 289 ITR 24 (Punj), **affirmed in** (2007) 289 ITR 26 (SC)].

(2) The amount written back in the profit and loss account by way of adjustment on a recomputation of the depreciation on the basis of a circular of the CLB not to be reduced from the profit exigible under section 32AB [*CIT v. Alfa Laval* (*India*) *Ltd.*, (2007) 295 ITR 451 (SC)].

(3) When the business of the assessee was one of manufacture and sale of electrodes then any profit earned from the said business activity could be taken into consideration while calculating the deduction available under section 32AB and as the sale of fixed assets was not the business activity of the assessee much less regular business activity, the profit earned by the assessee from such sale would not partake of the character of profit earned from its main business so as to entitle it to claim deduction under section 32AB [*CIT v. D&H Secheron Electrodes Ltd.*, (2008) 298 ITR 101 (MP)].

LexisNexis

(4) Investment made out of borrowed funds will not be utilization of income during the year and will not qualify for benefit under section 32AB [*Industrial Cables* (*India*) *Ltd. v. CIT*, (2008) 304 ITR 272 (Punj)].

(5) The assessee held not entitled to the special deduction under section 32AB in respect of the benefits of poultry farming [*CIT v. Shivalik Poultries,* (2005) 274 ITR 529 (Punj)].

Deposit how to be made.—A deposit under the provisions of **section 32AB** may be made by any depositor [which means an assessee who is eligible to make a deposit under section 32AB] in accordance with the provisions of the IDA Scheme [paragraph 3(1)]. Such deposit may be made in one lump sum or in instalments (not exceeding four instalments in each financial year) in multiples of Rs. 1,000 [paragraph 3(2)].

Manner of deposit.—Every depositor making a deposit has to apply the deposit office [which means any office of the Development Bank where the account is maintained] in Form A, or as near thereto as may be, together with the amount of deposit payable by a crossed cheque or demand draft drawn in favour of such office on a bank situated at the place where the deposit office is situated [paragraph 4(1) read with paragraph 4(3)].

Opening of an account.—Paragraph 4(2) ordains that on receipt of such an application for the first time, the deposit office has to open an account [which means a deposit account under the IDA Scheme] in the name of the depositor.

Subsequent deposits.—Every subsequent deposit is required to be made into the deposit office at which the account stands by a crossed cheque or demand draft drawn in favour of such office on a bank situated at the place where the deposit office is situated [paragraph 4(3)].

Receipt for deposit.—Paragraph 4(4) ordains that every deposit is to be evidenced by a receipt issued in Form B, or as near thereto as may be, by the deposit office. In the event of loss or destruction of such receipt, paragraph 5 empowers the deposit office to issue, on an application made to it in this behalf, a duplicate of such receipt.

Issue of statement or duplicate statement.—Paragraph 4(5) enjoins upon the deposit office to issue to the depositor a statement of account in Form C, or as near thereto as may be, on the expiry of each quarter ending

on 30th June, 30th September, 31st December and 31st March in a year showing the amount of deposits made during the quarter previous to the quarter to which the statement relates. In the event of loss or destruction of such statement of account, paragraph 5 empowers the deposit office to issue, on an application made to it in this behalf, a duplicate of such statement of account.

Interest.—Under paragraph 7(1), the deposit is, subject to paragraph 7(2), to carry simple interest at the rate of 10 per cent. per annum for the financial year ending with the 31-3-1987. Thereafter, such deposit is to carry simple interest at such rates as may be specified by the Development Bank for each subsequent year to be calculated from the first day of the month immediately following the month in which the amount of deposit is credited to the deposit account.

Paragraph 7(2) takes care of a situation where during any financial year any part of the deposit is withdrawn. In such a case, the interest payable on the deposits is to be calculated on the basis of minimum monthly balance in the account during that financial year.

Paragraph 7(3) ordains that the interest payable for any financial year or part thereof shall soon after the close of the financial year be credited to the designated account.

Charge or alienation.—Paragraph 8 enacts disenabling provisions and provides that the amounts standing to the credit of any deposit account—

—are not to be placed or offered as security for any loan or guarantee and

—are not to be charged or alienated in any manner whatsoever except in favour of Development Bank.

Transfer of the account.—Paragraph 6 enables a depositor to apply for the transfer of account from one deposit office to another deposit office.

Closure of the account.—Under paragraph 10(1), if the depositor desires to close the deposit account, an application is required to be made with the approval of the Income-tax Officer or any other officer who has jurisdiction over the depositor, in Form E, or as near thereto as may be, and the deposit office is enjoined upon, as soon as may be, subject to the provisions of paragraph 9 about utilisation of the amounts, to pay the amount of balance (including interest accrued as on the last day of the month preceding the month in which the said application has been made) lying to the credit of the depositor by means of a credit to the designated account.

Paragraph 10(2) takes care of a situation where any person other than the depositor acquires a right under clause (*i*) or clause (*ii*) of the proviso to section 32AB(7) to receive the amount lying to the credit of the deposit account. In such a situation, the Development Bank is enjoined upon to pay such amount to the person if the Income-tax Officer or any other officer who has jurisdiction in the matter over the depositor certifies to this effect.

LexisNexis

Computation of profits for the purposes of section 32AB(1).—Section 32AB(3) enacts provisions about the computation of the profits of business or profession of an eligible assessee for the purposes of section 32AB(1).

For the purposes of computation of the profits of eligible business or profession, for assessment years 1987-88 to 1990-91, of an assessee for the purposes of section 32AB(1), section 32AB(3) envisages two situations, namely:—

Situation I: Where separate accounts in respect of such eligible business or profession are maintained.

Situation II: Where separate accounts in respect of such eligible business or profession are not maintained or are not available.

So far as Situation I is concerned, such computation involves the following four steps:—

Step I: Amounts of profits are to be computed in accordance with the requirements of Parts II and III of the Sixth Schedule to the Companies Act, 1956 (1 of 1956)[29].

Step II: From the amounts of profits so computed as per Step I, an amount equal to the depreciation computed in accordance with the provisions of section 32(1) is to be deducted.

Step III: The resultant sum arrived at after Step II is to be increased by the aggregate of—

—the amount of depreciation;

—the amount of income-tax paid or payable, and provisions therefor;

—the amount of surtax paid or payable under the Companies (Profits) Surtax Act, 1964 (7 of 1964);

—the amounts carried to any reserves, by whatever name called;

—the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities;

29. Repealed and replaced by Act 18 of 2013.

—the amount by way of provision for losses of subsidiary companies; and

—the amount or amounts of dividends paid or proposed,

if any debited to the profit and loss account.

Step IV: The resultant sum after Step III is to be reduced by any amount or amounts withdrawn from reserves or provisions, if such amounts are credited to the profit and loss account.

In case of *Situation II*, such computation involves the following two steps:—

Step I: From the total profits of the business or profession of the assessee, the depreciation computed in accordance with the provisions of section 32(1) is to be allowed deduction.

Step II: The resultant sum after Step I is to be allocated in the same proportion as the total sales, turnover or gross receipts of the *eligible business or profession* bear to the total sales, turnover or gross receipts of the *business or profession* carried on by the assessee.

In a case relating to assessment years 1987-88 and 1988-89, it has been held that it is the computation made in accordance with section 32AB(3), which is to be the basis for determining the 20 per cent. of the profits of the business for the purpose of section 32AB(1)(*ii*). The computation of income under the provisions of the Income tax Act is of no relevance for the purpose of determining the extent of benefit under section 32AB(1). The computation under the Income-tax Act is relevant after the ascertainment of the amount of the deposit and the 20 per cent. of the profits of the business calculated in accordance with section 32AB(3), and the amount to be allowed in the computation under the Income-tax Act is the lower of the two figures and the deduction is to be allowed in the manner provided in section 32AB(1) [*CIT v. Tamil Nadu Mercantile Bank Ltd.*, (2002) 255 ITR 205, 208 (Mad).

As ordained by section 32AB(3)(*a*), the determination of the profit required to be made in accordance with Parts II and III of the Sixth Schedule to the Companies Act, 1956 (1 of 1956)[30], is required to be made after taking into account all the activities of the assessee governed by the Companies Act, as the profit and loss account required to be drawn up by a company must necessarily reflect all the income and all the expenditure incurred by the company in that year. Section 32AB does not require the profit for the purpose of section 32AB(1) to be calculated in accordance with the provisions of the Income-tax Act. All that it provides is that the calculations should first be made in accordance with the Companies Act and the requirements more specifically required of Parts II and III of the Sixth Schedule to the Companies Act. There is, therefore, no scope at all for imposing the concept of different heads of income found in the Income-tax Act, into the calculation of profit required to be made in terms of section 32AB(3) [*Carborandum Universal Ltd. v. CIT,* (2004) 265 ITR 372, 376, 377 (Mad)]. In the facts of that case, the Assessing Officer has excluded the amount of dividend received as also the income by way of interest and rents by relying on the fact that those incomes are to be taxed under the Income-tax Act as 'Income from other sources'. It has been held that by doing so, the Assessing Officer has failed to give effect to the plain language and the mandate of section 32AB(3).

In *Alfa Laval India Ltd. v. Deputy CIT* [(2004) 266 ITR 418, 424 (Bom)], it has been held that as per the circular issued by the Company Law Board, it was necessary for the assessee to rework the depreciation. As a result of which increased profits to the tune of Rs. 81,33,667 had to be written back by way of adjustment in the profit and loss account. Therefore, no fault could be found with the adjustment made by the assessee in the profit and loss account. For working out relief under section 32AB(3), the profits of the business are required to be reduced by an amount or amounts withdrawn from reserves or provisions, if such amounts are credited to the profit and loss account. In the present case, there is no withdrawal of amount from reserves or provisions and, therefore, the amount written back and credited to the profit and loss account, on account of reworking of the depreciation, as per the circular of the Company Law Board, could not be reduced from the profits eligible for relief under section 32AB.

In the facts of *Assam Brook Ltd. v. CIT* [(2004) 267 ITR 121, 124, 128 (Cal)], the Tribunal was held justified in law as well as on facts to direct the Assessing Officer to compute 20 per cent. of the eligible profit inclusive of rental income, interest, dividend, profit on sale of assets, replantation subsidy along with other income as found in profit and loss account against the correct interpretation of section 32AB.

The deduction under section 32AB(1), for assessment year 1990-91, in respect of the profits of the paper division had to be determined from the profits of the paper division as determined under section 32AB(3)(*a*) without setting off the loss suffered by the agro division [*CIT v. Pudumjee Agro Industries Ltd.*, (2006) 285 ITR 301 (Bom), **followed in** *CIT v. Kelvinator of India Ltd.*, (2015) 371 ITR 51, 67 (Del) = 275 CTR (Del) 1].

Section 32AB provides for total income chargeable to tax under the head 'Profits and gains of business or profession'. Section 32AB(3) provides for the profits of business or profession of an assessee for the purposes of section 32AB(1). Income-tax refunds cannot be considered to be amounts withdrawn from reserves or

30. Repealed and replaced by Act 18 of 2013.

provisions. The income-tax refund amounts as credited to the profit and loss account are not required to be deducted from the book profits [*CIT v. Motor Industries Ltd.*, (2006) 286 ITR 531 (Karn)].

In *Jindal Aluminium Ltd. v. Deputy CIT* [(2015) 370 ITR 235, 245 (Karn)], it has been held that a sum of Rs. 32,22,067 paid as customs duty shown in P&L A/c had been deducted by virtue of section 32AB(3) as it is a contingent liability & not an ascertained liability and, therefore, it has to be added back.

It is pertinent to note that for and from assessment year 1991-92, the concept of eligible business or profession as also that of two situations has been dropped. Therefore, for and from assessment year 1991-92, the computation of the profits of business or profession of an assessee for the purposes of **section 32AB(1)** involves four steps as contemplated by Situation I above.

Utilisation not to be made for making certain purchases.—Section 32AB(4) places a ban on the utilisation of any amount for the purchase of—

—any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house [clause (*a*)];

—any office appliances (not being computers) [clause (*b*)];

—any road transport vehicles [clause (*c*)];

—any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year [clause (*d*)];

—(w. e. f. 1-4-1991) any new machinery or plant to be installed in an industrial undertaking, other than a small-scale industrial undertaking as defined in clause (*b*) of the *Explanation* to section 80HHA, for the purposes of business of construction, manufacture or production of any article or thing specified in the list in Schedule XI to the 1961 Act [clause (*e*)].

It is specifically provided that no deduction under **section 32AB(1)** is to be allowed where any of the abovestated banned purchases is made.

Accounts to be got audited, s. 32AB(5).—See, condition No. (3) under the heading "*Requisite conditions*", under section 32AB, *ante.*

In *CIT v. Punjab Financial Corporation* [(2002) 254 ITR 6, 14-15 (Punj—FB)], it has been held that the requirement of filing the duly audited report in Form No. 3AA [(w. e. f. 1-4-2003) Form No. 3AAA] along with the return cannot be treated as mandatory and the assessee cannot be deprived of the benefit of deduction if the same is filed before the finalisation of the assessment. In other words, the Assessing Officer can, for the purpose of allowing deduction in terms of section 32AB(1), accept the audit report even though the same may not have been filed along with the return, as required by section 32AB(5). In taking this view, the Full Bench has **overruled** *CIT v. Jaideep Industries* [(1989) 180 ITR 81 (Punj)] and has **followed** *CIT v. Gujarat Oil & Allied Industries* [(1993) 201 ITR 325 (Guj)] as also *CIT v. A.N. Arunachalam* [(1994) 208 ITR 481 (Mad)], all the three cases decided in the context of the provisions of the then section 80J(6A). Also see, *CIT v. Mahashakti Rice Mills*, (2003) 177 Taxation 767, 769-70 (Punj).

The words 'shall not be admissible', occurring in section 32AB(5) is directory and not mandatory in nature. Under that section, the assessee is permitted to produce the said report even after the filing of the return but before the assessment is made. The directory nature of the requirement does not wholly do away with the requirement of filing the report altogether [*CIT v. Berger Paints* (*India*) *Ltd.*, (2002) 254 ITR 503, 507, 509 (Cal)].

The filing of the audit report along with the return, as contemplated under section 32AB(5) is only directory and not mandatory [*CIT v. Print Systems & Products*, (2006) 285 ITR 260 (Mad)].

The substantive part of the provision of section 32AB requires the deposit of a sum in a Development Bank the accounts of the assessee, who claims deduction in respect of such deposits, must be audited. Since proof of the fact that the accounts have been audited before filing the return, the return is required to be submitted along with the certificate of the auditor that all the accounts have been audited. The requirement of submitting proof of the fact that the accounts have been audited is for only one purpose, namely, to ensure that the accounts have been audited before the claim to deduction under section 32AB is laid before the ITO for consideration [*CIT v. Dr. L.M. Singhvi*, (2007) 289 ITR 425 (Raj)].

The provisions of section 32AB(5) are not mandatory and the AO has discretion to entertain the audit report even though it was not filed along with the return for grant of benefit of deduction to the assessee in terms of section 32AB(1) [*CIT v. Sankalp Welfare Society*, (2008) 303 ITR 64 (Punj)].

Computers, defined.—Clause (*a*) of the *Explanation* to section 32AB coins the definition of the expression "computers" so as *not to include* calculating machines and calculating devices.

According to the *Random House Dictionary of English Language* (College Edition) (page 277), the expression "computer" is "a mechanical or electronic apparatus capable of carrying out repetitious and highly complex mathematical operations at high speeds".

According to the *Webster's Third New International Dictionary* (unabridged), Volume I, page 468, the expression "computer" means: 'one that computes: as a: a calculator especially designed for the solution of complex mathematical problems, specifically: a programmable electronic device that can store, retrieve, and process data'.

According to the *New Encyclopaedia Britannica* (Fifteenth Edition) Volume 21, pages 562-63: Modern computers are of three general types: (*i*) analogue, (*ii*) digital, and (*iii*) hybrid. They differ in operating principles, general design, and applications. Because of their great versatility, digital computers are the most widely used. An analogue computer solves problems by operating on continuous variables rather than on discontinuous or discrete units as do digital computers. A digital computer differs in principle from an analogue computer rather in the way that counting differs from measuring. An analogue signal has a continuously valid interpretation from the smallest to the largest value that it can achieve. A digital signal has only a discrete number of interpretations, usually (though not necessarily) two. A hybrid computer system consists of a combination of analogue and digital computers.

In the context of the provisions of the Central Excise Tariff Act, 1985 (5 of 1986), it has been held that a computer and its software are distinct and separate is clear, both as a matter of commercial parlance as also upon the material on record. A computer may not be capable of effective functioning unless loaded with software such as discs, floppies and CD ROMs, but that is not to say that these are a part of the computer or to hold that, it they are sold along with the computer, their value must form part of the assessable value of the computer for the purposes of excise duty. To give an example, a cassette-recorder will not function unless a cassette is inserted in it; but the two are well known and recognised to be different and distinct articles. The value of the cassette, if sold along with the cassette-recorder, cannot be included in the assessable value of the cassette-recorder. Just so, the value of software, if sold along with the computer, cannot be included in the assessable value of the computer for the purposes of excise duty [*PSI Data Systems Ltd. v. Collector of Central Excise*, (1997) 2 SCC 78, 83].

LexisNexis

The above view has been **followed in** *O.R.G. Systems v. Collector of Central Excise* [(1998) 6 SCC 56, 60].

Development Bank, defined.—According to **clause (*b*) of the *Explanation* to section 32AB**, the expression "Development Bank" means—

—in the case of an assessee carrying on business of growing and manufacturing tea in India, the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);

—in the case of other assessees, the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964), and includes such bank or institution as may be specified in the IDA Scheme in this behalf.

Eligible business or profession, defined for assessment years 1987-88 to 1990-91.—Clause (*i*) of section 32AB(2) coins a definition of the expression "eligible business or profession", for the purposes of section 32AB for assessment years 1987-88 to 1990-91, so as—

—to mean and include business or profession

—but not to include—

—the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI to the 1961 Act carried on by an industrial undertaking, which is not a small-scale industrial undertaking as defined in clause (*b*) of the *Explanation* to section 80HHA;

—the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small-scale industrial undertaking as defined in clause (*b*) of the *Explanation* to section 80HHA, engaged in the business of construction, manufacture or production of any article or thing specified in the list in Schedule XI to the 1961 Act.

It may be noted that the said clause (*i*) of section 32AB(2) shall stand omitted with effect from 1-4-1991. Thus, for and from assessment year 1991-92, there will be no specific definition of the expression "eligible business or profession".

A perusal of the above clause (*i*) of section 32AB(2) clearly postulates that the only business which has been left out of the definition of 'eligible business or profession' is business of construction, manufacture or production under clause (*a*) or business of leasing or hiring of machinery or plant for an industrial undertaking. In order to attract the restrictive meaning of this term, the business must be of construction, manufacture or production. Mere trading activity by no stretch of imagination can come within the purview of business which is

not eligible business for the purpose of the said section notwithstanding that article or thing in which a person is trading is falling under the Eleventh Schedule [*Desai Brothers v. Deputy CIT*, (1999) 240 ITR 121, 126 (Guj)].

In *Appollo Tyres Ltd. v. CIT* [(2002) 255 ITR 273, 281-82 (SC), **affirming on this point,** *CIT v. Appollo Tyres Ltd.*, (1999) 237 ITR 706 (Ker)], it has been held that the business of the assessee-company of buying and selling of units was an 'eligible business' as contemplated under section 32AB, and the income earned from its investment in the units of the UTI had to be included in computing the profits of 'eligible business' under section 32AB. The fact that the income was shown under a different head of income did not deprive the assessee-company so long as the investment in the units was in the course of its 'eligible business'. Therefore, the dividend income earned by the assessee-company from its investment in the UTI should be included in computing the profits of 'eligible business' under section 32AB. Also see, *CIT v. Ansal Housing Finance & Leasing : Ansal Properties & Industries Ltd. : Ansal Housing & Construction Ltd.*, (2013) 354 ITR 180 (Del).

Every 'eligible business' is not entitled to a deduction under section 32AB. An 'eligible business' is entitled to a deduction only in respect of its income chargeable to tax under the head 'Profits & gains of business or profession' [*CIT v. Hero Cycles Ltd.*, (2017) 393 ITR 144, 156 (Punj), SLP gr. (2017) 391 ITR 344 (St.)].

New ship, defined.—According to **clause (*ii*) of section 32AB(2)**, the expression "new ship" *includes* a ship which before the date of acquisition by the assessee was *used by any other person*, if it was *not* at any time previous to the date of such acquisition *owned by any person resident in India.*

New aircraft, defined.—Clause (*ii*) of section 32AB(2) coins a definition of the expression "new aircraft" so as to *include* an aircraft which before the date of acquisition by the assessee was *used by any other person,* if it was not at any time previous to the date of such acquisition *owned by any person resident in India.*

New machinery or plant, defined.—The definition of the expression "new machinery or plant" is contained in **clause (*iii*) of section 32AB(2)**. According to that definition, that expression includes—

—machinery or plant which before its installation by the assessee was used outside India by any other person,

—if the following cumulative conditions are fulfilled, namely:—

—such machinery or plant was not, at any time previous to the date of such installation by the assessee, used in India;

—such machinery or plant is imported into India from any country outside India; and

—no deduction on account of depreciation in respect of such machinery or plant—

—has been allowed or

—is allowable

under the 1961 Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

LexisNexis

Profits of the business or profession, meaning of.—According to section 32AB(3), 'profits of the business or profession' for the purpose of section 32AB(1), would be an amount arrived at after deducting an amount equal to the depreciation computed according to the requirements of Part II and Part III of Schedule VI to the Companies Act, 1956 (1 of 1956)[31] [*CIT v. Lakhani Rubber Udyog Ltd.*, (2007) 290 ITR 111 (Punj)].

Utilisation of the amounts, how to be made.—Paragraph 9(1) of the IDA Scheme enumerates the purposes for which the eligible assessee may utilise—

—the whole or any part of the amount deposited by him in a deposit account maintained by him with the Development Bank under section 32AB(1)(*a*), or

—any amount out of the income chargeable to tax under the head "Profits and gains of business or profession", without depositing the same under section 32AB(1)(*a*).

Such enumerated purposes are—

—purchase of new ship or new aircraft or new machinery or new plant [not covered by section 32AB(4)] for the purposes of the business or profession carried on by the depositor;

—purchase of new computers [as defined] to be installed either in the office or at a place where the depositor carries on business or profession;

—repayment of the principal amount of term loans—

—contracted after 31-3-1986 and

—taken for a period of three years or more from—

—a financial corporation which is engaged in providing long-term finance for industrial development in India or

31. Repealed and replaced by Act 18 of 2013.

—a scheduled bank or

—any other specified institution.

Withdrawals from the deposit account—procedure and utilisation.—Paragraph 9(2) of the IDA Scheme entitles a depositor to make withdrawal from the deposit, but such withdrawal cannot be made more than once in every three calendar months. Such withdrawal is possible by making an application in Form D appended to the IDA Scheme. However, such withdrawal application is to be granted only if the depositor has, for a minimum period of one year prior to the date of such withdrawal, in his account a minimum balance of an amount which is not less than the amount to be withdrawn.

It is also provided that on receipt of the request for withdrawal, the deposit office has, as soon as may be, to pay the amount to the depositor through a credit to the designated account [which means an account of the depositor exclusively for the purposes of the IDA Scheme opened with a scheduled bank].

Further, the amount so credited to the designated account is to be utilised by the depositor within 15 working days from the date of such credit for which the amount has been withdrawn. Where any amount so withdrawn or any part thereof is not so utilised, the same is to be refunded to the Development Bank. On such refund, the amount or part thereof, as the case may be, is to be treated a fresh deposit in the account for the purposes of withdrawal under paragraph 9(2)(*a*) of the IDA Scheme.

Withdrawals not permitted for a certain period except in certain circumstances.—Section 32AB(5A) enacts that any amount standing to the credit of the assessee in the deposit account is not to be allowed to be withdrawn before the expiry of a period of 5 years from the date of deposit except—

—for the purposes specified in paragraph 9(1) of the IDA Scheme or

—in the circumstances specified below:—

(*a*) closure of business;

(*b*) death of an assessee;

(*c*) partition of a Hindu undivided family;

(*d*) dissolution of a firm;

(*e*) liquidation of a company.

LexisNexis

The ***Explanation*** **to section 32AB(5A)** declares, for the removal of doubts, that nothing contained in section 32AB(5A) is to affect the operation of the provisions of section 32AB(5AA) or section 32AB(6) in relation to any withdrawals made from the deposit account either before or after the expiry of a period of 5 years from the date of deposit.

Certain withdrawals are chargeable as deemed business income.—Section 32AB(5AA) takes care of a situation where any amount, standing to the credit of the assessee in the deposit account, is withdrawn during any previous year by the assessee on closure of business or on dissolution of a firm. In such a situation, the whole of such amount—

—is to be deemed to be the profits and gains of business or profession of that previous year and

—is accordingly to be chargeable to income-tax as the income of that previous year,

as if the business had not closed or, as the case may be, the firm had not been dissolved.

Amount utilised, not to be allowed as business expenditure.—Section 32AB(5B) concerns a situation where any amount standing to the credit of the assessee in the deposit account is utilised by the assessee for the purposes of any expenditure in connection with—

—(for assessment years 1987-88 to 1990-91) the eligible business or profession

—(for and from assessment year 1991-92) the business or profession

in accordance with the IDA Scheme.

In such a situation, such expenditure is not to be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

Amount not utilised, to be chargeable as deemed business income.—Section 32AB(6) deals with a situation where—

—any amount, standing to the credit of the assessee in the deposit account, released during any previous year by the Development Bank for being utilised by the assessee—

—for the purposes specified in paragraph 9(1) of the IDA Scheme or

—at the closure of the account in circumstances other than the circumstances specified in clauses (*b*), (*c*) and (*e*) [namely, death of an assessee, parti-tion of a Hindu undivided family and liquidation of a company] of sec-tion 32AB(5A),

—is not utilised—

—in accordance with, and

—within the time specified in,

the IDA Scheme, either wholly or in part.

In such a situation, the whole of such amount or, as the case may be, part thereof which is not so utilised—

—is to be deemed to be the profits and gains of business or profession of that previous year and

—is, accordingly, to be chargeable to income-tax as the income of that previous year.

Transfer of the acquired asset within a certain period gives rise to deemed business income.—Section 32AB(7) takes care of a situation where—

—any asset acquired in accordance with the IDA Scheme

—is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired.

In such a situation, such part of the cost of such asset as is relatable to the deductions allowed under section 32AB(1)—

—is to be deemed to be profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and

—is, accordingly, to be chargeable to income-tax as the income of that previous year.

However, as per the **proviso to section 32AB(7)**, such deeming provisions are not to apply—

(*i*) where the asset is sold or otherwise transferred by the assessee to Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[32]; or

(*ii*) where the sale or transfer of the asset is made in connection with the succession of firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the IDA Scheme continues to apply to the company in the manner applicable to the firm.

LexisNexis

The ***Explanation*** **to section 32AB(7)** provides that the provisions of the above clause (*ii*) are to apply only where—

(*i*) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;

(*ii*) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

(*iii*) all the shareholders of the company were partners of the firm immediately before the succession.

Power of Central Government to modify Schedule XI.—Section 32AB(8) empowers the Central Government to omit, if it considers it necessary or expedient so to do, any article or thing from the list of articles or things specified in Schedule XI to the 1961 Act by issuing a notification in the Official Gazette.

Power of Central Government to except any class of assessees from application of section 32AB.—Under **section 32AB(9)**, the Central Government has been empowered, by issuing a notification in the Official Gazette, to direct, after making such inquiry as it may think fit, that the provisions of section 32AB are not to apply to any class of assessees, with effect from such date as it may specify in the notification.

Bar on deduction under section 32AB in certain cases.—See, under section 32A, *ante.*

It may also be noted that **section 32AB(10)**, as it stood up to 31-3-1989, placed a bar on deduction under section 32AB in the case of an assessee who had claimed the deduction allowable under section 33AB.

Questions of law.—(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that sub-section (2) of section 32AB which defines 'eligible business or profession' does not restrict it to be the unit put to operation or started in the year but means the entire business carried on by the assessee [*CIT v. Upper India Steel Manufacturing & Engineering Co.* (*P.*) *Ltd.,* (1997) 227 ITR 255, 256-57 (Punj)].

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that interest income constitutes an eligible income for the purposes of deduction under section 32AB of the Income-tax Act, 1961 (43 of 1961) [*CIT v. Tirath Ram Ahuja Ltd.*, (2000) 242 ITR 646, 647 (Del)].

32. Repealed and replaced by Act 18 of 2013.

(3) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding the order of the Commissioner of Income-tax (Appeals) in granting relief to the assessee under section 32AB on the interest component of the income earned out of monies invested in short term deposits for the assessment year 1990-91 [*CIT v. Jaiswal Chemicals P. Ltd.* : *Abhijit Iron Processors P. Ltd.*, (2001) 248 ITR 106, 108 (SC)].

(4) Whether, on the facts and in the circumstances of the case, the Tribunal is correct in holding that the assessee-company is entitled to include CCS also for the purpose of calculation of 20 per cent. profits of business even if it is established as a revenue receipt [*CIT v. India Fruits* (*P.*) *Ltd.* (2000) 154 Taxation 557, 558 (AP)].

Remand to AO.—The AO had failed to record any specific and categorical findings with regard to the facts of the instant case, the nature of the business activities carried out by the assessee and the reason for earning interest on certain deposits and, as such, the matter has been remanded to AO for recording a finding after providing an opportunity to the assessee [*Karnataka State Agro Corn Products Ltd. v. Deputy CIT*, (2009) 316 ITR 468 (Karn)].

Investment Deposit Account Scheme, 1986.—In exercise of the powers conferred by sub-section (1) of section 32AB of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby frames the following scheme, namely:—

1. Short title and application.—(1) This Scheme may be called **the Investment Deposit Account Scheme, 1986.**

(2) It applies to all the assessees who are eligible for the deduction under section 32AB of the Income-tax Act, 1961 (43 of 1961), other than the assessees carrying on the business of growing and manufacturing tea in India.

2. Definitions.—(1) In this Scheme, unless the context otherwise requires,

(*a*) "account" means a deposit account under this Scheme;

(*b*) "deposit office" means any office of the Development Bank where the account is maintained;

(*c*) "depositor" means an assessee who is eligible to make a deposit under section 32AB of the Income-tax Act;

(*d*) "designated account" means an account of the depositor exclusively for the purposes of the Scheme opened with a scheduled bank;

(*e*) "Income-tax Act" means the Income-tax Act, 1961 (43 of 1961);

(*f*) "paragraph" means a paragraph of this Scheme and "sub-paragraph" means a sub-paragraph of the paragraph in which it occurs;

(*g*) "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934).

(2) All references to "Forms" in this Scheme shall be construed as references to the forms set out in the Appendix to this Scheme.

3. Deposit how to be made.—(1) A deposit under the provisions of section 32AB of the Income-tax Act may be made by any depositor in accordance with the provisions of this Scheme.

(2) Such deposit may be made in one lump sum or in instalments in multiples of one thousand rupees (not exceeding four instalments in each financial year).

4. Manner of deposit.—(1) Every depositor making a deposit shall apply to the deposit office in Form A, or as near thereto as may be, together with the amount of deposit payable in the manner specified in sub-paragraph (3).

(2) On receipt of an application for the first time under sub-paragraph (1), the deposit office shall open an account in the name of the depositor.

(3) Every subsequent deposit shall be made into the deposit office at which the account stands by a crossed cheque or demand draft drawn in favour of such office on a bank situated at the place where the deposit office is situated.

(4) Every deposit shall be evidenced by a receipt issued in Form B, or as near thereto as may be, by the deposit office.

LexisNexis

(5) The deposit office shall issue to the depositor a statement of account in Form C, or as near thereto as may be, on the expiry of each quarter-ending on 30th June, 30th September, 31st December and 31st March in a year showing the amount of deposits made during the quarter previous to the quarter to which the statement relates.

5. Issue of duplicate statement.—In the event of loss or destruction of the receipt or statement of account referred to in sub-paragraph (4) or sub-paragraph (5) of paragraph 4, the deposit office may, on an application made to it in this behalf, issue a duplicate thereof.

6. Transfer of the account.—A depositor may apply for the transfer of the account from one deposit office to another deposit office.

7. Interest.—(1) Subject to sub-paragraph (2), the deposit shall carry simple interest at the rate of 10 per cent. per annum for the financial year ending with the 31st March, 1987, and thereafter at such rates as may be specified by the Development Bank for each subsequent year to be calculated from the first day of the month immediately following the month in which the amount of deposit is credited to the account.

(2) Where during any financial year any part of the deposit is withdrawn, the interest payable on the deposits shall be calculated on the basis of minimum monthly balance in the account during that financial year.

(3) The interest payable for any financial year or part thereof shall soon after the close of the financial year be credited to the designated account.

8. Charge or alienation.—The amounts standing to the credit of any account shall not be placed or offered as security for any loan or guarantee and shall not be charged or alienated in any manner whatsoever except in favour of Development Bank.

9. Utilisation of the amounts for the purposes of section 32AB.—(1) An assessee, whose total income includes income chargeable to tax under the head "Profits and gains of business or profession", may utilise—

(*a*) the whole or any part of the amount deposited by him in a deposit account under clause (*a*) of sub-section (1) of section 32AB of the Income-tax Act, or

(*b*) any amount out of such income, without depositing the same under clause (*a*) of sub-section (1) of section 32AB of the Income-tax Act,

in accordance with this Scheme, for any of the following purposes, namely:—

(*i*) purchase of new ship or new aircraft or new machinery or new plant for the purposes of the business or profession carried on by the depositor;

(*ii*) purchase of new computers to be installed either in the office or at a place where the depositor carries on business or profession;

(*iii*) repayment of the principal amount of term loans contracted after the 31st March, 1986, and taken for a period of three years or more from a financial corporation which is engaged in providing long-term finance for industrial development in India or from a scheduled bank or from any such other institution as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(2) (*a*) Withdrawal from the deposit may be made by a depositor not more than once in every three calendar months, by making an application in Form 'D':

Provided that no such application shall be granted unless the depositor has, for a minimum period of one year prior to the date of such withdrawal, in his account a minimum balance of an amount which is not less than the amount to be withdrawn.

(*b*) On receipt of the request for withdrawal, the deposit office shall, as soon as may be, pay the amount to the depositor through a credit to the designated account.

(*c*) The amount credited to the designated account under clause (*b*) shall be utilised by the depositor within fifteen working days from the date of such credit for the purpose for which the amount has been withdrawn; [33][and the amount or any part thereof which has not been so utilised shall be refunded to the Development Bank] and on such refund, the amount or part thereof, as the case may be, shall be treated as a fresh deposit in the account for the purposes of withdrawal under clause (*a*) of sub-paragraph (2) of paragraph 9 above.

10. Closure of the account.—(1) If a depositor desires to close the account, an application shall be made, with the approval of the Income-tax Officer or any other officer who has jurisdiction over the depositor, in Form 'E', or as near thereto as may be, and the deposit office shall, as soon as may be, subject to the provisions of paragraph 9 above, pay the amount of balance (including interest accrued as on the last day of the month preceding the month in which the said application under this paragraph has been made) lying to the credit of the depositor by means of a credit to the designated account.

LexisNexis

33. Subs. as per corrigendum: Notification No. GSR 1213(E), dated 19th November, 1986: (1987) 165 ITR (St.) 178.

(2) Where any person, other than the depositor, acquires a right under clause (*i*) or clause (*ii*) of the proviso to sub-section (7) of section 32AB of the Income-tax Act to receive the amount lying to the credit of the account, the Development Bank shall pay such amount to the person if the Income-tax Officer or any other officer who has jurisdiction in the matter over the depositor certifies to this effect [*Notification No. G.S.R. 945(E), dated 15-7-1986*].

FORM A

Industrial Development Bank of India

Investment Deposit Account Scheme, 1986

Application for opening a New Account

(*Paragraph 4(1) of the Scheme*)

Inv. Dep. A/c. Number.....Branch.....
Name

(For Office Use)
Office Code: .....
Voucher No.: .....
Voucher Date: .....

Amount deposited .....
(in words) .....
(in figures) Rs. .....
By Cheque/Demand Draft Number .....
Depositor Details
Type Individual—Sole prop.—Firm—Company—other (specify)
Address .....
.....
.....
(Dist.) (State)..... (Pin)
Financial year from month ..... to month .....
Permanent I.T. Account No. .....
Bank details for withdrawals

Name .....
Branch…….…. Account No .....

Date .....
Place .....

Signature of the depositor

LexisNexis

(For office use only)

Opened an account in favour of .....
on..... The account number allotted is .....
.....

Specimen Signature of Individual/ Principal Officer/Liquidator

Signature of Officer-in-Charge

Industrial Development Bank of India Investment Deposit Account Scheme, 1986

Acknowledgment

Branch.....
Inv. Dep. A/c. Number.....
Received from
Name .....
Address .....
.....
.....

Rs. …… by cheque/DD as the deposit towards Investment Deposit Account. The amount will be credited subjected to realisation.

The statement of accounts will be sent in due course.

Date ..... *Signature of Officer-in-Charge*
Place .....

FORM B

Industrial Development Bank of India Investment Deposit Account Scheme, 1986
Receipt for Deposit

(*Paragraph 4(4) of the Scheme*)

Name of the Deposit Office

Receipt No.
Received from .....
(Name and address of the depositor)
Whose Permanent Account No. is..... Rs. ..... (Rupees ..... (in figures) (in words)
only) for credit into the Investment Deposit Account No. …….
(Code No.....) ……
Signature of Officer-in-Charge

Place .....
Date .....
(Seal)

FORM C
Industrial Development Bank of India Investment Deposit Account Scheme, 1986
Office.....
Statement of Accounts as on.....
(*See Paragraph 4(5) of the Scheme*)

Designated Account No.
Name of the Bank/Branch & its address:

Name of Depositor..... Inv. Dep. Account Number .....
Address..... Permanent I.T. A/c. No. .....
..... Period from .....…..... to .....
.....

Sl. No.	Date	Cheque/DD No.	Particulars	Credit Rs.	Debit Rs.	Outstanding balance principal (Rs.)	Interest accrued as on (Rs.)
			Opening Balance				
1.							
2.							
3.							
4.							
5.							
			Closing Balance				

Place .....
Date ..... *Signature of Officer-in-Charge*

Counterfoil

FORM D

Industrial Development Bank of India Investment Deposit Account Scheme, 1986
Application for withdrawal

(*Paragraph 9 of the Scheme*)

Inv. Dep. A/c. No. ..... Branch.....
Name of the Depositor..... (Rupees .....

LexisNexis

Please pay a sum of Rs. ..... (in words)
.....) from out of the balance in the above account by way of credit to the designated account.

A. Purchase of new ship/aircraft/ machinery/computer from	**B.** Repayment of term loan to
***1.**	****1.**
2.	**2.**
3.	**3.**
4.	**4.**
5.	**5.**

as provided in the scheme.

I hereby declare and confirm that the amount sought to be withdrawn is proposed to be utilised for the purposes specified in the Investment Deposit Account Scheme, 1986.

Signature of the Depositor/authorised officer of the Firm/Company.

Amount paid by credit to the designated account No. .....
with.....through MT/TT
(Name and place of the bank/branch)

Date *Seal of the Bank* *Signature of Officer-in-Charge.*

* Name of supplier or other person receiving payment for or on behalf of supplier.
** Name of financial corporation/bank or notified institution.

Notes :

1. This counterfoil should be preserved and attached to the "Return of income" along with a copy of the statement of account for claiming deduction under section 32AB of the Income-tax Act, 1961, in respect of the relevant previous year.

2. If the application for withdrawal is made by a person other than the depositor, necessary evidence in support of the application should be furnished through the Income-tax Officer (paragraph 10(2) of the Scheme).

LexisNexis

(*To be returned to the depositor*)

FORM D

Industrial Development Bank of India Investment Deposit Account Scheme, 1986

Application for withdrawal

(*Please see notes overleaf*)

Inv. Dep. A/c. No. ..... Branch.....
Name of the Depositor.....
Please pay a sum of Rs. ..... (Rupees .....
.....) from out of the balance in the above account by way of credit to the…
..... (in words)
..... designated account.

A. Purchase of new ship/aircraft/ machinery/computer from	**B.** Repayment of term loan to
***1.**	****1.**
2.	**2.**
3.	**3.**
4.	**4.**
5.	**5.**

as provided in the scheme.

I hereby declare and confirm that the amount sought to be withdrawn is proposed to be utilised for the purposes specified in the Investment Deposit Account Scheme, 1986.

Signature of the Depositor/authorised officer of the Firm/Company.

Amount paid by credit to the designated account No. .....
with.....through MT/TT
(Name and place of the bank/branch)

Date *Seal of the Bank* *Signature of Officer-in-Charge.*

* Name of supplier or other person receiving payment for or on behalf of supplier.
** Name of financial corporation/bank or notified institution.

FORM E

Industrial Development Bank of India Investment Deposit Account Scheme, 1986

Application for Closing of Account

(*See Paragraph 10 of the Scheme*)

To
.....
.....
.....

I, ……, being the ..... of
(Name in block letters) (designation/capacity)
..... wish to close the Investment
.....(Name and address of the Firm/Company)*
Deposit Account No. .....standing in my name/in the name of.....
(name and address of the Firm/Company)*
in term of sub-paragraph (1) of Paragraph 10 of the Investment Deposit Scheme and consequently withdraw the balance to the credit of that account.

Place ..... ……
Date ..... *Signature*

LexisNexis

Approved

(Stamp and signature (with date) of Income-tax Officer/other officer having competent jurisdiction).

* Delete whatever is not applicable.

Note:

The amount payable net of any expenses for making the remittance shall be credited to the designated account of the depositor.

Omitted/Phased-out provisions of section 32AC of the 1961 Act

[1][**S. 32AC. Investment in new plant or machinery.—**(1) Where an assessee, being a company, engaged in the business of manufacture or production of any article or thing, acquires and installs new asset after the 31st day of March, 2013, but before the 1st day of April, 2015, and the aggregate amount of actual cost of such new assets exceeds one hundred crore rupees, then, there shall be allowed a deduction,—

(*a*) for the assessment year commencing on the 1st day of April, 2014, of a sum equal to fifteen per cent of the actual cost of new assets acquired and installed after the 31st day of March, 2013, but before the 1st day of April, 2014, if the aggregate amount of actual cost of such new assets exceeds one hundred crore rupees; and

(*b*) for the assessment year commencing on the 1st day of April, 2015, of a sum equal to fifteen per cent of the actual cost of new assets acquired and installed after the 31st day of March, 2013, but before the 1st day of April, 2015, as reduced by the amount of deduction allowed, if any, under clause (*a*).

[2][(1A) Where an assessee, being a company, engaged in the business of manufacture or production of any article or thing, acquires and installs new assets and the amount of actual cost of such new assets [3][acquired during any previous year exceeds twenty-five crore rupees and such assets are installed on or before the 31st day of March, 2017], then, there shall be allowed a deduction of a sum equal to fifteen per cent of the actual cost of such new assets for the assessment year relevant to that previous year:

[4][*Provided* that where the installation of the new assets are in a year other than the year of acquisition, the deduction under this sub-section shall be allowed in the year in which the new assets are installed:]

[5][*Provided further* that] no deduction under this sub-section shall be allowed for the assessment year commencing to the 1st day of April, 2015, to the assessee, which is eligible to claim deduction under sub-section (1) for the said assessment year.

(1B) No deduction under sub-section (1A) shall be allowed for any assessment year commencing on or after the 1st day of April, 2018.]

(2) If any new asset acquired and installed by the assessee is sold or otherwise transferred, except in connection with the amalgamation or demerger, within a period of five years from the date of its installation, the amount of deduction allowed under sub-section (1) [6][or sub-section (1A)] in respect of such new asset shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which such new asset is sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of such new asset.

LexisNexis

(3) Where the new asset is sold or otherwise transferred in connection with the amalgamation or demerger within a period of five years from the date of its installation, the provisions of sub-section (2) shall apply to the amalgamated company or the resulting company, as the case may be, as they would have applied to the amalgamating company or the demerged company.

(4) For the purposes of this section, "new asset" means any new plant or machinery (other than ship or aircraft) but does not include—

(*i*) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;

(*ii*) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

(*iii*) any office appliances including computers or computer software;

(*iv*) any vehicle; or

(*v*) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.]

Introduction under 1961 Act.—*The Finance Act, 2013.*—By **the Finance Act, 2013** (17 of 2013), **section 32AC** has been **inserted** (**w. e. f. 1-4-2014**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 3 of 2014, dated 24-1-2014*, as follows:—

---

1. Section 32AC has been inserted by the Finance Act, 2013 (17 of 2013), s. 6 (w. e. f. 1-4-2014).
2. Sub-sections (1A) and (1B) have been inserted by the Finance (No. 2) Act, 2014 (25 of 2014), s. 11(*i*) (w. e. f. 1-4-2015).
3. Subs., for "acquired and installed during any previous year exceeds twenty-five crore rupees", by the Finance Act, 2016 (28 of 2016), s. 14(*i*) (w. r. e. f. 1-4-2016).
4. Ins. by the Finance Act, 2016 (28 of 2016), s. 14(*ii*) (w. r. e. f. 1-4-2016).
5. Subs., for "Provided that", by the Finance Act, 2016 (28 of 2016), s. 14(*iii*) (w. r. e. f. 1-4-2016).
6. Ins. by the Finance (No. 2) Act, 2014 (25 of 2014), s. 11(*ii*) (w. e. f. 1-4-2015).

'**10.** *Incentive for acquisition and installation of new plant or machinery by manufacturing company.*—**10.1** In order to encourage substantial investment in plant or machinery, a new section 32AC has been inserted in the Income-tax Act to provide that where an assessee, being a company,—

(*a*) is engaged in the business of manufacture of an article or thing; and

(*b*) invests a sum of more than ₹100 crore in new assets (plant or machinery) during the period beginning from 1-4-2013 and ending on 31-3-2015, then, the assessee shall be allowed—

(*i*) for assessment year 2014-15, a deduction of 15 percent of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the cost of such assets exceeds ₹ 100 crore;

(*ii*) for assessment year 2015-16, a deduction of 15 percent of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1-4-2013 and ending on 31-3-2015, as reduced by the deduction allowed, if any, for assessment year 2014-15.

10.2 The phrase "new asset" has been defined as new plant or machinery but does not include—

(*i*) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;

(*ii*) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

(*iii*) any office appliances including computers or computer software;

(*iv*) any vehicle;

(*v*) ship or aircraft; or

(*vi*) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

10.3 Further, the suitable safeguards have been provided to restrict the transfer of the plant or machinery for a period of 5 years. However, this restriction shall not apply in a case of amalgamation or demerger but shall continue to apply to the amalgamated company or resulting company, as the case may be.

10.4 *Applicability.*—This amendment takes effect from 1-4-2014 and will, accordingly, apply in relation to the assessment year 2014-15 and subsequent assessment years.'.

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 2014.*—By **the Finance (No. 2) Act, 2014** (25 of 2014), the following **amendments** (**w. e. f. 1-4-2015**) have been made—

—**sections 32AC(1A) & (1B)** have been **inserted**; and

—**section 32AC(2)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 1/2015, dated 21-1-2015*, as follows:—

'**11.** *Investment allowance to a manufacturing company.*—**11.1** In order to encourage the companies engaged in the business of manufacture or production of an article or thing to invest substantial amount in acquisition and installation of new plant and machinery, Finance Act, 2013 (17 of 2013), inserted section 32AC in the Income-tax Act to provide that where an assessee, being a company, is engaged in the business of manufacture of an article or thing and invests a sum of more than ₹ 100 crores in new assets (plant and machinery) during the period beginning from 1-4-2013, and ending on 31-3-2015, then the assessee shall be allowed a deduction of 15 per cent of cost of new assets for assessment years 2014-15 and 2015-16.

11.2.1 As growth of the manufacturing sector is crucial for employment generation and development of an economy, section 32AC of the Income-tax Act has been amended to extend the deduction available under the said section for investment made in plant and machinery up to 31-3-2017.

11.2.2 Further, in order to simplify the existing provisions of section 32AC of the Income-tax Act and also to make medium size investments in plant and machinery eligible for deduction, section 32AC has been amended to provide that the deduction under the said section shall be allowed if the company on or after 1-4-2014, invests more than ₹ 25 crores in plant and machinery in a previous year.

11.2.3 Section 32AC has been further amended to provide that the assessee who is eligible to claim deduction under the existing combined threshold limit of ₹ 100 crores for investment made in previous years 2013-14 and 2014-15 shall continue to be eligible to claim deduction under the existing provisions contained in sub-section (1) of section 32AC even if its investment in the year 2014-15 is below the new threshold limit of investment of ₹ 25 crores during the previous year.

11.3 The deduction allowable under this section after the amendment in different scenario of investment is given by way of illustration in the following table:—

Sl. No.	*Particulars*	*P.Y. 2013-14*	*P.Y. 2014-15*	*P.Y. 2015-16*	*P.Y. 2016-17*	*Remarks*
1	Amount of investment	20	90	—	—	Under the existing section 32AC(1)
	Deduction allowable	*Nil*	16.5	—	—	
2	Amount of investment	30	40	—	—	Under the amended section 32AC(1A)
	Deduction allowable	*Nil*	6	—	—	
3	Amount of investment	150	10	—	—	Under the existing section 32AC(1)
	Deduction allowable	22.5	1.5	—	—	
4	Amount of investment	60	20	—	—	No deduction either under section 32AC(1) or 32AC(1A)
	Deduction allowable	*Nil*	*Nil*	—	—	
5	Amount of investment	30	30	30	40	Under the amended section 32AC(1A)
	Deduction allowable	*Nil*	4.5	4.5	6	
6	Amount of investment	150	20	70	20	Deduction both under sections 32AC(1) & 32AC(1A)
	Deduction allowable	22.5	3	10.5	*Nil*	

11.4 *Applicability*.—These amendments takes effect from 1-4-2015, and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent years.'.

II. *The Finance Act, 2016.*—By **the Finance Act, 2016** (28 of 2016), the following **amendments** (**w. e. f. 1-4-2016**) have been made—

—**section 32AC(1A)** has been **amended**;

—a new **1st proviso to section 32AC(1A)** has been **inserted** before the existing proviso to section 32AC(1A); and

—existing proviso to section 32AC(1A) has been **made** as **2nd proviso to section 32AC(1A)**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 3 of 2017, dated 20-1-2017*, as follows:—

'**42.** *Rationalization of scope of tax incentive under section 32AC.*—**42.1** The existing provision of sub-section (1A) in section 32AC of the Income-tax Act provides for investment allowance at the rate of 15% on investment made in new assets (plant and machinery) exceeding ₹ 25 crores in a previous year by a company engaged in manufacturing or production of any article or thing subject to the condition that the acquisition and installation has to be done in the same previous year. This tax incentive is available up to 31.03.2017.

42.2 The dual condition of acquisition and installation causes genuine hardship in cases in which assets having been acquired could not be installed in same previous year.

42.3 The provision of sub-section (1A) of section 32AC of the Income-tax Act has been amended so as to provide that the acquisition of the plant & machinery of the specified value has to be made in the previous year. However, installation may be made by 31.03.2017 in order to avail the benefit of investment allowance of 15%. It has been further provided that where the installation of the new asset is in a year other than the year of acquisition, the deduction under this sub-section shall be allowed in the year in which the new asset is installed.

42.4 *Applicability.*—This amendment takes effect retrospectively from 1-4-2016 and will, accordingly, apply in relation to assessment year 2016-17 and subsequent assessment years.'.

Investment allowance in case of new plant or machinery.—Investment allowance in case of new plant or machinery (*i.e.*, new asset) is available for assessment years 2014-15 to 2017-18 in view of sections 32AC(1) and 32AC(1A) of the 1961 Act.

Law for assessment years 2014-15 and 2015-16.—The provisions of **section 32AC(1) of the 1961 Act** are applicable if the following conditions are satisfied:—

(*a*) Assessee is a company which is engaged in the business of manufacture or production of any article or thing.

(*b*) Such assessee acquires and installs *new asset* [as defined] between 1-4-2013 and 31-3-2015.

LexisNexis

(*c*) Aggregate amount of actual cost of such new assets exceeds ₹ 100 crores.

If all the above conditions are fulfilled, then deduction under section 32AC(1) of the 1961 Act is to be allowed in the following manner:—

(1) For assessment year 2014-15: 15% of the actual cost of new assets acquired and installed in previous year 2013-14 was to be allowed as deduction if the aggregate amount of actual cost of such new assets exceeded ₹ 100 crores.

(2) For assessment year 2015-16: 15% of the actual cost of new assets acquired and installed in previous years 2013-14 and 2014-15 *as reduced by* the amount of deduction allowed in assessment year 2014-15, if any.

Law for assessment years 2015-16 to 2017-18.—The provisions of **section 32AC(1A) of the 1961 Act**, which has been **inserted** by **the Finance (No. 2) Act, 2014**, are applicable if the following conditions are satisfied:—

(*a*) Assessee is a company which is engaged in the business of manufacture or production of any article or thing.

(*b*) Such assessee acquires and installs *new asset* [as defined].

(*c*) For assessment year 2015-16, amount of actual cost of such new assets acquired and installed during previous year 2014-15 exceeds ₹ 25 crores. **However**, as per **2nd proviso to section 32AC(1A) of the 1961 Act**, no deduction shall be allowed for assessment year 2015-16 to such assessee which is eligible to claim deduction under section 32AC(1A) of the 1961 Act.

For assessment year 2016-17 and 2017-18, amount of actual cost of such new assets acquired during previous years 2015-16 and 2016-17 exceeds ₹ 25 crores and such assets are installed on or before 31-3-2017.

If all the above conditions are fulfilled, then deduction under section 32AC(1A) of the 1961 Act is to be allowed of a sum equal to 15% of the actual cost of such new assets for the assessment year relevant to that previous year. In case, where the installation of the new assets is in a year other than the year of acquisition, then deduction shall be allowed in the year in which the new assets is installed as per **1st proviso to section 32AC(1A) of the 1961 Act**.

Section 32AC(1B) of the 1961 Act explicitly enacts that deduction under section 32AC(1A) of the 1961 Act shall not be allowed for and from assessment year 2018-19. Thus, the provisions are relevant for assessment years 2015-16 to 2017-18.

"New asset", defined.—Section 32AC(4) of the 1961 Act coins a definition of the expression 'new asset' which **means** any new plant or machinery. But the definition **does not include** the following:—

(*i*) Any plant or machinery which before its installation by the assessee was used either within or outside India by any other person.

(*ii*) Any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house.

(*iii*) Any office appliances including computers or computer software.

(*iv*) Any vehicle (including ship or aircraft).

(*v*) Any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

Consequence of sale or transfer of new asset within specified period of 5 years.—As per **section 32AC(2) of the 1961 Act**, if any new asset acquired and installed by the assessee is sold or otherwise transferred, except in connection with the amalgamation or demerger, within a period of 5 years from the date of its installation, the amount of deduction allowed under section 32AC of the 1961 Act [whether under section 32AC(1) or under section 32AC(1A) of the 1961 Act] in respect of such new asset shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which such new asset is sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of such new asset.

Thus, in the year of sale or transfer, such new asset which has been sold or otherwise transferred will be prone to dual liability, *i.e.*, under the head "Profits and gains of business or profession" and under the head "Capital gains", if any.

As per **section 32AC(3) of the 1961 Act**, where the new asset is sold or otherwise transferred in connection with the amalgamation or demerger within a period of 5 years from the date of its installation, the above provisions of section 32AC(2) of the 1961 Act shall apply to the amalgamated company or the resulting company, as the case may be, as they would have applied to the amalgamating company or the demerged company.

LexisNexis

Omitted/Phased-out provisions of section 32AD of the 1961 Act

[1][**S. 32AD. Investment in new plant or machinery in notified backward areas in certain States.—**(1) Where an assessee, sets up an undertaking or enterprise for manufacture or production of any article or thing, on or after the 1st day of April, 2015, in any backward area notified by the Central Government in this behalf, in the State of Andhra Pradesh or in the State of Bihar or in the State of Telangana or in the State of West Bengal, and acquires and installs any new asset for the purposes of the said undertaking or enterprise during the period beginning on the 1st day of April, 2015, and ending before the 1st day of April, 2020, in the said backward area, then, there shall be allowed a deduction of a sum equal to fifteen per cent of the actual cost of such new asset for the assessment year relevant to the previous year in which such new asset is installed.

(2) If any new asset acquired and installed by the assessee is sold or otherwise transferred, except in connection with the amalgamation or demerger or re-organisation of business referred to in clause (*xiii*) or clause (*xiiib*) or clause (*xiv*) of section 47, within a period of five years from the date of its installation, the amount of deduction allowed under sub-section (1) in respect of such new asset shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which such new asset is sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of such new asset.

(3) Where the new asset is sold or otherwise transferred in connection with the amalgamation or demerger or re-organisation of business referred to in clause (*xiii*) or clause (*xiiib*) or clause (*xiv*) of section 47 within a period of five years from the date of its installation, the provisions of sub-section (2) shall apply to the amalgamated company or the resulting company or the successor referred to in clause (*xiii*) or clause (*xiiib*) or clause (*xiv*) of section 47, as the case may be, as they would have applied to the amalgamating company or the demerged company or the predecessor referred to in clause (*xiii*) or clause (*xiiib*) or clause (*xiv*) of section 47.

(4) For the purposes of this section, "new asset" means any new plant or machinery (other than a ship or aircraft) but does not include—

(*a*) any plant or machinery, which before its installation by the assessee, was used either within or outside India by any other person;

(*b*) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

(*c*) any office appliances including computers or computer software;

(*d*) any vehicle; or

(*e*) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.]

LexisNexis

Introduction under 1961 Act.—*The Finance Act, 2015.*—By **the Finance Act, 2015** (20 of 2015), **section 32AD** has been **inserted** (**w. e. f. 1-4-2016**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 19/2015, dated 27-11-2015*, as follows:—

'**14.** *Incentives for the States of Andhra Pradesh, Bihar, Telangana and West Bengal.*—**14.1** Manufacturing sector plays significant role in the economic growth of any region. In order to encourage the setting up of industrial undertakings in the backward areas of the State of Andhra Pradesh or the State of Bihar or the State of Telangana or the State of West Bengal, a new section 32AD has been inserted in the Income-tax Act and also the provisions of section 32 of the Income-tax Act has been amended to provide following incentives:

14.2 *Additional Investment Allowance.*—**14.2.1** Section 32AD has been inserted in the Income-tax Act to provide for an additional investment allowance of an amount equal to 15% of the cost of new asset acquired and installed by an assessee, if—

(*a*) he sets up an undertaking or enterprise for manufacture or production of any article or thing on or after 1-4-2015, in any notified backward area in the State of Andhra Pradesh or the State of Bihar or the State of Telangana or the State of West Bengal; and

(*b*) the new assets are acquired and installed for the purposes of the said undertaking or enterprise during the period beginning from the 1-4-2015 and ending on 31-3-2020.

1. Section 32AD has been inserted by the Finance Act, 2015 (20 of 2015), s. 11 (w. e. f. 1-4-2016).

14.2.2 This deduction shall be available over and above the existing deduction available under section 32AC of the Income-tax Act. Accordingly, if a company sets up an undertaking in the notified backward area in the State of Andhra Pradesh or in the State of Bihar or in the State of Telangana or in the State of West Bengal, it shall be eligible to claim deduction under the existing provisions of section 32AC of the Income-tax Act as well as under this newly inserted section 32AD of the Income-tax Act if it fulfils the conditions (such as investment above a specified threshold) provided in section 32AC as well as conditions specified in section 32AD.

14.2.3 The phrase "new asset" has been defined as plant or machinery but does not include—

(*i*) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;

(*ii*) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

(*iii*) any office appliances including computers or computer software;

(*iv*) any vehicle;

(*v*) any ship or aircraft; or

(*vi*) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

14.2.4 With a view to ensure that the manufacturing units which are set up by availing this incentive actually contribute to economic growth of these backward areas by carrying out the activity of manufacturing for a reasonable period of time, suitable safeguards have been provided for restricting the transfer of the plant or machinery for a period of 5 years. However, this restriction shall not apply to the amalgamating or demerged company or the predecessor in a case of amalgamation or demerger or business reorganisation but shall continue to apply to the amalgamated company or resulting company or successor, as the case may be.

14.3 *Additional Depreciation at the rate of 35%.*—**14.3.1** To incentivise investment in new plant or machinery, additional depreciation of 20% is allowed under the existing provisions of section 32(1)(*iia*) of the Income-tax Act in respect of the cost of plant or machinery acquired and installed by certain assessees. This depreciation allowance is allowed over and above the deduction allowed for general depreciation under section 32(1)(*ii*) of the Income-tax Act.

LexisNexis

14.3.2 In order to incentivise acquisition and installation of plant and machinery for setting up of manufacturing units in the notified backward areas in the State of Andhra Pradesh or in the State of Bihar or in the State of Telangana or in the State of West Bengal, a new proviso has been inserted in section 32(1)(*iia*) of the Income-tax Act to provide for higher additional depreciation at the rate of 35% (instead of 20%) in respect of the actual cost of new machinery or plant (other than a ship and aircraft) acquired and installed by an assessee for setting up of a manufacturing undertaking or enterprise in the notified backward area of the said States on or after the 1-4-2015.

14.3.3 This higher additional depreciation shall be available in respect of acquisition and installation of any new machinery or plant for the purposes of the said undertaking or enterprise during the period beginning on the 1-4-2015, and ending before the 1-4-2020. The eligible machinery or plant for this purpose shall not include the machinery or plant which are currently not eligible for additional depreciation as per the existing proviso to section 32(1)(*iia*) of the Income-tax Act.

14.4 *Applicability.*—These amendments takes effect from 1-4-2016, and will, accordingly, apply in relation to the assessment year 2016-17 and subsequent assessment years.'.

Investment allowance in case of new plant or machinery in notified backward areas of certain States.— Investment allowance in case of new plant or machinery (*i.e.*, new asset) in notified backward areas in the States of Andhra Pradesh or Bihar or Telangana or West Bengal is available for assessment years 2016-17 to 2020-21 in view of section 32AD(1) of the 1961 Act.

The provisions of **section 32AD(1) of the 1961 Act** are applicable if the following conditions are satisfied:—

(*a*) Assessee sets up an undertaking or enterprise for manufacture or production of any article or thing on or after 1-4-2015 in any notified backward areas in the States of Andhra Pradesh or Bihar or Telangana or West Bengal.

(*b*) Such assessee acquires and installs any *new asset* [as defined] for the purposes of the said undertaking or enterprise during the previous years 2015-16 to 2019-20 in the said backward area.

If both the above conditions are fulfilled, then deduction under section 32AD(1) of the 1961 Act is to be allowed of a sum equal to 15% of the actual cost of such new asset for the assessment year relevant to the previous year in which such new asset is installed.

"New asset", defined.—**Section 32AD(4) of the 1961 Act** coins a definition of the expression 'new asset' which **means** any new plant or machinery. But the definition **does not include** the following:—

(*i*) Any plant or machinery, which before its installation by the assessee, was used either within or outside India by any other person.

(*ii*) Any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house.

(*iii*) Any office appliances including computers or computer software.

(*iv*) Any vehicle (including ship or aircraft).

(*v*) Any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

Notified backward areas.—The notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal are as follows:—

S. No.	State of—	Notified backward areas		Notification No.
(1)	Bihar	(1) Patna (2) Nalanda (3) Bhojpur (4) Rohtas (5) Kaimur (6) Gaya (7) Jehanabad (8) Aurangabad (9) Nawada (10) Vaishali (11) Sheohar	(12) Samastipur (13) Darbhanga (14) Madhubani (15) Purnea (16) Katihar (17) Araria (18) Jamai (19) Lakhisarai (20) Supaul (21) Muzaffarpur	*SO 2241(E), dated 17-8-2015*: (2015) 376 ITR (St.) 235-36
		(22) Arwal (23) Banka (24) Begusarai (25) Bhagalpur (26) Buxar (27) Gopalganj (28) Khagaria (29) Kishanganj (30) Madhepura	(31) Munger (32) West Champaran (33) East Champaran (34) Saharsa (35) Saran (36) Sheikhpura (37) Sitamarhi (38) Siwan	*SO 2478(E), dated 20-7-2016*: (2016) 386 ITR (St.) 6-7
(2)	Telangana	(1) Adilabad (2) Nizamabad (3) Karimnagar (4) Warangal (5) Medak	(6) Mahbubnagar (7) Rangareddy (8) Nalgoda (9) Khammam	
(3)	West Bengal	(1) South 24 Parganas (2) Bankura (3) Birbhum (4) Dakshin Dinajpur (5) Uttar Dinajpur (6) Jalpaiguri	(7) Malda (8) East Medinipur (9) West Medinipur (10) Murshidabad (11) Purulia	
(4)	Andhra Pradesh	(1) Anantapur (2) Chittoor (3) Cuddapah (4) Kurnool	(5) Srikakulam (6) Vishakhapatnam (7) Vizianagaram	*SO 3075(E), dated 28-9-2016*: (2016) 387 ITR (St.) 36

LexisNexis

Consequence of sale or transfer of new asset within specified period of 5 years.—As per **section 32AD(2) of the 1961 Act**, if any new asset acquired and installed by the assessee is sold or otherwise transferred, except in connection with the amalgamation or demerger or business reorganisation referred to in section 47(*xiii*)/(*xiiib*)/(*xiv*) of the 1961 Act, within a period of 5 years from the date of its installation, the amount of deduction allowed under section 32AD(1) of the 1961 Act in respect of such new asset shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which such new asset is sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of such new asset.

Thus, in the year of sale or transfer, such new asset which has been sold or otherwise transferred will be prone to dual liability, *i.e.*, under the head "Profits and gains of business or profession" and under the head "Capital gains", if any.

As per **section 32AD(3) of the 1961 Act**, where the new asset is sold or otherwise transferred in connection with the amalgamation or demerger or business reorganisation referred to in section 47(*xiii*)/(*xiiib*)/(*xiv*) of the 1961 Act within a period of 5 years from the date of its installation, the above provisions of section 32AD(2) of the 1961 Act shall apply to the amalgamated company or the resulting company or the successor, as the case may be, as they would have applied to the amalgamating company or the demerged company or the predecessor.

LexisNexis

Omitted/Phased-out provisions of section 33 of the 1961 Act

S. 33. Development rebate.—[1][(1) (*a*) In respect of a new ship or new machinery or plant (other than office appliances or road transport vehicles) which is owned by the assessee and is wholly used for the purposes of the business carried on by him, there shall, in accordance with and subject to the provisions of this section and of section 34, be allowed a deduction, in respect of the previous year in which the ship was acquired or the machinery or plant was installed or, if the ship, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, a sum by way of development rebate as specified in clause (*b*).

(*b*) The sum referred to in clause (*a*) shall be—

(A) in the case of a ship, forty per cent of the actual cost thereof to the assessee;

(B) in the case of machinery or plant,—

(*i*) where the machinery or plant is installed for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule,—

(*a*) thirty-five per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) twenty-five per cent of such cost, where it is installed after the 31st day of March, 1970;

(*ii*) where the machinery or plant is installed after the 31st day of March, 1967, by an assessee being an Indian company in premises used by it as a hotel and such hotel is for the time being approved in this behalf by the Central Government,—

(*a*) thirty-five per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) twenty-five per cent of such cost, where it is installed after the 31st day of March, 1970;

(*iii*) where the machinery or plant is installed after the 31st day of March, 1967, being an asset representing expenditure of a capital nature on scientific research related to the business carried on by the assessee,—

LexisNexis

---

1. Subs. by the Finance (No. 2) Act, 1967 (20 of 1967), s. 33 and 3rd Sch. (w. e. f. 1-4-1968), for the following sub-section (1):—

"(1) In respect of a new ship acquired or new machinery or plant (other than office appliances or road transport vehicles) installed after the 31st day of March, 1954, which is owned by the assessee and is wholly used for the purposes of the business carried on by him, a sum by way of development rebate, equivalent to—

(*i*) in the case of a ship acquired after the 31st day of December, 1957, forty per cent and in the case of a ship acquired before the 1st day of January, 1958, twenty-five per cent of the actual cost of the ship to the assessee,

(*ii*) in the case of machinery or plant installed before the 1st day of April, 1961, twenty-five per cent of the actual cost of the machinery or plant to the assessee, and

(*iii*) in the case of machinery or plant installed after the 31st day of March, 1961—

(*a*) where the machinery or plant is installed after the 31st day of March, 1963, and before the 1st day of April, 1965, for the purposes of business of mining coal, thirty-five per cent of the actual cost of the machinery or plant to the assessee,

(*b*) where the machinery or plant is installed before the 1st day of April, 1965, for the purposes of any other business, twenty per cent,

(*c*) where the machinery or plant is installed after the 31st day of March, 1965—

(*A*) for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule,—

(*a*) thirty-five per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) twenty-five per cent of such cost, where it is installed after the 31st day of March, 1970, and

(*B*) for the purposes of any other business,—

(*a*) twenty per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) fifteen per cent of such cost, where it is installed after the 31st day of March, 1970,

shall, subject to the provisions of section 34, be allowed as a deduction in respect of the previous year in which the ship was acquired or the machinery or plant was installed or, if the ship, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year.".

The above sub-section (1) was amended (w. r. e. f. 1-4-1963) by s. 2 of the Income-tax (Amendment) Act, 1963 (43 of 1963); amended (w. e. f. 1-4-1965) by s. 8 of the Finance Act, 1965 (10 of 1965) and amended (w. r. e. f. 1-4-1965) by s. 5 of the Finance (No. 2) Act, 1965 (15 of 1965).

(*a*) thirty-five per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) twenty-five per cent of such cost, where it is installed after the 31st day of March, 1970;

(*iv*) in any other case,—

(*a*) twenty per cent of the actual cost of the machinery or plant to the assessee, where it is installed before the 1st day of April, 1970, and

(*b*) fifteen per cent of such cost, where it is installed after the 31st day of March, 1970.]

[2][(1A) (*a*) An assessee who, after the 31st day of March, 1964, acquires any ship which before the date of acquisition by him was used by any other person shall, subject to the provisions of section 34, also be allowed as a deduction a sum by way of development rebate at such rate or rates as may be prescribed, provided that the following conditions are fulfilled, namely:—

(*i*) such ship was not previous to the date of such acquisition owned at any time by any person resident in India;

(*ii*) such ship is wholly used for the purposes of the business carried on by the assessee; and

(*iii*) such other conditions as may be prescribed.

(*b*) An assessee who instals any machinery or plant (other than office appliances or road transport vehicles) which before such installation by the assessee was used outside India by any other person shall, subject to the provisions of section 34, also be allowed as a deduction a sum by way of development rebate at such rate or rates as may be prescribed, provided that the following conditions are fulfilled, namely:—

(*i*) such machinery or plant was not used in India at any time previous to the date of such installation by the assessee;

(*ii*) it is imported in India by the assessee from any country outside India;

(*iii*) no deduction on account of depreciation or development rebate in respect of such machinery or plant has been allowed or is allowable under the provisions of the Indian Income-tax Act, 1922 (11 of 1922), or this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;

(*iv*) such machinery or plant is wholly used for the purposes of the business carried on by the assessee; and

(*v*) such other conditions as may be prescribed.

(*c*) The development rebate under this sub-section shall be allowed as a deduction in respect of the previous year in which the ship was acquired or the machinery or plant was installed or, if the ship, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year.]

(2) In the case of a ship acquired or machinery or plant installed after the 31st day of December, 1957, where the total income of the assessee assessable for the assessment year relevant to the previous year in which the ship was acquired or the machinery or plant installed or the immediately succeeding previous year, as the case may be, [3][(the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of this section or sub-section (1) of section 33A or any deduction under Chapter VI-A [4][* *])] is *nil* or is less than the full amount of the development rebate calculated [5][at the rate applicable thereto under sub-section (1) or sub-section (1A), as the case may be],—

(*i*) the sum to be allowed by way of development rebate for that assessment year [6][under sub-section (1) or sub-section (1A)] shall be only such amount as is sufficient to reduce the said total income to *nil*; and

(*ii*) the amount of the development rebate, to the extent to which it has not been allowed as aforesaid, shall be carried forward to the following assessment year, and the development rebate to be allowed for the following assessment year shall be such amount as is sufficient to reduce the total income of

---

2. Sub-section (1A) has been inserted by the Finance Act, 1964 (5 of 1964), s. 8 (w. e. f. 1-4-1964).

3. Subs., for "(the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of this section or sub-section (1) of section 33A)", by Act 20 of 1967, s. 33 and 3rd Sch. (w. e. f. 1-4-1968).

4. The words, figures and letter "or section 280-O" have been omitted by the Finance Act, 1988 (26 of 1988), s. 54(*iv*) (w. e. f. 1-4-1988).

5. Subs. by Act 5 of 1964, s. 8, for "at the rate applicable thereto under that sub-section" (w. e. f. 1-4-1964).

6. Subs. by Act 5 of 1964, s. 8, for "under sub-section (1)" (w. e. f. 1-4-1964).

LexisNexis

the assessee assessable for that assessment year, computed in the manner aforesaid, to *nil*, and the balance of the development rebate, if any, still outstanding shall be carried forward to the following assessment year and so on, so however that no portion of the development rebate shall be carried forward for more than eight assessment years immediately succeeding the assessment year relevant to the previous year in which the ship was acquired or the machinery or plant installed or the immediately succeeding previous year, as the case may be.

Explanation.—Where for any assessment year development rebate is to be allowed in accordance with the provisions of sub-section (2) in respect of ships acquired or machinery or plant installed in more than one previous year, and the total income of the assessee assessable for that assessment year [7][(the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of this section or sub-section (1) of section 33A or any deduction under Chapter VI-A [8][* *])] is less than the aggregate of the amounts due to be allowed in respect of the assets aforesaid for that assessment year, the following procedure shall be followed, namely:—

(*i*) the allowance under clause (*ii*) of sub-section (2) shall be made before any allowance under clause (*i*) of that sub-section is made; and

(*ii*) where an allowance has to be made under clause (*ii*) of sub-section (2) in respect of amounts carried forward from more than one assessment year, the amount carried forward from an earlier assessment year shall be allowed before any amount carried forward from a later assessment year.

[9][(3) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers to the amalgamated company any ship, machinery or plant in respect of which development rebate has been allowed to the amalgamating company under section (1) or sub-section (1A),—

(*a*) the amalgamated company shall continue to fulfil the conditions mentioned in sub-section (3) of section 34 in respect of the reserve created by the amalgamating company and in respect of the period within which such ship, machinery or plant shall not be sold or otherwise transferred and in default of any of these conditions, the provisions of sub-section (5) of section 155 shall apply to the amalgamated company as they would have applied to the amalgamating company had it committed the default; and

LexisNexis

---

7. Subs., for "(the total income for this purpose being computed without making any allowance under sub-section (1) or sub-section (1A) of this section or sub-section (1) of section 33A)", by Act 20 of 1967, s. 33 and 3rd Sch. (w. e. f. 1-4-1968).

8. The words, figures and letter "or section 280-O" have been omitted by Act 26 of 1988, s. 54(*iv*) (w. e. f. 1-4-1988).

9. Subs. by Act 20 of 1967, s. 9 (w. r. e. f. 1-4-1967), for the following:—

'(3) Where in a scheme of amalgamation, a company (hereinafter in this sub-section referred to as the predecessor) sells or otherwise transfers to the company formed in pursuance of the predecessor's amalgamation with that company (hereinafter in this sub-section referred to as the successor) any ship, machinery or plant in respect of which development rebate has been allowed to the predecessor under sub-section (1) or sub-section (1A),—

(*a*) the successor shall continue to fulfil the conditions mentioned in sub-section (3) of section 34 in respect of the reserve created by the predecessor and in respect of the period within which such ship, machinery or plant shall not be sold or otherwise transferred and in default of any of these conditions, the provisions of sub-section (5) of section 155 shall apply to the successor as they would have applied to the predecessor had it committed the default;

(*b*) the balance of development rebate, if any, still outstanding to the predecessor in respect of such ship, machinery or plant shall be allowed to the successor in accordance with the provisions of sub-section (2), so, however, that the total period for which the balance of development rebate shall be carried forward in the assessments of the predecessor and the successor shall not exceed the period of eight years specified in sub-section (2) and the successor shall be treated as the assessee in respect of such ship, machinery or plant for the purposes of this section and section 34.

Explanation.—For the purposes of this sub-section, "amalgamation" means the merger of two or more companies (each of which is hereinafter in this *Explanation* referred to as the amalgamating company) to form one company (hereinafter in this *Explanation* referred to as the amalgamated company) in such a manner that—

(*i*) all the property of the amalgamating companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(*ii*) all the liabilities of the amalgamating companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation; and

(*iii*) shareholders holding not less than nine-tenths in value of the shares of the amalgamating companies immediately before the amalgamation become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company;

and includes the merger of a subsidiary company in the holding company, where the whole of the share capital of the subsidiary company is held by the holding company or its nominee.'.

In the above sub-section (3), the words, etc., "or sub-section (1A)" were added, and "this section" was substituted for "section 33", by the Finance Act, 1964 (5 of 1964), with effect from April 1, 1964, and the words "and the subsidiary company is an Indian company" at the end of the *Explanation* were omitted by the Finance Act, 1966 (13 of 1966), with effect from April 1, 1966.

(*b*) the balance of development rebate, if any, still outstanding to the amalgamating company in respect of such ship, machinery or plant shall be allowed to the amalgamated company in accordance with the provisions of sub-section (2), so, however, that the total period for which the balance of development rebate shall be carried forward in the assessments of the amalgamating company and the amalgamated company shall not exceed the period of eight years specified in sub-section (2) and the amalgamated company shall be treated as the assessee in respect of such ship, machinery or plant for the purposes of this section and section 34.]

(4) Where a firm is succeeded to by a company in the business carried on by it as a result of which the firm sells or otherwise transfers to the company any ship, machinery or plant, the provisions of clauses (*a*) and (*b*) of sub-section (3) shall, so far as may be, apply to the firm and the company.

Explanation.—The provisions of this clause shall apply only where—

(*i*) all the property of the firm relating to the business immediately before the succession becomes the property of the company;

(*ii*) all the liabilities of the firm relating to the business immediately before the succession become the liabilities of the company; and

(*iii*) all the shareholders of the company were partners of the firm immediately before the succession.

[10][(5) The Central Government, if it considers necessary or expedient so to do, may, by notification in the Official Gazette, direct that the deduction allowable under this section shall not be allowed in respect of a ship acquired or machinery or plant installed after such date, not being earlier than three years from the date of such notification, as may be specified therein.]

[11][(6) Notwithstanding anything contained in the foregoing provisions of this section, no deduction by way of development rebate shall be allowed in respect of any machinery or plant installed after the 31st day of March, 1965, in any office premises or any residential accommodation, including any accommodation in the nature of a guest-house:]

[12][*Provided* that the provisions of this sub-section shall not apply in the case of an assessee being an Indian company, in respect of any machinery or plant installed by it in premises used by it as a hotel, where the hotel is for the time being approved in this behalf by the Central Government.]

LexisNexis

Legislative amendments under 1961 Act.—I. *The Income-tax (Amendment) Act, 1963.*—By **the Income-tax (Amendment) Act, 1963** (43 of 1963), the following **amendments** (**w. r. e. f. 1-4-1963**) have been made—

—**section 33(1)(*i*)** has been **amended**; and

—**sections 33(1)(*ii*) & (*iii*)** have been **substituted** for the originally enacted section 33(1)(*ii*).

II. *The Finance Act, 1964.*—By **the Finance Act, 1964** (5 of 1964), the following **amendments** (**w. e. f. 1-4-1964**) have been made—

—**section 33** has been **amended**; and

—**sections 33(1A) & (5)** have been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 20, dated 7-7-1964*, as follows:—

'*Development rebate in respect of second-hand ships and machinery or plant.*—**66.** Section 8 of the Finance Act, 1964, has introduced a new sub-section (1A) in section 33 of the Income-tax Act providing for a deduction for development rebate, subject to the provisions of section 34 of that Act (creation of a development rebate reserve) and also certain other conditions in respect of a ship and machinery or plant (other than office appliances and road transport vehicles) which before the date of its acquisition by the assessee for the purpose of his business had been used by the previous owner thereof. While sub-section (1A) lays down the main conditions for the grant of development rebate in respect of such assets, it authorises the Board to prescribe any other conditions in this behalf in the rules framed under the Act, and also to prescribe the rates at which such development rebate shall be allowed. Rules in regard to these matters are being formulated by the Board and will be notified shortly.

67. Under this provision, development rebate will be allowable in respect of previously used ships acquired by an assessee after 31st March, 1964, subject to the following conditions, besides such other conditions as may be prescribed in the Income-tax Rules:

---

10. Sub-section (5) has been inserted by Act 5 of 1964, s. 8 (w. e. f. 1-4-1964).

11. Sub-section (6) has been inserted by the Finance Act, 1965 (10 of 1965), s. 8 (w. e. f. 1-4-1965).

12. Ins. by Act 20 of 1967, s. 33 and 3rd Sch. (w. e. f. 1-4-1968).

(*i*) Such ship should *not* have been used, at any time, prior to the date of its acquisition by the assessee, by any person resident in India;

(*ii*) It should be wholly used for the purposes of the business carried on by the assessee.

68. In regard to previously used machinery or plant (other than office appliances and road transport vehicles), development rebate will be admissible subject to the following conditions, besides such other conditions as may be prescribed in the Income-tax Rules:—

(*i*) Such machinery or plant should not have been used in India at any time before the date of its installation by the assessee and should have been imported in India by the assessee from a foreign country.

(*ii*) No deduction on account of development rebate or depreciation should have been allowed or be allowable in respect of such machinery or plant under the Indian Income-tax Act, 1922, or the Income-tax Act, 1961, for any period prior to the installation thereof by the assessee.

(*iii*) Such machinery or plant should be wholly used for the purpose of the business carried on by the assessee.

The provision for allowance of development rebate in respect of previously used machinery or plant will also have prospective operation, and it will be specified in the rules made under section 33(1A) that it will be admissible in respect of such assets installed by an assessee after 31st March, 1964.

69. It has to be noted that as the admissibility of development rebate in respect of previously used ships acquired by an assessee after 31st March, 1964, will be governed by the provisions of section 33(1A) of the Income-tax Act, the executive instructions in the matter contained in Board's Circular No. 27 (LIX-2) of 1955, dated the 6th July, 1955 (permitting the allowance of development rebate in respect of second-hand ships, acquired by an assessee after 31st March, 1954, if such ship had not been used in Indian waters by an Indian owner on or before the said date) *will not apply in respect of previously used ships acquired by an assessee after 31st March, 1964.* For similar reasons, *the executive instructions contained in the Board's Circular No. 40(XLVII-6) of 1962, dated 3rd December, 1962, permitting the allowance of development rebate (as well as the tax relief under sections 84 and 101) of the Income-tax Act, in respect of second-hand machinery or plant under certain conditions will not apply in respect of previously used machinery and plant imported by an assessee from abroad for the purpose of his business after 31st March, 1964.* The executive instructions in the aforesaid circular will apply only in respect of such used ships and machinery or plant as have been acquired or installed by an assessee for the purpose of his business before 1st April, 1964.

Power of the Central Government to discontinue the deduction of development rebate.—**70.** A new sub-section (5) has been inserted in section 33 of the Income-tax Act, by section 8(*v*) of the Finance Act, 1964, enabling the Central Government to make an order notified in the Official Gazette, directing that the deduction on account of development rebate under section 33 of the Income-tax Act shall not be allowed in respect of a ship acquired or machinery or plant installed after such date (not being earlier than three years from the date of such notification) as may be specified in the order.

Regarding this provision, the Minister of Finance has stated in his speech in the Lok Sabha on 10th March, 1964, in reply to the general discussions on the Budget:

> "In the light of the priorities of the Fourth Plan, a fresh system of rebates may have to be introduced and, therefore, a notice had to be given to industry that such a change might be made. This does not, however, mean that the system of development rebate is going to be scrapped altogether. The Budget proposals have, in fact, given fresh incentive to investment in certain key industries by lowering the rate of corporation tax on them and there can be no question of reducing the development rebate in respect of them even in the Fourth Plan because they will obviously continue to be important. In the next Budget, the Government hope to announce the rates of development rebate to be made applicable during the Fourth Plan period. Present thinking indicates that this will be on a graduated scale weighted in favour of the essential industries with a higher capital content".'.

III. *The Finance Act, 1965.*—By **the Finance Act, 1965** (10 of 1965), the following **amendments** (**w. e. f. 1-4-1965**) have been made—

—**section 33(1)(*iii*)** has been **substituted**;

—**section 33(2)** has been **amended**; and

—**section 33(6)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 3P, dated 11-10-1965*, as follows:—

'*Development rebate.*—**69.** The rates of development rebate in respect of new machinery or plant installed after 31-3-1965, have been regarded on the principle of selective support for industries which are of special importance for the industrial development of India and whose growth will also be helpful in promoting

import substitution. The quantum of development rebate in respect of machinery or plant installed by an assessee after 31-3-1965, for the purposes of a business of construction, manufacture or production of certain articles or things relating to such priority industries has been fixed at a rate which is higher than that provided in respect of any other machinery or plant. The abovementioned articles or things relating to priority industries have been enumerated in the new Fifth Schedule, added to the Income-tax Act by the Finance Act, 1965 (10 of 1965), and amended by the Finance (No. 2) Act, 1965 (15 of 1965), to include 'coal and lignite' therein, with effect from 1-4-1965. The articles and things enumerated in the Fifth Schedule to the Income-tax Act [as amended by the Finance (No. 2) Act, 1965 (15 of 1965)] are the same as the articles and things relating to priority industries listed in Part III of the First Schedule to the Finance Act, 1965 (10 of 1965) (the profits derived from the manufacture or production of which qualify for a special rebate of income-tax in the case of a company), except that 'tea' is not included in the list in the Fifth Schedule.

70. The revised rates of development rebates in respect of new machinery or plant installed in a business after 31-3-1965—provided in section 33 of the Income-tax Act, as amended by the Finance Act, 1965 (10 of 1965) and, subsequently by the Finance (No. 2) Act, 1965 (15 of 1965), with effect from 1-4-1965—are as follows:—

	Description		*Rate of development rebate* (*% of the actual cost to the assessee of new machinery or plant*)
	(1)		(2)
(1)	Machinery or plant used for the construction, manufacture, or production of any one or more of the articles or things specified in the Fifth Schedule to the Income-tax Act—		
	(*a*) installed during the period from 1-4-1965, to 31-1-1970	...	35%
	(*b*) installed after 31-3-1970	...	25%
	[Prior to the amendment of section 33 of the Income-tax Act by the Finance (No. 2) Act, 1965 (15 of 1965), new coal mining machinery installed up to 31-3-1966 was eligible, under clause (*iii*) of sub-section (1) of that section, for development rebate at 35% and after 31-3-1966 at 20%. However, the Finance (No. 2) Act, 1965 (15 of 1965), has amended the above-mentioned provision and included 'coal and lignite' in the Fifth Schedule to the Income-tax Act, with effect from 1-4-1965 and so new coal mining machinery will continue to be eligible for development rebate at the rate of 35% up to 31-3-1970 and 25% after that date.]		
(2)	Any other new machinery or plant not covered by the preceding item (1)—		
	(*a*) installed up to 31-3-1970	...	20%
	(*b*) installed after 31-3-1970	...	15%

LexisNexis

71. The rate of development rebate in respect of new ships remains the same as before, *viz.*, 40% of the cost thereof.

72. The Finance Act, 1965 (10 of 1965), has also added a new sub-section (6) to section 33 of the Income-tax Act with effect from 1-4-1965, providing that *no development rebate shall be allowed in respect of any machinery or plant installed* after 31-3-1965, in any office premises or any residential accommodation, including any accommodation in the nature of a guest house. The effect of this provision is that development rebate will not be admissible in respect of machinery or plant such as air-conditioners, frigidaires, room heaters, electric fans, etc., installed after 31-3-1965, in any office premises or any residential accommodation including a guest house.'.

IV. *The Finance (No. 2) Act, 1965.*—By **the Finance (No. 2) Act, 1965** (15 of 1965), the following **amendments** (**w. e. f. 1-4-1965**) have been made—

—**section 33(1)(*iii*)(*a*)** has been **amended**; and

—**section 33(1)(*iii*)(*c*)** has been **substituted**.

For the scope and effect of the above amendments, reference may be made to paras. 69 to 72 of the *Departmental Circular No. 3P, dated 11-10-1965*, which have been reproduced above.

V. *The Finance Act, 1966.*—By **the Finance Act, 1966** (13 of 1966), ***Explanation* to section 33(3)** has been **amended** (**w. e. f. 1-4-1966**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 4P, dated 21-7-1966*, as follows:—

'*Development rebate provisions modified.*—**39.** The rate of development rebate under section 33(1)(*iii*)(*a*) of the Income-tax Act in respect of new machinery or plant installed during the 5-year period from the 1st April, 1965, to 31st March, 1970, for the purposes of the business of construction, manufacture or production of any one or more of the articles and things specified in the list in the Fifth Schedule is 35% of the cost thereof, and in respect of such machinery installed after 31st March, 1970, it is 25%, as against the general rates of 20% and 15% of the cost of new machinery or plant installed for the purposes of any other business during the respective periods. The Finance Act, 1966, has extended the higher rates of development rebate to new machinery or plant installed after 31st March, 1966, for the purposes of the business of manufacture or production of tea, newsprint and printing machinery. This has been done by adding the items "tea", "newsprint", and "printing machinery" to the list of articles and things in the Fifth Schedule to the Income-tax Act, with effect from 1st April, 1966, with the specific provision that for purposes of section 33(1) of the Income-tax Act, the amendment to the Fifth Schedule shall have, effect in respect of machinery or plant installed after the 31st March, 1966, *vide* section 37(2) of the Finance Act, 1966.

40. One of the conditions laid down in section 34(3)(*a*) of the Income-tax Act for the allowance of the deduction for development rebate is that an amount equal to 75% 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 for being utilised during a period of 8 years next following for the purposes of the business of the undertaking, other than for distribution by way of dividends or profits, etc. This requirement of creating a development rebate reserve of 75% of the amount of development rebate often rendered it difficult for shipping enterprises making a substantial addition to their shipping fleet, to maintain a reasonable level of distribution of dividends to their shareholders. The quantum of the development rebate reserve has, therefore, been reduced in respect of ships acquired after 28th February, 1966, from 75% to 50% of the development rebate to be actually allowed.

LexisNexis

41. While some companies have been creating the development rebate reserve by debiting the amount thereof in the 'above-the-line' section of the profit and loss account in which the profits of the relevant year are arrived at, others have been making the debit in the 'below-the-line' section of the profit and loss account, often referred to as the Profit and Loss Appropriation Account, which, *inter alia*, contains credits for the profits, if any, brought forward from the earlier years or amounts transferred from various reserve accounts of the company. The provisions in Part II of Schedule VI to the Companies Act, 1956, in regard to the requirement as to the profit and loss account do not make a distinction between the 'above-the-line' and 'below-the-line' sections of the profit and loss account. The debit for development rebate reserve in the 'below-the-line' section of profit and loss account is, therefore, to be regarded as adequate compliance with the condition in section 34(3)(*a*) of the Income-tax Act that the debit should be made to the profit and loss account of the relevant previous year. However, a doubt had arisen in regard to the point as to whether a debit for the development rebate reserve in an amount in excess of the profits of the relevant previous year (as arrived at in the profit and loss account) could be regarded as adequate compliance with the condition that the debit should be made to the profit and loss account of the *relevant previous year*. This is because in such a case, the excess debit would represent an appropriation out of the profits of earlier years brought forward or the reserves transferred to the profit and loss appropriation account, instead of being an appropriation out of the profits of the relevant previous year. It was, however, not the intention to deny the deduction for development rebate merely for the reason that the amount of the development rebate reserve debited to the profit and loss account exceeded the profits of the relevant previous year as arrived at in the profit and loss account. The Finance Act, 1966, has, therefore, added an *Explanation* to section 34(3)(*a*) of the Income-tax Act which states, in substance, for the removal of doubts, that the deduction for development rebate shall not be denied by reason only that the amount of development rebate reserve debited to the profit and loss account of the relevant previous year exceeds the amount of the profits of such previous year (as arrived at without making the debit aforesaid) in accordance with the profit and loss account. The *Explanation* has been given retrospective effect from the commencement of the Income-tax Act. It may be mentioned that this *Explanation* does not, in any way, affect the existing provision in section 33(2) of the Income-tax Act under which the deduction to be allowed for development rebate for an assessment

year is to be limited to such amount as is sufficient to reduce the total income for the assessment year (as computed without making the deduction) to *nil*.

42. The Finance Act, 1966, has also amended the definition of the term "amalgamation" in the *Explanation* to section 33(3) of the Income-tax Act to enlarge its scope, so as to cover the merger of a foreign subsidiary company with its foreign holding company. The definition of the term "amalgamation" is relevant for the provision in section 33(3) of the Income-tax Act, which secures that in a case where a company which has availed of or is entitled to development rebate, in respect of ships, machinery or plant, transfers its business to another company in a scheme of amalgamation, within a period of eight years following the previous year to which the development rebate relates, the benefit of the development rebate is continued in the hands of the successor company. Ordinarily, the development rebate allowed to a person is liable to be withdrawn under section 34(3)(*b*) of the Income-tax Act if the assets in respect of which development rebate has been granted are sold or otherwise transferred by that person at any time before the above-mentioned period of 8 years to any person other than the Government, a local authority or a corporation set up under a State, Provincial or Central enactment or a Government company. However, in view of the special provisions in section 33(3), the development rebate is not withdrawn where the assets have been transferred by a company to another company in a scheme of amalgamation. Further, section 33(3) confers another benefit on companies acquiring the business of another company in a scheme of amalgamation, by way of allowing the transferee company to carry forward and to deduct from its profits, the amount of development rebate which was due to the transferor company but which could not be availed of by it due to insufficiency of profits. The term 'amalgamation' as defined in the *Explanation* to section 33(3) of the Income-tax Act before its amendment by the Finance Act, 1966, covered the merger of an Indian subsidiary company with its holding company but did not cover the merger of a foreign subsidiary company, carrying on business in India, with its foreign holding company. This had the unintended effect of discouraging amalgamation in the latter cases. To avoid hardship in such cases, the merger of foreign subsidiary companies with their holding companies has also been brought within the purview of the definition of the term "amalgamation". The amendment made to this definition is effective in respect of the assessment year 1966-67 and subsequent years.'.

VI. *The Finance (No. 2) Act, 1967.*—By **the Finance (No. 2) Act, 1967** (20 of 1967), the following **amendments** have been made—

—**section 33(1)** has been **substituted** (**w. e. f. 1-4-1968**);

—**section 33(2) and *Explanation* thereunder** have been **amended** (**w. e. f. 1-4-1968**);

—**section 33(3)** has been **substituted** (**w. e. f. 1-4-1967**); and

—**proviso to section 33(6)** has been **added** (**w. e. f. 1-4-1968**).

LexisNexis

The scope and effect of the amendments to sections 33(1) & (6) have been elaborated in the following portion of the *Departmental Circular No. 5P, dated 9-10-1967*, as follows:—

'*Modifications made in sections 33(1) and 33(6) explained.*—**41.....**(*ii*) The business of a hotel carried on by an Indian company will be treated as a priority industry, for the purposes of the Income-tax Act where the hotel is, for the time being, approved in this behalf by the Central Government. An Indian company engaged in such business will be entitled to the following tax concessions:—

(*a*) It will be entitled to deduct development rebate on new machinery or plant installed in the hotel at the higher rate of 35% of the cost thereof where it is installed during the period from the 1st April, 1967, to 31st March, 1970, and at 25% of the cost thereof, where it is installed after 31st March, 1970, as against the normal rate of development rebate in the case of non-priority industries of 20% of the cost of new machinery or plant installed therein up to 31st March, 1970, and 15% of the cost of new machinery or plant installed after 31st March, 1970. The provision in sub-section (6) of section 33 of the Income-tax Act, 1961, which bars the allowance of deduction on account of development rebate in respect of machinery or plant installed after 31st March, 1965, in any office premises or residential accommodation including any accommodation in the nature of a guest house will not apply in respect of any premises used by it as a hotel. [*Section 33, sub-clause (B)(ii) of clause (b) of sub-section (1) as substituted by the Finance (No. 2) Act, 1967, and the new proviso to sub-section (6)*]

* * *

Provisions for encouraging scientific research.—**42.** Under the existing provisions of the Income-tax Act, an assessee who instals any new machinery or plant for the purpose of scientific research related to the business carried on by him is eligible for a deduction by way of development rebate on such machinery or plant at the general rate of 20% of the cost thereof. Further, an assessee who incurs any capital expenditure on scientific research related to the business carried on by him (*e.g.*, capital expenditure incurred for

acquiring a building or machinery or plant or other equipment for scientific research) is entitled, under the existing provisions of section 35 of the Income-tax Act, to deduct such expenditure from his business profits over a period of five years, in equal instalments, commencing from the year in which the expenditure is incurred. The Finance (No. 2) Act, 1967, has amended the relevant provisions in the Income-tax Act with effect from 1-4-1968, *i.e.*, for and from the assessment year 1968-69, to provide further incentives for the promotion of scientific research in the country. The substance of the new provisions is as follows:—

(*i*) New machinery or plant acquired and installed by an assessee after March 31, 1967, for the purpose of scientific research related to his business will be eligible for development rebate at the higher rate applicable to any new machinery or plant installed in any of the specified priority industries, *i.e.*, at 35% of the actual cost of the new machinery or plant installed up to 31-3-1970, and at 25% of the actual cost thereof where it is installed after 31-3-1970. [*Section 33, sub-clause (B)(iii) of clause (b) of sub-section (1), as substituted with effect from 1-4-1968*]'.

For the scope and effect of the substitution of section 33(3), reference may be made to paras. 55 to 58 of the *Departmental Circular No. 5P, dated 9-10-1967*.

The scope and effect of the amendment to section 33(2), as also of section 33A(2), have been elaborated in the following portion of the *Departmental Circular No. 5P, dated 9-10-1967*, as follows:—

'*Modifications in the provisions of sections 33(2) and 33A(2).*—**91.....** (*ii*) under the existing provisions of section 33(2) and section 33A(2) of the Income-tax Act, the deductions for any year on account of development rebate and development allowance, respectively, are limited of the assessee's total income of that year as computed without making the said deductions. (Any amount of development rebate or development allowance which remains unabsorbed is carried forward to the following assessment year.) The relevant provisions have been amended to secure that for the assessment year 1968-69, and subsequent years, the deduction on account of development rebate or development allowance will be limited to the assessee's total income as computed without making the said deductions and also *without making* any deduction under the new Chapter VIA or any deduction on account of annuity deposit under Section 280-O of the Income-tax Act. These amendments have been made in view of the position that the deductions under the new Chapter VIA are to be allowed from the assessee's "gross total income", and the deduction under section 280-O, on account of annuity deposit, is to be allowed from the total income as computed under all other provisions of the Income-tax Act.....'.

VII. *The Finance Act, 1988.*—By **the Finance Act, 1988** (26 of 1988), **section 33(2) and the *Explanation* thereunder** have been **amended** (**w. e. f. 1-4-1988**).

Introduction of development rebate—*1922 Act.*—Development rebate as an allowance in the computation of business income was first introduced in the Indian Income-tax Act, 1922 (11 of 1922), section 10(2)(*vib*), on 1-4-1955, by section 8 of the Finance Act, 1955, whereby a development rebate was allowed at the rate of 25 per cent. of the cost of all new plant and machinery installed after 31-3-1954, for business purposes, instead of the then existing initial depreciation allowance of 20 per cent. in respect of such machinery or plant. No development rebate was specifically provided in respect of new ships; it was, presumably, taken as a 'plant'.

A new section 10(2)(*vib*) was substituted in place of the original one by section 7 of the Finance Act, 1958, whereby—

(*i*) the development rebate in the case of ships acquired after 31-12-1957, was specifically provided for at the rate of 40 per cent.;

(*ii*) in the case of ships acquired or machinery and plant installed after 31-12-1957, the grant of development rebate was made subject to the conditions (*a*) that a development rebate reserve of 75% of the rebate to be actually allowed is made, and (*b*) such reserve amount is not utilised by the assessee for distribution by way of dividends or profits or for remittance outside India as profits or for creation of any asset outside India or for any purpose other than for the business of the undertaking for a period of 10 years, and (*c*) the asset was not sold or otherwise transferred by the assessee to any person other than the Government at any time before the expiry of 10 years from the end of the year in which the asset was acquired or installed, and

(*iii*) provisions for carry forward of unabsorbed development rebate were enacted, so as to be available for a period of eight years.

By the Taxation Laws (Amendment) Act, 1960, a proviso was added to section 10(2)(*vi-b*) providing that development rebate was not to be admissible in respect of road transport vehicles and office appliances. The amendment was effective from 1-4-1960, even though the Amending Act was enacted on 6-9-1960 [see, *Maneklal Vallabhadas Parikh v. CIT,* (1969) 72 ITR 637 (Guj); *CIT v. Southern Roadways P. Ltd.,* (1975) 98 ITR 205 (SC)], *i.e.*, for and from assessment year 1960-61 [*Rajnandgaon Roadways* (*P.*) *Ltd. v. CIT,* (1978) 114 ITR 291 (MP)].

LexisNexis

The Finance Act, 1961, substituted sub-clauses (*i*) and (*ii*) of section 10(2)(*vib*) so as to secure that in respect of new plant or machinery installed on or after 1-4-1961, the development rebate was to be allowed at the rate of 20 per cent. instead of 25 per cent. of the actual cost thereof. In the case of new ships, the rate of 40 per cent. remained unchanged. Further, a new clause (*vic*) was inserted in section 10(2) providing that subject to certain conditions, where a company was amalgamated with another company or where a firm was converted into a private company and any ship, machinery or plant on which development rebate was admissible to the predecessor was transferred by the predecessor to the successor, the development rebate already allowed in respect of the asset transferred was not to be withdrawn and any unabsorbed portion of the development rebate was to be available to the successor.

From the historical background, which may be used for proper construction of the provisions [*Holme v. Guy,* (1877) 5 Ch. D. 901, 905; *R.M.D. Chamarbaugwalla v. Union of India,* AIR 1957 SC 628, 631], it is clear that development rebate was not introduced only for the advantage of selected industries [*Sundaram Motors P. Ltd. v. CIT,* (1969) 71 ITR 587, 591 (Mad)].

1961 Act.—The provisions of section 10(2)(*vib*) and 10(2)(*vic*) of the 1922 Act were reflected in sections 33 and 34 of the 1961 Act. The material change was that the period of 10 years for utilisation of the reserve and non-transfer of the asset under the 1922 Act was reduced to a period of 8 years under the 1961 Act provisions [see, *Indian Oil Corporation Ltd. v. S. Rajagopalan,* (1973) 92 ITR 241, 247 (Bom); *Addl. CIT v. Shri Subhlaxmi Mills Ltd.,* (1975) 100 ITR 188, 190-93 (Guj)].

Relevant rule.—Rule 5B of the Income-tax Rules, 1962, is relevant to section 33.

Amendment of the Fifth Schedule.—By amending the Fifth Schedule to the Income-tax Act, 1961 (43 of 1961), **the Finance Act, 1968** (19 of 1968), has enlarged the scope of priority industries entitled to development rebate at higher rate.

It may be mentioned in this connection that under section 33(1)(*b*)(B)(*i*), machinery or plant installed for the purposes of business of manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule qualifies for development rebate at the rate of 35% of the actual cost of such machinery or plant to the assessee, where it is installed before the 1-4-1970, and 25% of such cost, where it is installed after 31-3-1970. The effect of inclusion of "Processed (including frozen) fish and fish products" in the Fifth Schedule is that new equipment (including refrigeration equipment in shore installations) for production of these articles will qualify for development rebate at the rate of 35% of the actual cost where this is installed before 1-4-1970, and 25% where it is installed after 31-3-1970. Trawlers used for deep-sea fishing already qualify for development rebate at the rate of 40%, applicable in the case of ships.

LexisNexis

By **the Finance Act, 1969** (14 of 1969)**,** two items, namely, cotton textiles and jute textiles, were added to the Fifth Schedule with the result that new machinery and plant installed in any of those industries also become eligible for a development rebate at the higher rate.

Discontinuance of development rebate allowance.—The following **notification** was issued by the Central Government in respect of discontinuance of development rebate allowance:

"In exercise of the powers conferred by **sub-section (5) of section 33** of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that the deduction in respect of development rebate under section 33 of the said Act shall not be allowed in respect of a ship acquired or machinery or plant installed after the 31-5-1974." [*Notification No. S.O. 2167, dated the 28-5-1971*].

Section 16 of the Finance Act, 1974 (Act No. 20 of 1974), however, provided:

"**S. 16.** *Continuance of development rebate in certain cases.*—The notification of the Government of India in the Ministry of Finance (Department of Revenue and Insurance) No. S.O. 2167, dated the 28th day of May, 1971, issued under sub-section (5) of section 33 of the Income-tax Act shall not apply in respect of—

(*a*) any ship acquired after the 31st day of May, 1974, but before the [13][1st day of January, 1977], by any assessee, if the assessee furnishes evidence to the satisfaction of the Income-tax Officer that he had, before the 1st day of December, 1973, entered into a contract for the purchase of such ship with the builder or owner thereof;

(*b*) any machinery or plant, being coal-fired equipment,[14] or any machinery or plant for converting oil-fired equipment into coal-fired equipment, installed by any assessee after the 31st day of May, 1974, but before the 1st day of June, 1977.

Explanation.—In this clause, 'equipment' means a boiler, furnace, kiln, oven or the like;

---

13. Subs. for "1st day of June, 1975", by the Finance Act, 1975, s. 30 (w. e. f. 1-4-1975).

14. 'Coal-fired equipment' includes gas-fired Kiln, furnace, etc. [vide Circular No. 170, dated 30th June, 1975].

(*c*) any machinery or plant [not being machinery or plant referred to in clause (*b*)] installed by any assessee after the 31st day of May, 1974, but before the 1st day of June, 1975, if the assessee furnishes evidence to the satisfaction of the Income-tax Officer that before the 1st day of December, 1973, he had purchased such machinery or plant or had entered into a contract for the purchase of such machinery or plant with the manufacturer or owner of, or a dealer in, such machinery or plant, or had, where such machinery or plant has been manufactured in an undertaking owned by the assessee, taken steps for the manufacture of such machinery or plant, and accordingly the provisions of the Income-tax Act shall have effect in relation to such ship, machinery or plant, subject to the conditions specified in clauses (*a*), (*b*) and (*c*).".

The provisions of the said section 16 of the Finance Act, 1974 (20 of 1974), have been explained in paragraph 38 of the departmental circular No. 138, dated 17-6-1974, which has been extracted at 233 ITR 391, 399 (Mad).

Commenting on the above circular, the Madras High Court in *CIT v. Southern Petro Chemical Industries Corporation Ltd.* [(1998) 233 ITR 391, 400 (Mad)] has observed:

'We are of the opinion that the circular of the Board does not have any overriding effect over the statutory conditions stipulated under section 33 of the Act, but the circular, in our view, reiterates that the development rebate would continue to be allowed in respect of machinery or plant where the conditions specified in clauses (*a*) to (*c*) of section 16 of the Finance Act, 1974 (20 of 1974), are satisfied and the conditions contained in the Income-tax Act are also fulfilled. The circular also has not dispensed with the requirement of the user of the machinery or plant in the assessment year for the grant of development rebate.'.

In the Madras case [233 ITR 391, 400 (Mad)], since the first appellate authority as well as the Tribunal has not recorded any finding whether the assessee had put the machinery to use either in the year of installation or in the immediately succeeding previous year, the matter has been remanded to the Tribunal to determine the question and to give a finding in that regard.

In effect, the development rebate has been replaced, in certain selected cases, by an initial depreciation allowance @ 20 per cent. of the actual cost.

In *CIT v. Anglo India Jute Mills Ltd.* [(1993) 202 ITR 104, 107, 108 (Cal)], it has been held that the above section 16 of the Finance Act, 1974 (20 of 1974), clearly provided that development rebate would not be admissible in the case of machinery or plant which are installed by the assessee after 31-5-1974, unless such machinery or plant was purchased by the assessee before 1-12-1973, or the assessee had entered into a contract for the purchase of such machinery or plant with the manufacturer or owner or a dealer in such machinery or plant before that date. In the instant case, since the ancillary equipment was neither purchased nor ordered before 1-12-1973, the assessee was not entitled to development rebate on these ancillary items.

In *Mafatlal Fine Spg. & Mfg. Co. Ltd. v. CIT* [(1994) 206 ITR 578, 581 (Bom)], it has been held that the admitted position was that the original order placed by the assessee for purchase of plant and machinery before 1-12-1973, did not include the accessories in question for which a separate order was placed by the assessee after 1-12-1973, and in that view of the matter, it is not covered by section 16(*c*) of the Finance Act, 1974 (20 of 1974). The Tribunal was, therefore, right in holding that the assessee was not entitled to development rebate on the accessories for which the orders were placed by the assessee after 1-12-1973.

By reason of section 16(*c*) development rebate under section 33 was continued beyond 31-5-1974, provided the following conditions were met: (*i*) the machinery or plant should have been installed by the assessee after 31-5-1974, but before 1-6-1975, and (*ii*) the assessee should furnish evidence to the satisfaction of the ITO that before 1-12-1973, he had either purchased such machinery or plant or had placed a contract for the purchase of such machinery or plant with the manufacturer or owner of, or a dealer in such machinery, or plant. When the machinery or plant had been manufactured in an undertaking owned by the assessee, he had taken steps for the manufacture of such machinery or plant [*New Excelsior Theatre Pvt. Ltd. v. CIT,* (1994) 210 ITR 570, 575-76 (Bom)]. In the facts of that case, the assessee was held not entitled to development rebate by virtue of the provisions of the said section 16(*c*) because of the fact that the assessee could not be considered as having entered into a contract for the purchase of the plant and machinery prior to 1-12-1973.

For falling within the ambit of the latter part of section 16(1)(*c*), the manufacture should be in an undertaking owned by the assessee. Erection of plant with components collected from time to time is not equivalent to manufacture in an undertaking of the assessee, and, therefore, such erection alone cannot qualify for the development rebate. In that view of the matter, the Tribunal was held not justified in allowing development rebate in respect of eight items which were cleared while the erection of the plant of the assessee was going on [*Travancore Electro-Chemical Industries Ltd. v. CIT,* (1995) 214 ITR 195, 201 (Ker)].

LexisNexis

Section 16(*c*) of the Finance Act, 1974 (20 of 1974), clearly requires that the benefit of continuance of development rebate would be available only if the assessee furnishes evidence to the satisfaction of the Income-tax Officer that 'he had entered into a contract' for the purchase of such machinery on or before 1-12-1973. From the language and object of that section 16(*c*), it is clear that the requirements specified therein are mandatory which must be fulfilled to avail of the benefit of the special provision contained therein [*CIT v. Lokmat News Papers Pvt. Ltd.,* (1995) 216 ITR 199, 205 (Bom)]. In the facts of that case, admittedly, the order for purchase (on 10-6-1973) of machinery was not placed by the assessee-company. It was not even in existence at that time as it was incorporated on 21-6-1973. Nor was it placed by the partnership firm of which it was a partner (from 1-7-1973) and on its dissolution (on 31-12-1973) took over the assets and liabilities thereof. The order was placed (on 10-6-1973) by a firm with which the assessee was not connected in any manner. On these facts, it has been held that the assessee-company was not entitled to development rebate on machinery and plant installed in the year ending 30-6-1974 relevant to the assessment year 1975-76.

On the construction of section 16(*c*) of the Finance Act, 1974 (20 of 1974), relating to continuance of development rebate in certain cases, see, *Rukmani Metals & Gaseous Ltd. v. CIT* [SLP (Civil) No. 14427 of 1982: (1983) 140 ITR (St.) 25 (SC)].

Question of law.—(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in allowing development rebate on plant and machinery for which agreement to supply was entered into on 28-12-1973 [*CIT v. Vippy Solvex Products P. Ltd.,* (1998) 230 ITR 92, 93-94 (MP)].

Scope and ambit of section 33.—Section 33 deals with the claim relating to development rebate. However, the benefit of development rebate was discontinued by Notification No. SO 2167, dated 28-5-1971. It provided that in exercise of the powers conferred by section 33(5), the Central Government hereby directed that the deduction in respect of development rebate under section 33 shall not be allowed in respect of a ship acquired or machinery or plant installed after 31-5-1974 [*CIT v. Vippy Solvex Products P. Ltd.*, (2005) 273 ITR 375 (MP)].

Provisions by way of an incentive.—The provisions for allowance of deduction of a development rebate in the computation of business income were introduced for giving incentives to businessmen to develop their business. It is not, strictly speaking, an expenditure which is allowed as a deduction. It cannot be treated by the assessee as a part of his income or profits for all purposes. Restrictions have been imposed on an assessee's right to deal with or dispose of the development rebate reserve [see, *West Laikdihi Coal Co. Ltd. v. CIT,* (1973) 87 ITR 501, 508 (Cal)].

LexisNexis

Strict compliance essential.—Section 33 is not a charging section. It has been introduced as a concession to the assessee and, to get the benefit of the section, the assessee must strictly comply with it [*CIT v. J. Thomas & Co. P. Ltd.,* (1977) 110 ITR 566 (Cal)].

Development rebate is over and above depreciation allowance.—The development rebate is allowable under an independent section 33, while depreciation is allowable under another section 32. Neither of the sections has been made subject to the provisions of the other. Hence, it is clear that the development rebate is allowable over and above the recoupment of the total cost of plant, machinery, etc., by way of depreciation allowance [*Addl. CIT v. Vishnu Industrial Enterprises,* (1980) 122 ITR 919, 922 (All)].

In other words, section 32 and 33 are two independent provisions and the claim under each of them has to be decided on the language thereof. Grant of development rebate is not dependent on the rate of depreciation allowable under section 32 of the Act read with Appendix I to the Rules. In that view of the matter, an assessee cannot be denied development rebate merely on the ground that the rate of depreciation prescribed in the Appendix I to the Rules happens to be 100 per cent., if the assessee has otherwise fulfilled the conditions or requirements of the law for allowability of development rebate. Therefore, the Tribunal was held not justified in holding that development rebate was not admissible on the rolling mill rolls because the rate of depreciation thereon happened to be 100 per cent. [*Bralco Metal Industries Pvt. Ltd. v. CIT,* (1994) 206 ITR 477, 484 (Bom)].

Even where 100 per cent depreciation has been allowed on the entire cost of the plant under the then first proviso to section 32(1) because the cost of each item of plant was less than specified value, the assessee would be entitled to development rebate on such plant [*CIT v. Gujarat State Fertilizers Co. Ltd.*, (1999) 240 ITR 536, 538-39 (Guj); *CIT v. Modi Industries Ltd.*, (2001) 250 ITR 35, 38-39 (Del)].

However, where the cost of loose tools, costing less than the specified value, has been allowed as revenue expenditure, the question of allowing development rebate did not arise [*Taylor Instrument Company* (*India*) *Ltd. v. CIT*, (2002) 254 ITR 125, 128 (Del)].

But development rebate is allowable only once in respect of an asset.—Development rebate is allowable by way of an incentive for industrial growth and expansion. It is a capital allowance. It has no connection with

depreciation allowance which is, normally, an annual recurrence. By its very nature, it has been made allowable only once in respect of a particular asset and that in the year of its installation or first use, as the case may be [*CIT v. Saurashtra Wire-healds Manufacturing Co. P. Ltd.,* (1968) 67 ITR 524, 536 (Guj); *Addl. CIT v. Shri Subhlaxmi Mills Ltd.,* (1975) 100 ITR 188, 190 (Guj); *Addl. CIT v. Vishnu Industrial Enterprises,* (1980) 122 ITR 919, 922 (All)].

Subject-matter on which development rebate may be claimed.—Section 33(1)(*a*) specifies that development rebate may be claimed in respect of—

(*i*) a new ship, or

(*ii*) new machinery or plant (other than office appliances or road transport vehicles)

which is—

(*a*) owned by the assessee and

(*b*) is wholly used for the purposes of the business carried on by the assessee.

In other words, for the application of section 33, there are three conditions which need to be satisfied. They are: (*i*) that the ship, machinery or plant must be owned by the assessee; (*ii*) is wholly used for the purposes of the business; and (*iii*) the business must be carried on by the assessee [*CIT v. Smt. Tara Sarup,* (1991) 188 ITR 783, 787 (Bom)]. In the facts of that case, it has been held that the assessee was entitled to development rebate under section 33 on the additions to the plant and machinery made during the previous year in the businesses styled Amar Tara Industries and Indian Cork Mills even though during the previous year, *i.e.*, on 1-3-1963, her aforesaid two proprietary businesses became partnership concerns.

Under section 33(1), two conditions precedent are required to be fulfilled for entitlement to development rebate, namely, a new ship acquired or new machinery or plant installed must be (1) owned by the assessee, and (2) wholly used for the purpose of the business carried on by him. In the context of section 33(1), the ownership consists of a bundle of rights, namely, title to, possession of and beneficial enjoyment thereof [*Mahabir Cold Storage v. CIT,* (1991) 188 ITR 91, 95 (SC)]. In that case, it has been observed (p. 97): "Unfortunately, the assessee did not bring on record the necessary material facts to establish that it became owner by any non-testamentary instrument acquiring right, title and interest in the plant and machinery....."

In the facts of *CIT v. Indian Explosives Ltd.* [(1993) 204 ITR 476, 480 (Cal)], it has been held that the assessee was not entitled to development rebate on railway siding as it was admittedly not the owner of the railway siding.

In *Addl. CIT v. Syntex Fabrics Ltd.* [(1991) 191 ITR 52 (All)], the business done by the promoters was accepted by the company incorporated by the promoters. The company was held entitled to development rebate in respect of such business.

In *CIT v. Northern India Iron & Steel Co. Ltd.* [(1995) 211 ITR 370, 378 (Del)], the assessee purchased new machinery and the same was installed in a factory leased by the assessee earlier. It has been held that the assessee was not entitled to development rebate under section 33 as the machinery could not be held to have been wholly used for the purposes of the business carried on by the assessee. Also see, *CIT v. Northern India Iron & Steel Co. Ltd.,* (1997) 226 ITR 342, 343 (Del).

In *CIT v. Gammon India Ltd.* [(1994) 124 CTR (Bom) 237, 238-39], the High Court has declined to answer the questions in view of the fact that in that case the Tribunal has simply followed its earlier order in the assessee's own case, which was rendered as back as in the year 1972, holding that barges were ships eligible for development rebate.

In *Symbiotics Ltd. v. CIT,* [(1994) 120 Taxation 181, 183 (Guj)], the Tribunal was held right in law in confirming order of the AAC that—

—the assessee was entitled to claim development rebate @ 15% on an eligible asset although no such claim was made by the assessee before the ITO;

—the ITO should dispose of the claim of the assessee for development rebate @ 15% on capital assets installed for scientific research and to allow the claim if the assessee satisfied all the conditions laid down by law.

Section 33(1) gives right to development rebate only to the owner who has acquired the ship or installed the machinery or plant. The necessary implication is that the assessee who claims development rebate should continue to remain to be the owner of the ship or plant or machinery during the relevant previous assessment year/years and the owner alone is entitled to the development rebate till it becomes nil in the relevant previous assessment year or the succeeding assessment years carried forward upto eight years and not thereafter [*Mahabir Cold Storage v. CIT,* (1991) 188 ITR 91, 97 (SC)].

It is further clarified in section 33(6) that no deduction by way of development rebate shall, however, be allowed in respect of any machinery or plant installed after 31-3-1965, in any office premises or any residential

LexisNexis

accommodation, including any accommodation in the nature of a guest house unless such machinery or plant is installed in the premises used by an approved hotel owned by an Indian company.

Pontoon, which is a flat bottomed boat used as ferry-boat, etc. [*CIT v. Shri Digvijay Cement Co. Ltd.,* (1986) 159 ITR 253 (Guj), special leave petition dismissed by the Supreme Court : (1990) 186 ITR (St.) 73 (SC)] or trawler [*Chola Fish & Farms Pr. Ltd. v. CIT,* (1987) 166 ITR 600 (Mad); *Chola Fish & Farms P. Ltd.,* (1996) 217 ITR 609, 614-15 (Mad)] is covered by the expression 'ship'. The Gujarat decision [159 ITR 253 (Guj)] has been **affirmed in** *CIT v. Digvijay Cement Co. Ltd.* [(1998) 232 ITR 709, 711 (SC)], holding that the pontoons and tugs are covered by the expression 'ship' and, therefore, were entitled to development rebate at a higher rate of 40 per cent. instead of 25 per cent. on the basis of 'plant'.

Dissenting from Gujarat view [159 ITR 253 (Guj)], it has been held that a pontoon, which is nothing but a platform for work, cannot be described as a ship [*Gammon India Ltd. v. CIT,* (1997) 228 ITR 691, 695, 696 (Bom)]. Therefore, in that case, the Tribunal was held justified in holding that 'pontoons' used for transporting men and material to site on sea do not fall within the definition of 'ships' and that the appellant was eligible for development rebate only at 15 per cent. and not at 40 per cent.

In *CIT v. Gujarat State Fertilizers Co. Ltd.* [(2001) 247 ITR 690, 691, 692 Guj)], the assessee was not entitled to development rebate on expenditure incurred on factory compound wall because the same did not constitute plant.

In *CIT v. Gujarat State Fertilizer Co.* [(2002) 255 ITR 294, 298-99 (Guj)], the assessee was held entitled to development rebate on effluent system and instruments.

In *GSC Industries* (*P.*) *Ltd. v. CIT* [(1999) 156 CTR (Del) 267, 267-68], assessee was held entitled to development rebate on seats (chairs) installed in the cinema auditorium.

In *Tamil Nadu Civil Supplies Corporation Ltd. v. CIT* [(2001) 249 ITR 214, 215 (SC), **affirming** *Tamil Nadu Civil Supplies Corporation Ltd. v. CIT*, (1997) 228 ITR 399 (Mad)], the assessee was held entitled to development rebate in respect of rice mills, the possession whereof was vested under Government order in 1972, for the assessment years 1973-74 and 1974-75, as the assessee had acquired dominion over the mills, even though the sale deeds were executed in the year 1978.

The allowability of the deduction claim is, by section 33(1)(*a*), made "subject to the provisions" of sections 33 and 34. The conditions, etc., enacted in section 34 are discussed under that section.

Machinery or plant.—Development rebate is allowable on machinery, complete by itself, and also on parts of a machinery [*CIT v. Maneklal Harilal Spng. & Mfg. Co. Ltd.,* (1977) 106 ITR 24, 27 (Guj); *CIT v. Chunilal Bhagwandas Mehta,* (1978) 113 ITR 436, 439 (Bom)]. It may be noted that machinery or plant costing up to Rs. 5,000 (for assessment years 1966-67 to 1983-84, Rs. 750), which is entitled to a 100 per cent. depreciation [under the first proviso to section 32(1)(*ii*) in the very first year of installation or use, as the case may be] shall, in addition thereto, be still entitled to a development rebate [*CIT v. Swadeshi Cotton Mills Co. Ltd.,* (1979) 117 ITR 321 (All)]. However, such machinery or plant is not eligible for investment allowance as has been provided in clause (*d*) of the proviso to section 32A(1).

An electric supply company was held to be entitled to development rebate on the cost of mains, service-lines and switch gears installed by it [*CIT v. Ambala Cantt. Electric Supply Co. Ltd.,* (1971) 82 ITR 217 (Punj)]. Cold storage room, platform for machinery, observation tower and cooling tower in case of an ice cream factory were also held eligible for development rebate [*CIT v. Pure Ice Cream Co.,* (1981) 129 ITR 394 (Del)]. In *CIT v. Heaveacrumb Rubber* (*P.*) *Ltd.* [(1989) 179 ITR 259 (Ker)], the water supply system and miscellaneous equipment were held to form part of the general machinery normally used in a rubber factory and, therefore, eligible for development rebate.

Similarly, a manufacturing company was held to be entitled to development rebate on the cost of construction of railway sidings, which were used for the purpose of transport of the goods manufactured by the company [*Kalinga Tubes Ltd. v. CIT,* (1974) 96 ITR 20 (Orissa)].

Development rebate has been **held allowable** in respect of—

—durable machine tools [*CIT v. Vulcan Laval Ltd.,* (1991) 188 ITR 453, 456 (Bom); *CIT v. Vulcan Laval Ltd.,* (1990) Tax LR 1130 (Bom)];

—oil wells as these constitute 'plant' and, therefore, drilling expenditure was held eligible for development rebate even though entire sum was allowed as revenue expenditure [*CIT v. Oil India Ltd.,* (1992) 198 ITR 701, 709-710 (Cal)];

—capital expenditure incurred on scientific research [*Sarabhai Sons Pvt. Ltd. v. CIT,* (1993) 114 Taxation 410, 412 (Guj)];

LexisNexis

—cylinders as income from hiring out of LPG cylinders was income from business [*Steel Rolling Mills of Hindusthan Pvt. Ltd. v. CIT,* (1992) 107 CTR (Cal) 65].

—the pumps and drainage pipes for effluent disposal [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 558 (Guj)];

—medical equipment installed in a hospital run by the assessee for labour welfare [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 562 (Guj)];

—assets of the training centre [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 562 (Guj)];

—expenditure incurred on the water works as a whole including that on the civil works [*Associated Cement Companies Ltd. v. CIT,* (1996) 221 ITR 215, 232-33 (Bom)].

Also see, *CIT v. Karamchand Premchand Pvt. Ltd.,* (1993) 200 ITR 281, 316 (Guj); *CIT v. Sarabhai M. Chemicals Pvt. Ltd.,* (1993) 112 Taxation 288 (Guj); *CIT v. Giriraj Exhibitors P. Ltd.,* SLP (Civil) No. 5726 of 1985 : (1990) 186 ITR (St.) 25 (SC).

However, development rebate has been held not allowable in respect of process warehouses and roads connecting the plants as these do not constitute 'plant' but constitute 'buildings' [*CIT v. Indian Explosives Ltd.,* (1991) 192 ITR 144, 150 (Cal)]. Also see *CIT v. Ambica Mills Ltd.,* (1998) 147 CTR (Guj) 340, 346.

In the facts of *Catalysts & Chemicals India* (*West Asia*) (*P.*) *Ltd. v. CIT* [(1992) 197 ITR 486, 490 (Ker)], the matter was remanded to the Tribunal to dispose of the same afresh considering the question of exclusion of certain items from the know-how as contained and conveyed in the books of manuals and valuation thereon in the context of allowability of development rebate.

Machinery given on hire.—The hiring out of machinery may earn business income and in that case the machinery hired out may earn development rebate allowance deductible from the hire [*Ajodhya Prasad Tara Chand Khekra v. CIT,* (1967) 66 ITR 576 (All); *CIT v. Castlerock Fisheries,* (1980) 126 ITR 382 (Ker), **affirmed in** *CIT v. Castle Rock Fisheries,* (1998) 231 ITR 304 (SC)]. But where the income from hire is assessable as other source income, no development rebate is allowable [*New Savan Sugar & Gur Refining Co. Ltd. v. CIT,* (1969) 74 ITR 7 (SC); *Watkins Mayor* (*Agrico*) *P. Ltd. v. CIT,* (1979) 117 ITR 202 (Punj)].

Where the income from hiring of machinery on lease basis has been assessed as business income, the assessee was entitled to development rebate on such machinery [*CIT v. International Computers Indian Manufacture Ltd.*, (1999) 239 ITR 499, 502 (Bom)].

Person taking on hire-purchase.—A person buying machinery on hire-purchase system may qualify for a development rebate allowance thereon [*S.P.B.P. Srirangacharyulu v. CIT,* (1965) 58 ITR 95 (AP). Also see, *Sardar Tara Singh v. CIT,* (1963) 47 ITR 756 (MP)].

In fact, the Board has conceded the point in the following departmental **circular**:—

Development rebate on the installation of machinery acquired on hire-purchase basis—Whether the assessee is entitled to.—"In Circular No. 9 of 1943, the Board issued instructions regarding the grant of depreciation allowance for machinery acquired under hire-purchase agreement to the effect that depreciation should be allowed in the first year itself on the estimated full initial value of the asset (the balance being taken as hire charges). The same basis may be followed for development rebate also, *i.e.*, the development rebate may be granted in the first year itself on the full initial value. No difficulty is likely to arise as a result of forfeiture of the asset to the 'hirer' as the existing provisions enable the Government to recover development rebate where the machinery is sold or otherwise transferred by the assessee." [*Board's F. No. 27(20)-IT/59, dated 26th June, 1959*].

Office appliances and road transport vehicles left out of the concession.—The 2nd proviso to section 10(2)(*vib*) of the 1922 Act, inserted by Act 28 of 1960, with effect from 1-4-1960, *i.e.*, for and from assessment year 1960-61, provided that no development rebate could be allowed in respect of any machinery or plant which consists of office appliances or road transport vehicles [*Rajnandgaon Roadways P. Ltd. v. CIT,* (1978) 114 ITR 291 (MP); *Maneklal Vallabhdas Parikh & Sons v. CIT,* (1969) 72 ITR 637, 640 (Guj)]. The provisions are not *ultra vires* as the legislature is perfectly entitled to choose the object for which an allowance may or may not be given in taxation matters [*Southern Roadways* (*Pr.*) *Ltd. v. Union of India,* (1962) 44 ITR 708 (SC); *CIT v. Southern Roadways P. Ltd.,* (1975) 98 ITR 205 (SC)]. Before coming into force of such amendment, development rebate was held allowable on such vehicles and the cases dealing with the subject, which are no longer applicable, are : *CIT v. Saraspur Mills Ltd.,* (1959) 36 ITR 580 (Bom); *CIT v. Lever Bros.,* (1959) 37 ITR 140 (Bom); *CIT v. Sri Rama Vilas Service Pr. Ltd.*, (1960) 38 ITR 25 (Mad); *CIT v. Calicut Wyanad Motor Service,* (1960) 38 ITR 479 (Ker); *Fomra Bros. v. CIT,* (1963) 49 ITR 684 (Mad)]. Similar was the case with office appliances [*Sundaram Motors Pr. Ltd. v. CIT,* (1969) 71 ITR 587 (Mad)]. But if, before the amendment

coming into force, there was an unabsorbed development rebate, the same shall have to be allowed set-off even after the amendment came into force because the amendment is not retrospective in effect [*Transport Co. Pr. Ltd. v. Second ITO,* (1964) 51 ITR 82 (Mad)].

Section 33 of the 1961 Act specifically excludes "office appliances" and "road transport vehicles" from "machinery or plant" which may earn a development rebate allowance under that section.

A machinery used for transporting men and material such as a lift is not excluded from eligibility of development rebate allowance [*CIT v. Jyoti Ltd.,* (1987) 163 ITR 274 (Guj). Also see, *Punjab National Bank Ltd. v. CIT,* (1983) 141 ITR 886 (Del)].

But dumpers were, on concession, held to be road transport vehicles [*Shiv Construction Co. v. CIT,* (1987) 165 ITR 160 (Guj); *CIT v. Shiv Constructions,* (1987) 165 ITR 159 (Guj)]. Also see, *Shah Construction Co. Ltd. v. CIT,* (1991) 188 ITR 537 (Bom).

The subject-matter of development rebate allowance is, thus, much narrower than that of depreciation allowance since building, furniture, office appliances and road transport vehicles qualify for the latter but not for the former. Whether a particular item of machinery is or is not a "road transport vehicle" is to be judged on a consideration of its exact function and use [see, *Orissa Minerals Development Co. Ltd. v. CIT,* (1979) 117 ITR 434 (Cal)].

Office appliances, what they are?—The plain meaning of the expression "office appliances" suggests that an office appliance is an appliance which is primarily used for office purposes, *i.e.*, as an aid or a facility for the proper functioning of the office. In this view of the matter, internal telephone system installed in a manufactory [*CIT v. Mohan Meakin Breweries Ltd.,* (1980) 122 ITR 203 (HP)] or data processing machine [*CIT v. I.B.M. World Trade Corporation,* (1981) 130 ITR 739 (Bom); *CIT v. International Computers Ltd.,* (1981) 131 ITR 1 (Bom)] do not constitute "office appliance".

These are also held not to constitute office appliances:—

1. Air-conditioners and electric fans even if installed in an office premises [*CIT v. Tarun Commercial Mills Ltd.,* (1985) 151 ITR 75 (Guj)].
2. Data processing machines [*CIT v. IBM World Trade Corporation,* (1986) 161 ITR 673 (Bom)]. Also see, *CIT v. International Computers & Tabulators (India) Pvt. Ltd.,* (1990) 186 ITR 616 (Bom).
3. Internal telephone system [*CIT v. Tata Chemicals Ltd.,* (1986) 162 ITR 662 (Bom)].
4. Computers [*CIT v. Tata Sons Pr. Ltd.,* (1992) 105 CTR (Bom) 219, 220].
5. Medical equipment installed in hospital for workers [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 560-61 (Guj)].
6. A prototype of machinery used in the workshop for the purpose of demonstration to the trainees [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 562 (Guj)].

LexisNexis

'Plant' to be given an extended meaning in section 33.—While the object of section 32 in providing for depreciation is to spread over the capital cost incurred on the acquisition of capital assets for the business over a period of years and to arrive at the real profits from operating the business, the object of providing development rebate in addition to depreciation is not to meet the cost incurred for the purpose of business but to make available the funds for future use for the purpose of development of the business and such fund is not to be used for the purpose of distribution of profits by way of dividend or remittance outside India for creation of any assets outside India. The allowance of development rebate is made only once in respect of the new machinery and a fixed percentage as prescribed in the Act from time to time is allowed as a deduction from the profits of that year. A fixed percentage of the said actual allowance has to be transferred to a reserve fund to be utilised by the assessee during the period of eight years next following for the purpose of business of the undertaking. Therefore, while interpreting the word 'machinery' or 'plant', this difference in the object of sections 32 and 33 has to be kept in mind. Another aspect which is to be kept in mind is that while for the purpose of depreciation, buildings have been dealt with separately from plant and machinery and depreciation at different rates has been provided for building, etc., development rebate is allowed at a flat rate on the cost of plant and machinery for the creation of development rebate fund or reserve to be used for the business. Thus, making sufficient fund available for the use of business otherwise than distribution of profits or creation of assets outside India coupled with definition of 'plant' given under section 43(3) leaves no room for doubt that an extended meaning was assigned to the word 'plant' under section 33 [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 558-59 (Guj)].

After **discussing and quoting** from the Supreme Court decision in *CIT v. Taj Mahal Hotel* [(1971) 82 ITR 44, 48 (SC)], it has been observed that from the above, it is also clear that if anything is installed which is primarily for the use of business to be run smoothly and to augment profits, rather than as an amenity necessary for the use of building alone, in that event, such adjuncts for the purpose of claiming development rebate under

section 33 may properly constitute 'plant' notwithstanding that the same may for the purpose of section 32 fall to constitute part of a building [*CIT v. Gujarat State Fertilizer Co. Ltd.,* (1996) 219 ITR 550, 560 (Guj)].

New machinery, etc.—The word 'new' may have different meanings, but, when used with reference to a machine, its meaning is 'new-made or brought into existence for the first time', which is one of the meanings given in the *Shorter Oxford Dictionary*. One does not discover the meaning of the word 'new' by trying to find out what is meant by the word 'old'. Nor is it of any assistance to say that the word is relative. 'New' as used in these provisions cannot mean 'new to the assessee'. The word 'new' in this context must mean 'not existing before; now made or brought into existence for the first time' in contradistinction and antithesis to the word 'used' [*Cochin Company v. CIT,* (1968) 67 ITR 199, 202-03 (SC)].

Reconditioned machinery.—If a machine is taken into parts and was reassembled after replacing worn out parts and after incorporating the latest modifications and the thus reconditioned machinery was entirely different from the old machine, it is substantially 'new' within the meaning of these provisions [see, *Cochin Company v. CIT,* (1968) 67 ITR 199, 203 (SC); *CIT v. Hindustan Milk Food Manufacturers Ltd.,* (1974) 96 ITR 278 (Punj)]. In the facts of *Porritts & Spencer* (*Asia*) *Ltd. v. CIT* [(1989) 180 ITR 211 (Punj), **followed in** *Porrits & Spencer* (*Asia*) *Ltd. v. CIT*, (1999) 149 Taxation 494, 495 (Punj)], the reconditioned machinery was not considered to be new for the purpose of allowing development rebate.

Installation must be of new machinery, etc.—One of the essential requisites for allowance of development rebate is that the plant or machinery must be new when installed [*CIT v. Saurashtra Wire-healds Mfg. Co. Pr. Ltd.,* (1968) 67 ITR 524, 536 (Guj)].

Installed—meaning of.—The expression "installed" does not necessarily mean "fixed in position" but is also used in the sense of "inducted or introduced" [*CIT v. Saraspur Mills Ltd.,* (1959) 36 ITR 580 (Bom)]. "Installed" would certainly mean "to place an apparatus in position for service or use" [*CIT v. Sri Rama Vilas Service* (*Pr.*) *Ltd.,* (1960) 38 ITR 25 (Mad); *CIT v. Indian Turpentine & Rosin Co. Ltd.,* (1970) 75 ITR 533 (All)]. When an engine is fixed in a vehicle, it is "installed" within the meaning of these provisions [*CIT v. Mir Mohammad Ali,* (1964) 53 ITR 165, 172 (SC); *Raju & Mannar v. CIT,* (1963) 50 ITR 202 (Mad), **affirmed,** (1966) 60 ITR 246 (SC); *Mangalore Ganesh Beedi Works v. CIT,* (1964) 52 ITR 615 (Mys)]. If the plant in combination with other appliances in the business effectuates and perpetuates the trade or commerce, then, in relation to such plant, "installed" means such induction or introduction whereby the plant may be placed in a position for service or use in the business [*Sundaram Motors Pr. Ltd. v. CIT,* (1969) 71 ITR 587, 593 (Mad)].

The word 'installed' does not necessarily mean embedded in the earth or the like. A machinery or a tool can be said to have been installed if it has been put into a position in which it can be used [*CIT v. Vulcan Laval Ltd.,* (1991) 188 ITR 453, 456 (Bom)].

LexisNexis

The test for finding out when the particular machinery was installed is the date when it was completed [*CIT v. Saurashtra Wire-healds Mfg. Co. Pr. Ltd.,* (1968) 67 ITR 524, 525 (Guj)]. What constitutes installation will depend upon the nature of the business and the article that has to be installed. A boiler in a factory cannot be said to be installed until it is set up and fixed in position for use as such [*Ajodhya Prasad Tara Chand Khekra v. CIT,* (1967) 66 ITR 576, 579 (All)]. In that case, the assessee's business consisted of hiring out of Kolhus. It was held that in a business of hiring out, the installation of a plant or machinery can only be by placing it in position for service or use. It was held that the moment the assessee hired out the *Kolhus,* the requirement for claiming development rebate was satisfied.

In *CIT v. Steel Rolling Mills of Hindustan Pr. Ltd.* [(1987) 164 ITR 633 (Cal)], the rental income from hiring out of gas cylinders was taxed as business income. A gas cylinder was held to have been installed as soon as it was brought into use for storing gas.

Installation completed in more than one year.—When a number of machineries are installed as part of one and the same unit of manufacture, the entire unit can be said to be installed on the day when the last of the machinery is installed. In case the installation is spread over more than one year, it is the date of completion of the installation which would be determinative of the year when development rebate may be claimed [*CIT v. Saurashtra Wire-healds Mfg. Co. Pr. Ltd.,* (1968) 67 ITR 524, 535 (Guj)].

Claim, whether to be only by the person who installed the machinery, etc.?—It often happens that a promoter instals machinery, etc., and transfers the whole thing to the promoted company. Or a partnership instals machinery, etc., and thereafter, there is some change in the constitution of the partnership, the new partnership taking advantage of the machinery, etc., brought in by the old partnership. There is a difference in judicial opinion on the point whether the company or the new partnership actually using the machinery, etc., could claim the benefit of the development rebate.

In *CIT v. Saurashtra Wire-healds Mfg. Co. P. Ltd.* [(1968) 67 ITR 524, 536-38 (Guj)], a sole proprietor installed the machinery and transferred his undertaking to the company. The company claimed development rebate. It was held that the company was entitled to the development rebate because the legislature has not used the expression "installed by the assessee". The Patna High Court, in *CIT v. Mahabir Cold Storage* [(1977) 100

ITR 686] was concerned with the circumstance where a firm installing machinery, etc., in its branch, took another person as a partner in respect of that branch. The claim for development rebate made by the branch was rejected on the ground that it is only that person who had installed the machinery, etc., who is entitled to successfully claim development rebate. The Patna decision [100 ITR 686 (Pat)] has been **affirmed** by the Supreme Court in *Mahabir Cold Storage v. CIT* [(1991) 188 ITR 91 (SC)]. Here, it is pertinent to note that the Supreme Court has proceeded on the basis that the appellant-assessee was a new entity and it was not a successor-in-interest of the old firm as per the provisions of the Act. Further, it was observed that the assessee did not bring on record the necessary material facts to establish that it became owner by any non-testamentary instrument acquiring right, title and interest in the plant and machinery [*Mahabir Cold Storage v. CIT,* (1991) 188 ITR 91, 97 (SC)]. Also see, *Mahabir Cold Storage v. CIT,* SLP (Civil) No. 8878 of 1984 : (1990) 186 ITR (St.) 30-31 (SC).

Is wholly used for the purposes of the business.—Development rebate in respect of machinery or plant, etc., can only be allowed where such machinery or plant, etc., has been "wholly used for the purposes of the business" carried on by the assessee [*New Savan Sugar & Gur Refining Co. Ltd. v. CIT,* (1969) 74 ITR 7 (SC); *CIT v. J. Thomas & Co. P. Ltd.,* (1977) 110 ITR 566 (Cal); *CIT v. Castlerock Fisheries,* (1980) 126 ITR 382 (Ker), **affirmed in** *CIT v. Castle Rock Fisheries,* (1998) 231 ITR 304 (SC)]. The expressions "wholly" and "exclusively" do not mean one and the same thing. The expression "wholly" used for the purposes of the business carried on by the assessee must, therefore, mean something different from the expression "exclusively used for the purposes of the business". The only meaning that can be attributed to the former expression is that of assets "used in their entirety" [*CIT v. Ouchterlony Valley Estates* (*1938*) *Ltd.,* (1965) 58 ITR 618, 621 (Ker)]. The word 'wholly' has no reference to the nature and extent of the business but only to the extent of the user and such user must be with reference to and only for the purpose of the business carried on by the assessee [*CIT v. Pandyan Bank Ltd.,* (1969) 71 ITR 707 (Mad)]. Also see, *CIT v. Jeewanlal* (*P.*) *Ltd.,* (1990) 183 ITR 128, 129-30 (Cal). The expression 'wholly used' for the purpose of the business refers to the manner of user. If one is the owner of the machinery and is using it oneself and one has full control over it, then one is using it oneself and nobody else is using it. It is the control which determines who is using it. User means not only getting benefit, but also controlling, running, stopping, repairing, replacing, etc. [*Punjab National Bank Ltd. v. CIT,* (1983) 141 ITR 886, 895 (Del)]. Machinery, etc., used for construction of additional factory building or for installation of new machinery, in a scheme of expansion, etc., is wholly used for business purposes attracting development rebate [*CIT v. Mysore Iron & Steel Ltd.,* (1978) 115 ITR 219 (Karn)]. The user of the machinery in test production or experimental manufacture has been held to be user for the purposes of the assessee's business even though the regular commercial production started in a subsequent year [*V. Ramakrishna & Sons Ltd. v. CIT,* (1984) 149 ITR 554, 562 (Mad)].

Where rental income from a particular asset is assessed as business income, the assessee may be entitled to claim development rebate if requisite conditions in that regard are satisfied [see, *Smt.Kavit Sanghi v. CIT,* (1982) 133 ITR 48 (MP); *CIT v. Steel Rolling Mills of Hindustan Pr. Ltd.,* (1987) 164 ITR 633 (Cal); *CIT v. Vinod Bhargava,* (1988) 169 ITR 549 (AP); *CIT v. Hindusthan Aluminium Corporation Ltd.,* (1989) 176 ITR 206 (Cal)].

User may be active, or even passive.—The user referred to in section 33(1) may be active as well as passive. Machinery which is kept ready for use can be said, also, to have been used for the purposes of section 33(1). Any forced idleness [*e.g.*, by strike, etc.] cannot disentitle the assessee from getting the benefit of development rebate on the ground of non-user [*CIT v. Vayithri Plantations Ltd.,* (1981) 128 ITR 675 (Mad)].

Asset used for profession.—The statute grants development rebate allowance when, *inter alia*, the machinery or plant is wholly used for the purposes of the "business" carried on by the assessee. The word 'profession' does not follow the word "business". Therefore, where any machinery or plant is wholly used by the assessee for the purposes of his profession [which word is defined under section 2(36) so as to include vocation], no development rebate is allowable in respect thereof. At the same time, if the activity, carried on by the assessee though garbed as profession, is really commercial or, in any event, if the vocation of the assessee is an admixture of both, then the assessee will be entitled to relief for development rebate. One such instance is where a medical practitioner runs a nursing home [*Dr. P. Vadamalayan v. CIT,* (1969) 74 ITR 94 (Mad)] or exploits an X-ray machine [*CIT v. Dr. V.K. Ramachandran,* (1981) 128 ITR 727 (Mad)].

Development rebate when admissible in respect of second-hand asset.—Section 33(1A) is an exception to the general rule that no development rebate can be allowed unless the ship or machinery or plant is *new*. Under sub-section (1A), development rebate is admissible even in respect of ship acquired second-hand after 31-3-1964, or machinery or plant (other than office appliances and road transport vehicles) installed after 31-3-1964, provided the following conditions are satisfied:—

(*i*) the asset is wholly used for the purpose of assessee's business;

LexisNexis

(*ii*) if the asset is a ship, it was not owned by any person resident in India at any time before it is acquired by the assessee;

(*iii*) if the asset is machinery or plant, it is imported by the assessee from abroad and has not been used in India prior to its installation by the assessee;

(*iv*) no deduction on account of depreciation or development rebate has been allowed on the machinery or plant in the assessment of any person prior to its installation by the assessee; and

(*v*) any other condition, if prescribed in the Rules, has also to be fulfilled before any such rebate can be claimed.

Prior to 1-4-1964, when the provisions of sub-section (1A) came into effect, such allowance was being granted in respect of second-hand ships or machinery, etc., under executive instructions contained in the following **departmental circulars**:—

I. Circular No. 27 (LIX-2) of 1955, F. No. 27 (12)-IT/55, dated 6-7-1955 (in relation to second-hand ships). This circular was held inapplicable in the case of a trawler purchased by an assessee, which was not a shipping concern [*Cochin Co. v. CIT,* (1978) 114 ITR 822 (Ker)];

II. Circular No. 40 (XLVII-16) of 1962, dated 3-12-1962, and F. No. 1 (16)-TPL, dated 30-9-1963 (in relation to second-hand machinery, etc.).

Year in respect of which development rebate may be claimed.—Provisions of section 33(1)(*a*), which apply to new ship, machinery or plant, and those of section 33(1A)(*c*), which have application to certain second-hand ships, machinery or plant, are the same on the point. An assessee is, normally, entitled to claim deduction for development rebate in respect of the assessment year relevant to the previous year in which,—

(*i*) in the case of a ship, the ship was acquired; and

(*ii*) in the case of machinery or plant, the machinery or plant was installed,

if the ship or the machinery or plant was wholly used, for the whole or any part of such year, for the purposes of the business carried on by the assessee.

There is one exception specified in sections 33(1)(*a*) and 33(1A)(*c*). If, however, the ship is acquired or machinery or plant is installed in a year in which these have not been used for assessee's business, but nevertheless, these are put to such use in the year just following the year of acquisition or installation, as the case may be, the assessee is entitled to claim deduction for development rebate in respect of the assessment year relevant to the previous year of such user.

LexisNexis

It thus follows that if there be a gap of more than one clear previous year between the acquisition or installation, as the case may be, of ship or machinery, etc., and its user, no development rebate can be claimed.

Where there was material for holding that the assessee was carrying on business of manufacturing as it actually produced 92 tonnes of paper between the period 1-4-1964 and 30-6-1964, the assessee was held not entitled to development rebate for the assessment year 1966-67 because he has failed to claim such deduction in the assessment year 1965-66 which was the proper year for the allowance of such deduction [*Vidarbha Paper Mills Ltd. v. CIT,* (1995) 82 Taxman 277, 278 (Bom)].

Ceiling of allowable deduction.—Section 33(2)(*i*) prescribes a ceiling of the allowable deduction to be made from an year's income. The ceiling is the amount of the positive figure of the total income, which for this purpose is to be computed without making any deduction for development rebate or development allowance or under Chapter VIA or (upto 31-3-1988) for annuity deposit. In other words, only so much of the allowable development rebate may be deducted from a year's 'total income' as would reduce such 'total income' to *nil*. Deduction beyond that cannot be given so as to turn the figure of the 'total income' into negative, *i.e.*, loss.

But the above ceiling has been enacted to be applicable to a ship acquired, or machinery or plant installed, after 31-12-1957.

It may be noted that for a ship acquired, or machinery or plant installed, on a date before 1-1-1958, there was no ceiling on deduction, but, also, there was no provision for carry forward of unabsorbed amount of allowable development rebate [*CIT v. Ahmedabad Jupitor Spng., Wvg. & Mfg. Co. Ltd.,* (1979) 119 ITR 209 (Guj)]. In that state of law, it was held that in making an assessment the full development rebate, as allowable under the law, had to be given deduction even if it turned a profit into a loss. Such resultant loss did not, however, retain, in the years succeeding, the character of unabsorbed development rebate (as in the case of unabsorbed depreciation) but merged in, and had assumed the character of, business loss [*Transport Co. Pr. Ltd. v. ITO,* (1964) 51 ITR 82, 86-87 (Mad)].

As the ceiling had been put into operation with effect from 1-4-1958, in respect of a ship acquired or machinery or plant installed after 31-12-1957, the corresponding provisions for a carry forward of the unabsorbed amount of allowable development rebate were also enacted.

It is an indisputable legal position that the sum to be allowed by way of development rebate was to be only such amount as was sufficient to reduce the total income to nil. The development rebate, to the extent to which it had not been allowed in the previous assessment year or succeeding years, was to be carried forward to the following year or years upto a maximum of eight years during which time the entire amount invested is computed in the manner prescribed under the Act to *nil*. The object thereby is that the development rebate in the manner specified under the Act was to be allowed in full. If any residue remains after the expiry of eight years, that amount was not to be adjusted and no balance could be carried forward to the 9th year [*Mahabir Cold Storage v. CIT,* (1991) 188 ITR 91, 95-96 (SC)].

Development rebate to be allowed first against business income.—In view of the classification of income under section 14 under different heads and each head of income being a distinct head, the deduction by way of development rebate can be claimed, in the first instance, against the income falling under the head 'Profits and gains of business or profession' and not against income under the head 'Capital gains' [*Great Eastern Shipping Co. Ltd. v. CIT,* (1994) 206 ITR 505, 507 (Bom)].

Provisions for carry forward of unabsorbed amount.—Section 33(2)(*ii*) provides for a carry forward of the unabsorbed amount of allowable development rebate to the following assessment year or years. If there be no positive figure of 'total income' or only a part of the allowable development rebate is absorbed in making the figure of 'total income' for that year at *nil*, the whole or balance of the unabsorbed amount may be carried forward to the following assessment year, and so on. But such carry forward shall be available for a period of eight assessment years immediately succeeding the assessment year in respect of which the claim could be made. Even in the succeeding assessment year, the ceiling operates and only so much of the unabsorbed amount of the development rebate may be absorbed as would go to make the 'total income' for that year to the figure at *nil*; the balance of the still unabsorbed development rebate shall be carried forward to the succeeding assessment year.

If, however, in any of these eight years, there is further development rebate admissible in respect of another ship acquired or further machinery or plant installed, the *Explanation* to section 33(2) provides that the first unabsorbed portion shall be first absorbed against the 'total income' and the subsequent development rebate would come in for deduction only when the full amount of the first rebate is absorbed or gets time-barred.

To take a specific illustration, it may be that the assessee has purchased ship or installed machinery M in the year X and again purchases a ship or instals further machinery N in the Year Y, and the development rebate of M and N exceeds, in both the years X and Y, the profits of the respective years. In such a case, the *Explanation* to section 33(2) provides that the unabsorbed development rebate in respect of M shall first be exhausted in the profits of the years X, X + 1, X + 2 and so on up to X + 8 and if any portion remains unabsorbed thereafter the same would be discarded. It is only after such development rebate in respect of M is allowed (and discarded, if necessary), that development rebate in respect of N will begin to be deducted.

In a nutshell, it may be noted that development rebate can be absorbed, either in the relevant assessment year or in any of the eight subsequent assessment years, against the "total income" of the assessee and not only against the income from the particular business in respect of which the development rebate was computed [*Rajapalayam Mills Ltd. v. CIT,* (1978) 115 ITR 777, 787-88 (SC)].

For availing the set off of the carry forward unabsorbed development rebate, the period of eight assessment years should be taken in natural sequence. In that view of the matter, where, due to change of previous year, there was no assessment for one of the said eight assessment years, the carry forward unabsorbed development rebate cannot be allowed to be set off for one more assessment year [*Premier Cable Co. Ltd. v. CIT,* (1992) 193 ITR 719, 732-33 (Ker), special leave petition granted by the Supreme Court : (1992) 193 ITR (St.) 108 (SC), **affirmed in** *Premier Cable Co. Ltd. v. CIT*, (1999) 237 ITR 202 (SC)].

Unabsorbed development rebate of earlier years can be carried forward and set-off against the income of the assessee in a subsequent year even though in that subsequent year, the asset concerned was not used for the assessee's own business but was hired out by him [*CIT v. Narang Dairy Products,* (1983) 142 ITR 532 (All), special leave petition dismissed by the Supreme Court : (1990) 181 ITR (St.) 11 (SC)].

Unabsorbed development rebate cannot be carried forward as a business loss under the provisions of section 72. It can only be carried forward as unabsorbed development rebate and set-off as per the provisions of section 33(2)(*ii*). Under section 33(2)(*ii*), the unabsorbed development rebate can be set-off against the 'total income' for the subsequent year. Such 'total income' must mean income from whatever source and computed for the other purposes of the Act, except for the deductions specifically excluded thereby. Thus, such unabsorbed development rebate can be set-off even against long-term capital gains. The option referred to in section 71(2) (operative upto 31-3-1988) does not matter [*CIT v. Victoria Mills Ltd.,* (1985) 153 ITR 733 (Bom)].

However, the Kerala High Court in *Collis Line Pr. Ltd. v. ITO* [(1982) 135 ITR 390 (Ker)] has proceeded on the basis that unabsorbed development rebate cannot be set-off against "Income from other sources". With respect, the matter requires reconsideration.

It may be noted that for getting the benefit of set-off of unabsorbed development rebate in a subsequent year, there is no pre-condition that the business must have been continued in that subsequent year [*CIT v. Kishanlal & Sons* (*Udyog*) *Pr. Ltd.,* (1985) 154 ITR 735 (Cal)].

For the purpose of giving set-off of development rebate relating to earlier assessment years against the profits of the current assessment year, such development rebate has been held to be redetermined according to the appropriate rates applicable to a priority industry [*CIT v. Valliappa Textiles Ltd.,* (1988) 172 ITR 168 (Karn)].

Carry forward not dependent on actual quantification by the ITO.—Once the assessee fulfills the statutory conditions for becoming entitled to deduction on account of development rebate, the carry forward of unabsorbed development rebate is not dependent on any quantification by the Income-tax Officer by way of making an assessment for that assessment year. The amount of deduction which is admissible can be ascertained by reference to the books of account maintained by the assessee while the assessment is being made for the year in which the deduction is actually being allowed [*CIT v. Arjun Prasad,* (1991) 190 ITR 179, 182 (Pat)]. In that case, it has been held that it was an admitted position that the assessee had created the required development rebate reserve. As per the findings of the Tribunal, it was also an ascertained fact that, during the assessment year 1973-74, as per the profit and loss account, there was a loss and, therefore, there was occasion for absorbing the deduction admissible on account of development rebate. As a consequence, as provided under section 33(2), the assessee was entitled to carry forward the unabsorbed development rebate to the succeeding assessment year, *i.e.*, 1974-75, as has been done in the present case and in law, the same was required to be allowed as a deduction from the total income of this assessment year.

Overriding provisions of section 79 do not affect the set-off of unabsorbed depreciation or unabsorbed development rebate.—Unlike unabsorbed depreciation, unabsorbed development rebate of a registered, or treated as registered, firm is not allocable amongst partners.—Section 32(2), in relation to unabsorbed depreciation, makes a specific provision that unabsorbed depreciation becomes depreciation of the succeeding year. The phraseology further suggests that unabsorbed depreciation of a registered, or treated as registered, firm is to be allocated amongst the partners of the firm. There is no such provision in section 33(2) relating to unabsorbed development rebate. There is, however, a provision in section 33(2)(*i*) to the effect that so much of the development rebate shall be taken into account in the assessment of a year as may reduce the income to nil, and any excess left over is to be treated as unabsorbed development rebate to be carried forward for set-off, under section 33(2)(*ii*), in the hands of the assessee itself, including a registered, or treated as registered, firm. Such unabsorbed development rebate is not allocable amongst the partners [*CIT v. Madras Wire Products,* (1979) 119 ITR 454 (Mad); *CIT v. National Coal Development Corporation,* (1986) 157 ITR 45 (Pat)].

LexisNexis

Amalgamated company to get the benefit—section 33(3).—Where one or more companies amalgamate with another company under a scheme of amalgamation, section 33(3) provides that there will be no break so far as development rebate is concerned, and the amalgamated company has to fulfil the conditions therefor.

From a reading of section 33(3)(*b*) and section 33(2)(*ii*), it becomes abundantly clear that unabsorbed development rebate can be carried forward by the amalgamated company 'only in the following assessment year'. In that view of the matter, the unabsorbed development rebate in the hands of the amalgamating company relating to the assessment year 1975-76 cannot be allowed to be set off against the profits of the amalgamated company (assessee-company) for the assessment year 1975-76. Such unabsorbed development rebate can be allowed to be carried forward by the amalgamated company only in the assessment year 1976-77 and the following assessment years as provided in section 33(2)(*ii*) [*CIT v. Tyresoles Concessionaries Pvt. Ltd.,* (1995) 213 ITR 660, 666-67 (Bom)].

Succession of a firm by company—section 33(4).—Ordinarily, the benefit of development rebate is available only to the person who acquires a ship or gets installed some machinery or plant and uses the same for purposes of his business. Sub-sections (3) and (4) enact exceptions to this general rule. Sub-section (3) extends the benefit to the amalgamated company and sub-section (4), in the circumstances therein specified, extends the benefit to the successor-in-business. In order that the benefit be available to the successor, sub-section (4) enacts that—

(*i*) the succession of a firm should be by a company, and

(*ii*) all the property of the firm relating to the business and all the business liabilities of the firm before succession should become the property and liabilities of the company, and

(*iii*) all the shareholders of the company must have been the partners of the firm immediately before the succession, and

(*iv*) the company fulfils all the conditions set out in section 34 for the availability of the benefit.

It may be noted that clause (*iii*) above is satisfied only where all the shareholders of the company had been partners of the firm immediately before the succession. There is, however, no breach of the condition of clause

(*iii*) if, after the formation of the company, any such shareholder transfers his holding of shares in such company [*CIT v. U.P. Shoe Industries P. Ltd.,* (1980) 122 ITR 938 (All)].

The *Explanation* to section 33(4) appears to have been added to ensure that a succession for the purpose of the above provision is a real succession and not a subterfuge or device to avoid the consequences of transfer of assets within the specified time. One of the requirements is that 'all the property of the firm relating to the business immediately before the succession becomes the property of the company'. The three requirements contained in the *Explanation* to section 33(4) are intended to ensure that there is a succession in the true sense of the term which results in transfer of plant and machinery and not a transfer simpliciter of plant and machinery in the garb of succession. The *Explanation* sets out the conditions with a view to restrict the benefit of section 33(4) to cases of real succession and it is that context that provides, *inter alia*, that all the property and liabilities of the firm relating to the business should become the property and liabilities of the company. Though, strictly speaking, cash may also be termed as property but in the context of succession of business, transfer or non-transfer of cash does not appear to have any significance. In the context and setting, the requirements of the *Explanation* to section 33(4) should be construed reasonably. A literal construction would defeat the obvious intention of section 33(4) and produce a wholly unreasonable result [*CIT v. Shrishakti Trading Co.,* (1994) 207 ITR 442, 451, 451-52 (Bom)]. In the facts of that case, the business of the firm transferred to the company as a going concern was valued at Rs. 32 lakhs. The only asset that was not transferred was cash in hand and at banks amounting to Rs. 9,196. It was held that such non-transfer of cash in hand and with banks could not in any way affect the succession of the assessee-firm by the company as a going concern. Therefore, the Tribunal was justified in holding that the ITO was not correct in withdrawing the development rebate allowed for assessment years 1961-62 and 1962-63 by invoking section 155(5)(*i*) and in refusing to allow development rebate for the assessment year 1963-64 on the very same ground.

It is pertinent to note that unless there is absolute identity of the firm, partners of the firm and the members of the company the benefits under section 33(4) are not available. The condition for operation of section 33(4) makes it abundantly clear that the provision is not of generic nature dealing with succession of business, but is applicable to that specie only with which it is dealing [*Kalindi Investment P. Ltd. v. CIT,* (1995) 213 ITR 207, 215 (Guj), **followed in** *CIT v. Fabriquip P. Ltd.*, (2003) 260 ITR 207, 211 (Guj)]. In the facts of that case, the contention on behalf of the assessee that the case of transfer of the undertaking as a whole is akin to succession of the business of a firm by the company as envisaged under section 33(4), was not accepted.

Central Government may withdraw the benefit.—Section 33(5), inserted by the Finance Act, 1964 (5 of 1964), empowers the Central Government to discontinue the giving of the benefit of development rebate in respect of a ship acquired or machinery installed after a specified date. This power can be exercised if and when the Central Government considers necessary or expedient so to do. In order to be able to exercise this power, the Central Government must issue a notification of its such decision in the Official Gazette specifying the date with effect from which the acquisition of the ship or the installation of the machinery or plant will not enjoy the benefits of development rebate deduction. Such date should be at least three years after the date of the notification. As has been seen earlier, the Central Government has factually withdrawn the benefit.

Machinery, etc., in office premises and in residential accommodation including guest house—development rebate, when available, when not available—section 33(6).—As has been seen in "*Legislative amendments*", the Finance Act, 1965 (10 of 1965), added a new sub-section (6) to section 33, providing that no development rebate shall be allowed in respect of any machinery or plant installed after 31-3-1965, in any office premises *or any residential accommodation including any accommodation* in the nature of a guest house. The provisions of section 33(6) can only be construed to mean office premises or residential accommodation of the assessee, either belonging to the assessee or otherwise in the occupation or use of the assessee. They would not have such wide import as to include office premises or residential accommodation belonging to a person other than the assessee concerned [*CIT v. Tinnevelly Tuticorin Tea Investment Co. Ltd.,* (1989) 179 ITR 550, 552 (Cal)]. In that case, the assessee, an electric supply undertaking, was held entitled to development rebate in respect of meters installed in the residential premises and office premises of the consumers.

Dissenting from the above Calcutta view [179 ITR 550 (Cal)], the Bombay High Court, in *CIT v. Thana Electricity Supply Ltd.* [(1994) 206 ITR 727, 746 (Bom)], has ruled that one cannot find any word or expression in section 33(6) which may justify any restrictive interpretation of that section 33(6) to confine its application only to office premises or residential accommodation 'owned or occupied by the assessee'. Trying to do so will amount to adding words to the statute which is not a permissible rule of interpretation. However, the Bombay High Court, relying on paragraph 72 of the departmental circular No. 3-P, dated 11-10-1965, has held (p. 747) that the above circular of the Board makes it clear that the plant and machinery referred to in section 33(6) would mean only the plant and machinery of the types set out in its circular which are of use to the occupants of the office, residence or guest house. Electric meters, definitely, do not

fall in this category. The meter is in fact necessary only for the purpose of measuring the consumption of electricity. It has no independent use of its own. In fact, it is not for the use in the office, residence, etc. It is a necessary adjunct to the supply line of electricity and the last point wherefrom starts the private line of the consumer. Though the meter is 'plant and machinery' in the technical sense, in the context of section 33(6), it cannot be said to be a plant or machinery installed in the office premises or residential accommodation, etc. Plant and machinery referred to in section 33(6) will only mean those plant or machinery which are intended for use in the office or the residence. The meter does not meet this description. It will, therefore, not fall within the purview of section 33(6). In that view of the matter, the Court was of the clear opinion, though on different grounds, that the Tribunal was right in holding that section 33(6) was not attracted and the assessee was entitled to development rebate in respect of electric meters, no matter they are installed whether in the office premises, residential accommodation, etc., or elsewhere.

In *Associated Cement Co. Ltd. v. CIT,* [(1994) 210 ITR 69, 76-77 (Bom)], it has been opined that the expression 'machinery or plant' cannot be restricted only to some of the species thereof mentioned in the memorandum explaining the provisions of the Finance Bill and the Board's abovesaid circular dated 11-10-1965.

A hotel premises is also included in the expression "residential accommodation" as used in section 33(6) [*CIT v. Hotel Amritha Pr. Ltd.,* (1980) 122 ITR 296 (Ker)], although it is not a guest house [*Sri Durga Enterprises v. ITO,* (1976) 102 ITR 745, 747 (Karn)].

It was felt that it will not be proper to debar good hotels from the benefit of section 33(1) in the interest of tourist traffic desirability. The Finance (No. 2) Act, 1967 (20 of 1967), therefore, added a proviso to section 33(6) excepting hotels belonging to Indian companies, if so approved by the Central Government, from the ban of section 33(6). Thus, machinery or plant installed in such hotels became entitled to the claim of development rebate, even though the machinery or plant is installed in the office premises, etc., of such hotels [*Sri Durga Enterprises v. ITO,* (1976) 102 ITR 745 (Karn)].

By virtue of the provisions of section 33(6), development rebate has been **held not eligible** in respect of the following:—

(1) safe deposit locker cabinets installed in the office premises [*Syndicate Bank v. CIT,* (1984) 150 ITR 198 (Karn)]. However, safe deposit lockers installed in the premises of a bank where no administrative work was carried on have been held eligible for development rebate [*Syndicate Bank v. CIT,* (1988) 172 ITR 561 (Karn)].

(2) air-conditioning plant installed in a conference room used for deliberations and taking of policy decisions regarding races and for discussion of racing events on race days and transactions of business by stewards [*Madras Race Club v. CIT,* (1985) 151 ITR 675 (Mad), special leave petition dismissed by the Supreme Court : (1995) 212 ITR (St.) 374 (SC)].

(3) air-conditioners installed in the conference hall in the assessee's factory premises also locating office, where there was no finding as to the purpose of the conference hall, namely, whether it was used exclusively for the purposes of the office, or exclusively for the purposes of the factory, or for both purposes, in which case what its dominant use was [*Zenith Steel Pipes Ltd. v. CIT,* (1990) 186 ITR 500 (Bom)].

(4) telephone equipment installed, after 31-3-1965, in the administrative building [*CIT v. Gujarat State Fertilizers Co. Ltd.,* (1993) 203 ITR 526, 528 (Guj), **followed in** *CIT v. Gujarat State Fertilizer Co.*, (2002) 255 ITR 294, 299 (Guj)].

(5) cost of the water works installed at the residential colonies as per the clear factual finding of the Tribunal in that regard [*Associated Cement Co. Ltd. v. CIT,* (1994) 210 ITR 69, 76 (Bom).

(6) air-conditioners and fans installed in the club house, which is either office premises or residence [*Madras Race Club v. CIT,* (1994) 210 ITR 680, 682 (Mad)].

On the other hand, the provisions of section 33(6) have been held not attracted and the development rebate has been **held eligible** in respect of the following:—

(1) electrical lighting installations in dispensary building and factory yard as the dominant purpose was to render medical assistance to the factory workers [*Zenith Steel Pipes Ltd. v. CIT,* (1990) 186 ITR 500, 502 (Bom)].

Development rebate allowance does not affect the written down value.—Unlike depreciation allowance which goes to diminish the actual cost or the written down value of the asset, the development rebate allowed

LexisNexis

deduction in respect thereof does not in any way affect its written down value. In this sense, the development rebate is a separate and independent allowance, and that in addition to any depreciation allowable. Allowed or not allowed, it has nothing to do with the actual cost or the written down value and does not, therefore, get reflected either in the balancing charge or the terminal allowance (operative upto assessment year 1987-88), if and as the case may be.

Rates of development rebate—sections 33(1) and 33(1A), rule 5B.—The following are the rates, prescribed from time to time, of development rebate as percentage of the actual cost of the asset to the assessee:—

A. New Ship—

(*i*) acquired up to 31-12-1957 .. 25%;

(*ii*) acquired after 31-12-1957 .. 40%.

B. New machinery or plant—

(*i*) Coal Mining machinery, etc., if installed—

between 1-4-54 and 31-3-61 .. 25%;
between 1-4-61 and 31-3-63 .. 20%;
between 1-4-63 and 31-3-70 .. 35%;
on or after 1-4-70 .. 25%.

(*ii*) Machinery, etc., used in any priority industry specified in Schedule V to the Act, if installed—

between 1-4-54 and 31-3-61 .. 25%;
between 1-4-61 and 31-3-65 .. 20%;
between 1-4-65 and 31-3-70 .. 35%;
on or after 1-4-70 .. 25%.

(*iii*) Machinery, etc., used in an approved hotel[15] run by an Indian company, if installed—

between 1-4-54 and 31-3-61 .. 25%;
between 1-4-61 and 31-3-67 .. 20%;
between 1-4-67 and 31-3-70 .. 35%;
on or after 1-4-70 .. 25%.

(*iv*) Machinery, etc., used in connection with scientific research related to the business, if installed—

between 1-4-54 and 31-3-61 .. 25%;
between 1-4-61 and 31-3-67 .. 20%;
between 1-4-67 and 31-3-70 .. 35%;
on or after 1-4-70 .. 25%.

(*v*) Any other machinery or plant, if installed—

between 1-4-54 and 31-3-61 .. 25%;
between 1-4-61 and 31-3-70 .. 20%;
on or after 1-4-70 .. 15%.

C. Second-hand ship acquired—

(*i*) before 1-4-1964 .. to be treated on par with new ship under executive instructions [Circular No. 27(LIX-2) of 1955, dated 6-7-1955];

(*ii*) after 1-4-1964 (*a*) at any time before the expiry of 7 years from the date she was built 30%;

(*b*) in any other case .. .. 20%.

D. Second-hand machinery or plant installed—

(*i*) before 1-4-1964 .. to be treated on par with new machinery, etc., under executive instructions [Circular No. 40 (XLVII-16) of 1962, dated 3-12-1962];

(*ii*) after 31-3-1964—

15. For availing the higher rate of development rebate, the hotel must specifically be approved under these provisions by the appropriate department of the Central Government. An approval given for any other purpose is of no consequence [*Hotel Horizon P. Ltd. v. Secretary to the Department of Tourism,* (1989) 175 ITR 284 (Del)]. Approval once granted cannot be rescinded on the ground that the approval was accorded due to oversight [*CIT v. Hotels* (*Andhra*) *P. Ltd.,* (1989) 175 ITR 295 (AP)].

LexisNexis

(*a*) coal mining machinery or plant—			
—if installed before 1-4-1966	..	..	20%;
—if installed after 31-3-1966	..	..	10%;
(*b*) other machinery or plant	..	..	10%.

Rollers.—"As rollers installed in machinery used in sugar works constitute 'plant', development rebate will be admissible in respect of the actual cost of such rollers" [*vide Circular No. 11-P* (*XIX-19*)*, dated 16-11-1968*].

Priority industry—what it means.—For the purposes of section 33, an industry is said to be a priority industry where the machinery or plant is installed for the purposes of business of—

—construction,

—manufacture or

—production

of any one or more of the articles or things specified in the list in the Fifth Schedule to the 1961 Act.

From the above, it is clear that the expression 'for the purposes of business of' applies to three activities which immediately follow that expression, namely, construction, manufacture or production. That expression does not apply only to construction. The three terms 'construction', 'manufacture' or 'production' are used to govern the business activities of the assessee in connection with the articles or things set out in the Fifth Schedule. There is no reason for construing this clause artificially so as to make a bifurcation between the business of construction, irrespective of what is constructed, and the business of manufacture or production of articles or things specified in the Fifth Schedule.

There are three activities serially set out there namely, construction, manufacture or production. A comma is, therefore, legitimately and as per the rules of grammar, required after the first activity to separate it from the second activity of manufacture. Since the second activity is followed by the word 'or', no comma is required after the second activity to separate it from the third activity. Therefore, punctuation is put as grammatically required. It does not disclose any intention of providing for a separate kind of business altogether. Punctuation, in any case, is a minor element in the construction of a statute. Only when a statute is carefully punctuated and there is no doubt about its meaning that weight should be given to punctuation. It cannot, however, be regarded as a controlling element for determining the meaning of a statute. In the present case, the plain meaning of the text is very clear and the use of a comma neither adds to it nor detracts from its ordinary meaning [*Hindustan Construction Co. Ltd. v. CIT,* (1994) 208 ITR 291, 296, 296-97 (Bom) judgment dated 11-11-1992]. In the facts of that case, the assessee-company, engaging in the business as construction engineers, carried out the work of construction of roads, dams, etc. Development rebate on the plant and machinery used in the business of carrying out construction work at a higher rate was held not eligible as the assessee was not engaged in a priority industry. This view is in consonance with the view taken by the Supreme Court in *CIT v. N.C. Budharaja & Co.* [(1993) 204 ITR 412, 434-35 (SC) decided on 7-9-1993], though on different grounds, in the context of the provisions of section 32A relating to investment allowance.

Higher rates for priority industries.—It has been seen above that machinery, etc., used in certain priority industries specified in the Fifth Schedule to the Act are eligible for development rebate at a higher rate. Where a particular machinery is found to fall in a particular category, it is not permissible to place that machine for the purpose of development rebate under the category to which it does not belong [*Addl. CIT v. Nagardas Bechardas & Bros. P. Ltd.,* (1976) 104 ITR 123, 128 (Guj)]. In order to avail higher rates of development rebate, it is not necessary that the machinery, etc., must be used exclusively for the manufacture of a priority item [*Addl. CIT v. Rambal* (*P.*) *Ltd.,* (1980) 123 ITR 130 (Mad); *CIT v. Rambal* (*P.*) *Ltd.,* (1988) 169 ITR 50 (Mad), **both affirmed in** *CIT v. Rambal Pvt. Ltd.,* (1997) 227 ITR 409, 413-14 (SC)]. Also, it is not necessary that the manufactured product should be sold to customers. It is sufficient if the manufactured item is consumed by the assessee himself in manufacturing some other goods [*CIT v. Hindusthan Motors Ltd.,* (1981) 127 ITR 210 (Cal)]. Thus, the assessee has been held entitled to higher development rebate on the cost of machinery newly installed for the manufacture of automobile ancillaries including those utilised by it in the assembling of its own cars [*CIT v. Hindusthan Motors Ltd.,* (1988) 170 ITR 431 (Cal), special leave petition dismissed by the Supreme Court : (1991) 189 ITR (St.) 42 (SC); *CIT v. Hindustan Motors Ltd.,* (1989) 175 ITR 411 (Cal)]. Similarly, irrespective of the ownership in the raw materials or the end-products, if the assessee had carried on its business of turning out automobile ancillaries and supplying them by manufacturing such automobile ancillaries with the aid of the machinery owned by it, though with the raw materials of another, the assessee would be entitled to the benefit of higher development rebate [*Unity Tools v. CIT,* (1990) 185 ITR 1, 5-6 (Mad)]. In *CIT v. Cochin Refineries Ltd.* [(1988) 173 ITR 461, 466 (Ker)], certain assets of a refinery such as waste ponds, fresh water tank, pipe racks, alloy piping, jetty facilities, cherry picker cranes, etc., were held

LexisNexis

eligible for development rebate at the higher rate applicable to the refinery plant. There has been a considerable litigation on the point whether a particular industry is a priority industry or not.

In *CIT v. Salem Textiles Ltd.* [(1999) 237 ITR 662, 664, 667-68 (Mad)], the Tribunal was held justified in law in directing the Officer to grant higher development rebate in respect of generators, trolley and diesel tanks on the ground that they form part of the 'textile machinery'.

Where the Tribunal has found that the machinery was used for production of articles specified in the Fifth Schedule, the assessee was held entitled to development rebate at the higher rate of 25 per cent. [*CIT v. International Computers Indian Manufacture Ltd.*, (1999) 239 ITR 499, 502 (Bom)].

In *CIT v. Freezeking Industries* (*P.*) *Ltd.* [(2001) 250 ITR 123, 124 (Del)], it has been held that the machinery used in the manufacturing of steel castings and forgings at an intermediary stage, by the assessee engaged in the manufacture of compressors for air-conditioning and refrigeration machinery, was not entitled to development rebate at the higher rate of 25 per cent. Also see, *CIT v. Freezeking Industries* (*P.*) *Ltd.*, (2002) 167 Taxation 177, 178 (Del).

Cases holding that the industry concerned was a **priority industry** are:—

1. Straw-board held covered under item (16) of the Fifth Schedule, *viz.*, "Paper and pulp" as it stood up to 31-3-1966 [*CIT v. Straw-Board Mfg. Co. Ltd.,* (1975) 98 ITR 78 (Punj)]. The Punjab decision [98 ITR 78 (Punj)] has been **affirmed** by the Supreme Court in *CIT v. Strawboard Manufacturing Co. Ltd.* [(1989) 177 ITR 431 (SC)]. Also see, *Dhampur Sugar Mills Ltd. v. CIT,* (1991) 188 ITR 787, 790-91 (All).
2. Mild steel rod and steel sections from steel billets and ingots held covered under item (1), *viz.*, "Iron and Steel (metal)" [*CIT v. Mittal Steel Re-rolling and Allied Industries* (*P.*) *Ltd.,* (1977) 108 ITR 207 (Ker); *CIT v. West India Steel Co. Ltd.,* (1977) 108 ITR 601 (Ker—FB); Addl. *CIT v. Trichy Steel Rolling Mills Ltd.,* (1979) 118 ITR 39 (Mad); *CIT v. Krishna Copper and Steel Rolling Mills,* (1979) 119 ITR 256 (Punj) (manufacture of iron rods and girders from metal scrap)]. The Punjab decision [119 ITR 256 (Punj)] and the Madras decision [118 ITR 39 (Mad)] have been **affirmed** by the Supreme Court in *CIT v. Krishna Copper & Steel Rolling Mills : Addl. CIT v. Trichy Steel Rolling Mills Ltd. : CIT v. Indian Steel Rolling Mills Ltd.* [(1992) 193 ITR 281 (SC)]. The Supreme Court has impliedly approved the decisions in *CIT v. Mittal Steel Re-rolling and Allied Industries P. Ltd.* [(1977) 108 ITR 207 (Ker)], *CIT v. West India Steel Co. Ltd.* [(1977) 108 ITR 601 (Ker—FB)], *CIT v. Ludhiana Steel Rolling Mills* [(1989) 180 ITR 155 (P & H)] and *Singh Engineering Works P. Ltd. v. CIT* [(1979) 119 ITR 891 (All)]; and has **impliedly not approved** the decisions in *Indian Steel and Wire Products Ltd. v. CIT* [(1977) 108 ITR 802 (Cal)] and *CIT v. Kay Charan P. Ltd.* [(1991) 190 ITR 190 (All)]. Also see, *CIT v. Trichy Steel Rolling Mills Ltd.,* SLP (Civil) No. 2758 of 1993 : (1993) 201 ITR (St.) 50 (SC).
3. Centrifugal pumps and electric motors constitute "agricultural implements" within item (9) [*CIT v. Dhandayuthapani Foundry P. Ltd.,* (1980) 123 ITR 709 (Mad)].
4. Processing frozen fish and fish products fall in item (30) [*CIT v. Castlerock Fisheries,* (1980) 126 ITR 382 (Ker), **affirmed in** *CIT v. Castle Rock Fisheries,* (1998) 231 ITR 304 (SC)].
5. Conduit pipes used for holding cables through which electricity flows are 'equipment' for transmission of electricity under item (7) [*R.S.G. Conduits and Tubes Pr. Ltd. v. CIT,* (1981) 127 ITR 83 (All)].
6. Nylon-6, manufactured from imported caprolactum held a "petro-chemical" falling under item (18) [*CIT v. Nirlon Synthetic Fibres & Chemicals Ltd.,* (1981) 130 ITR 14 (SC); *J.K. Synthetics Ltd. v. CIT,* (1981) 130 ITR 23 (SC); *CIT v. Century Enka Ltd.,* (1981) 130 ITR 267 (Cal); *CIT v. J.K. Synthetics Ltd.,* (1990) 181 ITR 505, 507 (Del); *CIT v. J.K. Synthetics Ltd.,* (1990) 181 ITR 537, 541 (Del); *CIT v. J.K. Synthetics Ltd.,* (1990) 182 ITR 409, 412 (Del). Also see, *CIT v. Indian Plastics & Chemicals Pr. Ltd.,* (1981) 130 ITR 745 (Karn) (manufacture of synthetic resin)]. Also see, *CIT v. J.K. Synthetics Ltd.,* (1992) 193 ITR 524, 529 (Del); *CIT v. Plastic Products Ltd.,* (1993) 112 Taxation 431, 432 (All); *CIT v. J.K. Synthetics Ltd.,* C.A. Nos. 5201-5204 of 1990 out of SLP (Civil) Nos. 10359-13562 of 1985 : (1991) 187 ITR (St.) 36-37 (SC).

Further cases holding that the industry concerned was a **priority industry** are as follows:—

(1) *CIT v. Ratlam Straw-Board Mills Pr. Ltd.,* (1981) 132 ITR 700 (MP) [manufacturing of straw-board].

(2) *CIT v. East India Industries* (*M*) *Pr. Ltd.,* (1983) 139 ITR 1059 (Mad) [manufacturing of waterproof paper].

(3) *CIT v. Simpson & Co. Ltd.,* (1983) 141 ITR 35 (Mad) [bus-body building]. Also see, *CIT v. Jayanand Khira & Co. Pr. Ltd.,* (1988) 170 ITR 31 (Bom).

(4) *CIT v. Perfect Liners,* (1983) 142 ITR 654 (Mad) [manufacture of component parts of internal combustion engine].

(5) *CIT v. Vijaya Spng. Mills Ltd.,* (1983) 143 ITR 64 (AP) [manufacturing cotton yarn]. Also see, *CIT v. North Arcot District Co-operative Spng. Mills Ltd.,* (1984) 148 ITR 406 (Mad); *CIT v. Alagappa Cotton Mills*, (1999) 235 ITR 327, 328-29 (Mad); *CIT v. Alagappa Cotton Mills*, (2002) 253 ITR 100, 102-03 (Mad)]; *CIT v. Vijaya Spinning Mills Ltd.,* SLP (Civil) No. 13685 of 1985 : (1990) 186 ITR (St.) 74 (SC).

(6) *Ahmedabad Mfg. & Calico Pr. Ltd. v. CIT,* (1986) 162 ITR 800 (Guj) [P.V.C. processing plant used for production of P.V.C. resins].

(7) *CIT v. Simac Group* (*India*) *Pr. Ltd.,* (1987) 163 ITR 867 (Bom) [manufacturing of hand-knitting machines].

(8) *CIT v. National Rayon Corporation Ltd.,* (1992) 193 ITR 744 (Bom) [manufacturing tyre-cord]. The Bombay decision [(1992) 193 ITR 744 (Bom)] has been **followed in** *CIT v. National Rayon Commercial Co. Ltd.* [(1992) 193 ITR 743 (Bom)].

(9) *CIT v. Alkali Chemical Corporation of India Ltd.,* (1987) 165 ITR 698 (Cal) [manufacturing polythene and rubber chemicals].

(10) *CIT v. Rambal Pr. Ltd.,* (1988) 169 ITR 50 (Mad), **affirmed in** *CIT v. Rambal Pvt. Ltd.,* (1997) 227 ITR 409, 413-14 (SC) [manufacturing bolts, nuts and screws for automobile machineries].

(11) *CIT v. Telelink Products* (*P.*) *Ltd.,* (1989) 177 ITR 291 (Bom) [telecommunication equipment manufactured by the assessee was covered by item (17) of the Fifth Schedule, *viz.*, "Electronic equipment, namely,..... electronic communication equipment....."].

(12) *CIT v. Ludhiana Steel Rolling Mills,* (1989) 180 ITR 155 (Punj) [manufacture of mild steel rounds and square bars].

(13) *CIT v. Chitram & Co. Pvt. Ltd.,* (1991) 191 ITR 96, 102-03 (Mad) [manufacture of gears].

(14) *CIT v. Sovrin Knit Works,* (1993) 199 ITR 679 (Punj—Larger FB) [special leave petition granted by the Supreme Court : (1994) 205 ITR (St.) 45 (SC)], **overruling** *Niemla Textile Finishing Mills P. Ltd. v. ITO,* (1985) 152 ITR 429 (Punj—FB) [dying, bleaching, printing and embroidering of grey cloth].

(15) *Industrial Machinery Manufacturers Pvt. Ltd. v. CIT,* (1993) 203 ITR 438 (Guj) [manufacturer of humidifiers as the same were textile machinery or textile accessories].

(16) *CIT v. Strong Steel Pr. Ltd.,* (1994) 206 ITR 628 (Guj), **following** *CIT v. Krishna Copper and Steel Rolling Mills,* (1992) 193 ITR 281 (SC) [rolling mill manufacturing G.P. sheets, angles, flats and other ancillary items].

(18) *CIT v. Secals Ltd.,* (1995) 212 ITR 346, 352-53 (Mad) [machinery set up for the manufacture of steel castings].

(19) *CIT v. Orient Marine Products Pvt. Ltd.,* (1995) 214 ITR 44, 47-48 (Mad) [business of the assessee admittedly consisted of processing of lobsters, frog legs, shrimps and prawns].

(20) *CIT v. Standard Chemical Co.,* (1996) 218 ITR 138, 139 (All) [cotton waste plant installed].

(21) *Gwalior Rayon Silk Manufacturing* (*Weaving*) *Co. Ltd. v. J.C. Luther,* (1995) Tax LR 763, 765 (Bom) [manufacture of rayon grade wood pulp or dissolved pulp].

(22) *CIT v. South India Viscose Ltd.,* (1998) 229 ITR 198, 201 (Mad), **followed in** *CIT v. South India Viscose Ltd.,* (1998) 229 ITR 203, 207-08 (Mad) [machinery installed in the pulp unit].

(23) *CIT v. Kel Components Ltd.,* (1998) 144 CTR (Mad) 281, 289 = (1999) 240 ITR 842, 849 (Mad) [manufacture of resistors (volume controls) falls within the expression 'electronic equipment' appearing under entry No. 17 of the Fifth Schedule and the Sixth Schedule, entitling the assessee to development rebate at a higher rate].

(24) *CIT v. Western Mechanical Industries P. Ltd.*, (1998) 234 ITR 210, 213 (Bom) [manufacture of heavy duty cranes].

(25) *Ambica Mills Ltd. v. CIT*, (1999) 235 ITR 264, 274 (Guj) [machinery used in machinery division].

(26) *CIT v. Associate Metals Company* (*P.*) *Ltd.,* (1999) 235 ITR 745, 746-47 (All) [manufacture of iron plates from ingots purchased from market].

(27) *S.S.M. Brothers* (*P.*) *Ltd. v. CIT*, (2000) 243 ITR 418, 420-21 (SC) [machinery used by the assessee for processing the cloth purchased by it by embroidering or dyeing it].

LexisNexis

(28) *CIT v. Simco Meters Ltd.*, (2001) 251 ITR 46, 48-49 (Mad) [manufacture of meters used for measurement of electricity as also manufacture of equipment for generation and transmission of electricity].

Also see, *CIT v. Modi Industries Ltd.,* SLP (Civil) No. 15622 of 1985 : (1991) 187 ITR (St.) 155 (SC); *CIT v. Rashtriya Metal Industries Ltd.,* SLP (Civil) No. 6281 of 1985 : (1992) 193 ITR (St.) 6-7 (SC); *CIT v. Essma Woollen Mills Ltd.,* SLP (Civil) Nos. 1489-1490 of 1995 : (1995) 212 ITR (St.) 61-62 (SC).

On the other hand, the following industries were **held not to be priority industries**:—

1. Wire rods held not falling in item (1) of the Fifth Schedule, *viz.*, "Iron and steel (metal)" [*Indian Steel & Wire Products Ltd. v. CIT,* (1977) 108 ITR 802 (Cal)].
2. Bonemeal, although a fertiliser in the general sense, does not fall within item (13) because of the fact that the entry is qualified by the word "namely" and, therefore, takes in only the types of fertilisers specified there [*CIT v. Arasan Fertilisers Pr. Ltd.,* (1978) 114 ITR 802 (Mad)].
3. Screws and bolts held not falling in item (20), *viz.*, "Automobile ancillaries" by the mere fact that the assessee was registered with IDA as a manufacturer of automobile accessories [*CIT v. Lakshmi Precision Screws Ltd.,* (1980) 125 ITR 338 (Punj)].

Further cases holding that the industry concerned was **not a priority industry** are as follows:—

(1) *Traco Cable Co. Ltd. v. CIT,* (1982) 138 ITR 385 (Ker) [manufacture of telephone cables].

(2) *CIT v. Khosla Plastics Pr. Ltd.,* (1982) 138 ITR 455 (Bom) [manufacture of electrical appliances, such as switches, sockets, etc.].

(3) *Indian Aluminium Co. Ltd. v. CIT,* (1983) 140 ITR 114 (Cal) [manufacture of pigments out of alumina].

(4) *CIT v. Tensile Steel Ltd.,* (1983) 141 ITR 223 (Guj), special leave petition granted by the Supreme Court: (1983) 140 ITR (St.) 3 (SC) [wire manufactured from billets of special steel].

(5) *Tarapore & Co.* (*Cochin*) *v. CIT,* (1985) 154 ITR 537 (Mad) [construction and repairing of dockyard].

(6) *CIT v. S.S.M. Sizing Centre,* (1985) 155 ITR 782 (Mad), special leave petition granted by the Supreme Court : (1991) 187 ITR (St.) 68-69 (SC) [warping, sizing and bleaching of cotton yarn after purchase].

(7) *CIT v. S.S.M. Finishing Centre,* (1985) 155 ITR 791 (Mad), special leave petition granted by the Supreme Court : (1991) 187 ITR (St.) 155-56 (SC) [bleaching, dyeing, etc., of cloth after purchase]. Also see, *CIT v. S.S.M. Finishing Centre,* (1990) 186 ITR 597 (Mad), special leave petition granted by the Supreme Court : (1991) 187 ITR (St.) 42 (SC); *S.S.M. Sizing Centre v. CIT,* SLP (Civil) No. 6764 of 1985 : (1992) 193 ITR (St.) 29-30 (SC); *CIT v. S.S.M. Processing Mills,* (1997) 227 ITR 596, 600-01, 606 (Mad); *CIT v. Rajalakshmi Textiles Processors Ltd.,* (1998) 146 CTR (Mad) 52, 54 = (1999) 235 ITR 718, 721 (Mad); *CIT v. Rajalakshmi Textile Processors Ltd.,* (1998) Tax LR 570, 571 (Mad) = (1999) 235 ITR 778, 780 (Mad).

(8) *CIT v. Veena Textiles Pr. Ltd.,* (1985) 155 ITR 794 (Mad), **reversed in** *S.S.M. Brothers* (*P.*) *Ltd. v. CIT*, (2000) 243 ITR 418, 420-21 (SC) [embroidering designs on cloth after purchase and dyeing of such cloth].

(9) *CIT v. Fitwell Caps Pr. Ltd.,* (1986) 159 ITR 454 (Karn) [manufacturing aluminium caps from aluminium sheets].

(10) *Hindustan Wire Products Ltd. v. CIT,* (1986) 161 ITR 749 (SC) [manufacturing insulated copper wire].

(11) *CIT v. Kerala Solvent Extractions Ltd.,* (1987) 165 ITR 174 (Ker) [extraction of oil from oil-cakes by the solvent extraction process and not directly from seeds].

(12) *CIT v. Sriyansh Knitters,* (1989) 178 ITR 466 (Punj) [machinery used for manufacture of woollen hosiery is not covered by item (32) of the Fifth Schedule, *viz.*, "Textiles (including those dyed, printed or otherwise processed) made wholly or mainly of cotton, including cotton yarn, hosiery and rope"].

(13) *CIT v. Ludhiana Steel Rolling Mills,* (1989) 180 ITR 155 (Punj) [manufacture of machinery like lathes, blowers, surface grinders and drills].

(14) *CIT v. Caltex* (*India*) *Ltd.,* (1989) 177 ITR 239 (Bom) [blending of various grades of lubricating oil, the end product was held to be a mixture of hydrocarbons and not 'mineral oil' (as used in item (3) of the Fifth Schedule)].

LexisNexis

(15) *Standard Batteries Ltd. v. CIT,* (1994) 205 ITR 209, 212 (Bom), **following** *CIT v. Standard Batteries Ltd.,* (1993) 201 ITR 977 (Bom) [manufacture of miners' safety cap lamps, mining batteries and components as these do not fall within the meaning of the expression 'mining machinery'].

(16) *Hindustan Construction Co. Ltd. v. CIT,* (1994) 208 ITR 291 (Bom), **followed in** *Hindustan Construction Co. Ltd. v. CIT,* (1994) 208 ITR 298 (Bom) [assessee, construction engineers, using machinery and plant in construction business].

(17) *Advani Oerlikon Pvt. Ltd. v. CIT,* (1991) Tax LR 338 (Bom) [manufacturing of welding electrodes].

(18) *CIT v. Bagpatia Food Industries,* (1995) 216 ITR 543, 545-46 (Raj) [vegetable oil and oilcakes not produced by the solvent-extraction process and industry established not for processing seeds]. Also see, *CIT v. Bagpatia Food Industries*, (2002) 169 Taxation 335, 336 (Raj).

(19) *Advani Oerlikon Ltd. v. CIT,* (1997) 141 Taxation 394, 395 (Bom) [plant and machinery used for manufacture of electrodes and carbon rods].

Also see, *Veena Textiles P. Ltd. v. CIT,* SLP (Civil) No. 834 of 1985: (1992) 195 ITR (St.) 145 (SC); *Tarapore & Co. v. CIT,* SLP (Civil) No. 14560 of 1984 : (1993) 201 ITR (St.) 21 (SC).

Aluminium (metal).—For the purpose of allowing the higher rate of development rebate, item (2) of the Fifth Schedule would include the manufacture of aluminium (metal) both from bauxite as well as from aluminium scrap [*vide, Circular No. 25-D* (*XIX-16*)*, dated 10-10-1966*]. "So long as the machinery and plant are used for the manufacture or production of aluminium (metal), whatever the raw material used, the assessee will be entitled to the development rebate at the enhanced rate" [*vide, CBDT letter F. No. 1*(*211*)*-65-TPL, dated 24-9-1965*].

Textile machinery.—'Textile machinery' (such as spinning frames, carding machines, power looms and the like), including textile accessories, ...includes wet processing machinery like dyeing, bleaching, finishing as well as textile accessories such as shuttles, bobbins, healds, reeds, inserts and other spares and attachments". Manufacturers of such machinery are entitled to the higher rate of development rebate [*vide, Circular letter No. 1* (*206*)*-65* (*TPL*)*, dated 15-1-1966*].

Allowance for development rebate—conditions for.—The conditions requisite for allowance of development rebate are as follows:—

(*i*) the newly purchased asset—

—must be owned by the assessee; and

—must be wholly used for the purposes of the business carried on by the assessee [s. 33(1)(*a*)];

(*ii*) the prescribed particulars have been furnished [s. 34(1) (operative upto 31-3-1988)];

(*iii*) the assessee must have created a development rebate reserve equal to 75% [50% in respect of ship acquired after 28-2-1966] of the amount of development rebate to be actually allowed. This is done by debiting that amount to the profit and loss account against crediting it to a (development rebate) reserve account in the books of the assessee. The amount in such reserve account may be utilised by the assessee, during a period of eight years next following, for the purposes of the business of the undertaking other than—

—for distribution by way of dividends or profits; or

—for remittance outside India as profits or for the creation of any asset outside India.

(*iii*) However, the condition as to the creation of such reserve is not necessary in cases of (*i*) a company assessee being a licensee within the meaning of the Electricity (Supply) Act, 1948 (54 of 1948); and (*ii*) ships acquired, or machinery or plant installed, prior to 1-1-1958 [s. 34(3)(*a*)];

(*iv*) the assessee does not sell or otherwise transfer the asset for a period of at least eight years [ten years under the 1922 Act] from the end of the previous year in which the ship was acquired or machinery, etc., was installed. Exceptions to this condition, however, are: where—

—the ship had been acquired, or machinery or plant was installed, before 1-1-1958;

—the asset is sold or otherwise transferred to the Government, a local authority, a statutory corporation or a Government company;

—the sale or transfer is made in connection with the amalgamation or succession, referred to in section 33(3) or 33(4) [s. 34(3)(*b*)].

In case of non-fulfilment of conditions at (*i*), (*ii*) or earlier part of (*iii*), no development rebate is to be allowed. In case of breach of No. (*iv*) or the later part of (*iii*) the development rebate originally allowed shall be deemed to have been wrongly allowed and the Assessing Officer shall rectify the assessment accordingly [s. 155(5)] [see, *Ajodhya Prasad Tarachand Khekra v. CIT,* (1967) 66 ITR 576, 578 (All); *CIT v. Orissa Flour Mills Pr. Ltd.,* (1976) 104 ITR 682, 684-85 (Ori); *New Savan Sugar & Gur Refining Co. Ltd. v. CIT,* (1969) 74

LexisNexis

ITR 7, 16-17 (SC); *CIT v. Saurashtra Wire-healds Mfg. Co. P. Ltd.,* (1968) 67 ITR 524, 535 (Guj); *CIT v. Veeraswami Nainar,* (1965) 55 ITR 35, 38-39 (Mad); *Addl. CIT v. Nagardas Bechardas & Bros. P. Ltd.,* (1976) 104 ITR 123, 129 (Guj)].

Questions of law.—These are questions of law:—

(1) Whether the Tribunal was justified in allowing the development rebate on the cost of cops [*CIT v. Modi Pon Ltd.,* (1989) 175 ITR 118 (All)].

(2) Whether the Tribunal was justified in holding that development rebate at the higher rate was admissible in relation to steel unit [*CIT v. Modi Industries Ltd.,* (1989) 180 ITR 249 (All)].

(3) Whether the Tribunal was justified in allowing development rebate on new electric fittings in the factory area [*CIT v. Modi Industries Ltd.,* (1989) 180 ITR 249 (All)].

Reference may be made to *CIT v. Punjab & Sind Bank Ltd.* [(1999) 239 ITR 343, 345 (Del)].

Remand to the Tribunal.—Where there was no material available on record to verify whether the assessee was entitled to higher development rebate and it was not known as to what were the items of industrial machinery that were used by the assessee in the assessment year under consideration for grant of higher development rebate, the matter was remanded to the Tribunal for ascertaining the facts on this aspect and to decide the same in accordance with law [*CIT v. E.I.D. Parry Ltd.,* (1997) 227 ITR 373, 379 (Mad)].

LexisNexis

Omitted/Phased-out provisions of section 33A of the 1961 Act

[1][**S. 33A. Development allowance.—**](1) In respect of planting of tea bushes on any land in India owned by an assessee who carries on business of growing and manufacturing tea in India, a sum by way of development allowance equivalent to—

(*i*) where tea bushes have been planted on any land not planted at any time with tea bushes or on any land which had been previously abandoned, [2][fifty per cent] of the actual cost of planting; and

(*ii*) where tea bushes are planted in replacement of tea bushes that have died or have become permanently useless on any land already planted, [3][thirty per cent] of the actual cost of planting,

shall, subject to the provisions of this section, [4][be allowed as a deduction in the manner specified hereunder, namely:—

(*a*) the amount of the development allowance shall, in the first instance, be computed with reference to that portion of the actual cost of planting which is incurred during the previous year in which the land is prepared for planting or replanting, as the case may be, and in the previous year next following, and the amount so computed shall be allowed as a deduction in respect of such previous year next following; and

(*b*) thereafter, the development allowance shall again be computed with reference to the actual cost of planting, and if the sum so computed exceeds the amount allowed as a deduction under clause (*a*), the amount of the excess shall be allowed as a deduction in respect of the third succeeding previous year next following the previous year in which the land has been prepared for planting or replanting, as the case may be:]

[5][*Provided* that no deduction under clause (*i*) shall be allowed unless the planting has commenced after the 31-3-1965, and been completed before the 1st day of April, 1990:

Provided further that no deduction shall be allowed under clause (*ii*) unless the planting has commenced after the 31st day of March, 1965, and been completed before the 1st day of April, 1970.]

(2) Where the total income of the assessee assessable for the assessment year relevant to [6][the previous year in respect of which the deduction is required to be allowed under sub-section (1)] [7][(the total income for this purpose being computed after deduction of the allowance under sub-section (1) or sub-section (1A) or clause (*ii*) of sub-section (2) of section 33, but without making any deduction under sub-section (1) of this section or any deduction under Chapter VI-A [8][* * * *])] is *nil* or is less than the full amount of the development allowance [9][calculated at the rates and in the manner specified in sub-section (1)]—

(*i*) the sum to be allowed by way of development allowance for that assessment year under sub-section (1) shall be only such amount as is sufficient to reduce the said total income to *nil*; and

(*ii*) the amount of the development allowance, to the extent to which it has not been allowed as aforesaid, shall be carried forward to the following assessment year, and the development allowance to be allowed for the following assessment year shall be such amount as is sufficient to reduce the total income of the assessee assessable for that assessment year, computed in the manner aforesaid, to *nil*, and the balance of the development allowance, if any, still outstanding shall be carried forward to the following assessment year and so on, so, however, that no portion of the development allowance shall be carried forward for more than eight assessment years immediately succeeding the assessment year in which the deduction was first allowable.

---

1. Section 33A has been inserted by the Finance Act, 1965 (10 of 1965), s. 9 (w. e. f. 1-4-1965).
2. Subs., for "forty per cent", by the Finance Act, 1966 (13 of 1966), s. 8 (w. e. f. 1-4-1966).
3. Subs., for "twenty per cent", by Act 13 of 1966, s. 8 (w. e. f. 1-4-1966).
4. Subs., for "be allowed as a deduction in respect of the third succeeding previous year next following the previous year in which the land is prepared for planting or replanting, as the case may be:", by Act 13 of 1966, s. 8 (w. e. f. 1-4-1966).
5. Subs. by the Finance Act, 1990 (12 of 1990), s. 9 (w. e. f. 1-4-1990), for the following:—
'*Provided* that no deduction under clause (*i*) shall be allowed unless the planting has commenced after the 31st day of March, 1965, and no deduction shall be allowed under clause (*ii*) unless the planting has commenced after the 31st day of March, 1965, and been completed before the 1st day of April, 1970.'.
6. Subs., for "the third succeeding previous year next following the previous year in which the land has been prepared", by Act 13 of 1966, s. 8 (w. e. f. 1-4-1966).
7. Subs., for "(the total income for this purpose being computed after making the allowance under sub-section (1) or sub-section (1A) or clause (*ii*) of sub-section (2) of section 33 but without making any allowance under sub-section (1) of this section)", by Act 20 of 1967, s. 33 and 3rd Sch. (w. e. f. 1-4-1968).
8. The words, etc. "or section 280-O" have been omitted by the Finance Act, 1988 (26 of 1988), s. 54(*v*) (w. e. f. 1-4-1988).
9. Subs., for "calculated at the rates specified in sub-section (1)", by Act 13 of 1966, s. 8 (w. e. f. 1-4-1966).

Explanation.—Where for any assessment year development allowance is to be allowed in accordance with the provisions of sub-section (2) in respect of more than one previous year, and the total income of the assessee assessable for that assessment year [10][(the total income for this purpose being computed after deduction of the allowance under sub-section (1) or sub-section (1A) or clause (*ii*) of sub-section (2) of section 33, but without making any deduction under sub-section (1) of this section or any deduction under Chapter VI-A [11][* * * *])] is less than the amount of the development allowance due to be made in respect of that assessment year, the following procedure shall be followed, namely:—

(*i*) the allowance under clause (*ii*) of sub-section (2) of this section shall be made before any allowance under clause (*i*) of that sub-section is made; and

(*ii*) where an allowance has to be made under clause (*ii*) of sub-section (2) of this section in respect of amounts carried forward from more than one assessment year, the amount carried forward from an earlier assessment year shall be allowed before any amount carried forward from a later assessment year.

(3) The deduction under sub-section (1) shall be allowed only if the following conditions are fulfilled, namely:—

(*i*) the particulars prescribed in this behalf have been furnished by the assessee;

(*ii*) an amount equal to seventy-five per cent of the development allowance 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—

(*a*) for distribution by way of dividends or profits; or

(*b*) for remittance outside India as profits or for the creation of any asset outside India; and

(*iii*) such other conditions as may be prescribed.

(4) If any such land is sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which the deduction under sub-section (1) was allowed, any allowance under this section shall be deemed to have been wrongly made for the purposes of this Act, and the provisions of sub-section (5A) of section 155 shall apply accordingly:

Provided that this sub-section shall not apply—

(*i*) where the land is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[12]; or

(*ii*) where the sale or transfer of the land is made in connection with the amalgamation or succession referred to in sub-section (5) or sub-section (6).

[13][(5) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers to the amalgamated company any land in respect of which development allowance has been allowed to the amalgamating company under sub-section (1),—

LexisNexis

---

10. Subs., for "(the total income for this purpose being computed after making the allowance under sub-section (1) or sub-section (1A) or clause (*ii*) of sub-section (2) of section 33 but without making any allowance under sub-section (1) of this section)", by Act 20 of 1967, s. 33 and 3rd Sch. (w. e. f. 1-4-1968).

11. The words, etc. "or section 280-O" have been omitted by the Finance Act, 1988 (26 of 1988), s. 54(*v*) (w. e. f. 1-4-1988).

12. Repealed and replaced by Act 18 of 2013.

13. Subs. by Act 20 of 1967, s. 10 (w. r. e. f. 1-4-1967), for the following:—

"(5) Where, in a scheme of amalgamation, a company (hereinafter in this sub-section referred to as the predecessor) sells or otherwise transfers to the company formed in pursuance of the predecessor's amalgamation with that company (hereinafter in this sub-section referred to as the successor) any land in respect of which development allowance has been allowed to the predecessor under sub-section (1),—

(*a*) the successor shall continue to fulfil the conditions mentioned in sub-section (3) in respect of the reserve created by the predecessor and in respect of the period within which such land shall not be sold or otherwise transferred and in default of any of these conditions, the provisions of sub-section (5A) of section 155 shall apply to the successor as they would have applied to the predecessor had it committed the default;

(*b*) the balance of development allowance, if any, still outstanding to the predecessor in respect of such land shall be allowed to the successor in accordance with the provisions of sub-section (2), so, however, that the total period for which the balance of development allowance shall be carried forward in the assessments of the predecessor and the successor shall not exceed the period of eight years specified in sub-section (2) and the successor shall be treated as the assessee in respect of such land for the purposes of this section.

Explanation.—For the purposes of this sub-section, 'amalgamation' shall have the meaning assigned to it in the *Explanation* to sub-section (3) of section 33.".

(*a*) the amalgamated company shall continue to fulfil the conditions mentioned in sub-section (3) in respect of the reserve created by the amalgamating company and in respect of the period within which such land shall not be sold or otherwise transferred and in default of any of these conditions, the provisions of sub-section (5A) of section 155 shall apply to the amalgamated company as they would have applied to the amalgamating company had it committed the default; and

(*b*) the balance of development allowance, if any, still outstanding to the amalgamating company in respect of such land shall be allowed to the amalgamated company in accordance with the provisions of sub-section (2), so, however, that the total period for which the balance of development allowance shall be carried forward in the assessments of the amalgamating company and the amalgamated company shall not exceed the period of eight years specified in sub-section (2) and the amalgamated company shall be treated as the assessee in respect of such land for the purposes of this section.]

(6) Where a firm is succeeded to by a company in the business carried on by it as a result of which the firm sells or otherwise transfers to the company any land on which development allowance has been allowed, the provisions of clauses (*a*) and (*b*) of sub-section (5) shall, so far as may be, apply to the firm and the company.

Explanation.—The provisions of this sub-section shall apply if the conditions laid down in the *Explanation* to sub-section (4) of section 33 are fulfilled.

(7) For the purposes of this section, "actual cost of planting" means the aggregate of—

(*i*) the cost of preparing the land;

(*ii*) the cost of seeds, cutting and nurseries;

(*iii*) the cost of planting and replanting; and

(*iv*) the cost of upkeep thereof for the previous year in which the land has been prepared and the three successive previous years next following such previous year,

reduced by that portion of the cost, if any, as has been met directly or indirectly by any other person or authority:

[14][*Provided* that where such cost exceeds—

(*i*) forty thousand rupees per hectare in respect of land situate in a hilly area comprised in the district of Darjeeling; or

(*ii*) thirty-five thousand rupees per hectare in respect of land situate in a hilly area comprised in an area other than the district of Darjeeling; or

(*iii*) thirty thousand rupees per hectare in any other area,

then, the excess shall be ignored.

Explanation.—For the purposes of this proviso, "district of Darjeeling" means the district of Darjeeling as on the 28th day of February, 1981, being the date of introduction of the Finance Bill, 1981, in the House of the People.]

(8) The Board may, having regard to the elevation and topography, by general or special order, declare any areas to be hilly areas for the purposes of this section and such order shall not be questioned before any court of law or any other authority.]

[15][*Explanation.*—For the purposes of this section, an assessee having a leasehold or other right of occupancy in any land shall be deemed to own such land and where the assessee transfers such right, he shall be deemed to have sold or otherwise transferred such land.]

Introduction under 1961 Act.—*The Finance Act, 1965.*—By **the Finance Act, 1965** (10 of 1965), **section 33A** has been **inserted** (**w. e. f. 1-4-1965**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 3P, dated 11-10-1965*, as follows:—

'*Development allowance for assessees growing and manufacturing tea in India.*—**73.** The Finance Act, 1965 (10 of 1965), has made a provision in this behalf in a new section 33A in the Income-tax Act, with

---

14. Subs. by the Finance Act, 1981 (16 of 1981), s. 6 (w. e. f. 1-4-1982), for the following:—
"*Provided* that where such cost exceeds twelve thousand five hundred rupees per hectare in respect of land situate in a hilly area or exceeds ten thousand rupees per hectare in any other area, then the excess shall be ignored.".

15. Ins. by the Finance Act, 1975 (25 of 1975), s. 5 (with retrospective effect from 1-4-1965).

LexisNexis

effect from 1-4-1965. Under this section, an assessee carrying on the business of growing and manufacturing tea in India is entitled to a deduction, in the computation of his profits, of a 'development allowance' with reference to the actual cost of planting tea bushes at the following rates, *viz.*:—

(1) in a case where tea bushes have been planted *after* 31-3-1965, on land which had been previously abandoned or which is newly brought under plantation, 40% of the cost of such planting; and

(2) in a case where tea bushes are planted at any time during the period from 1-4-1965 to 31-3-1970, *on land which is already under plantation, in replacement of bushes which have become permanently useless,* 20% of the actual cost of such planting.

The allowance is to be granted in respect of the fourth 'previous year' reckoned from the 'previous year' in which the land is prepared for planting or replanting, as the case may be.

74. The 'actual cost' of planting comprises the cost of preparing the land, the cost of seeds, cuttings and nurseries, the cost of planting and replanting and the cost of upkeep thereof, for the previous year in which the land has been prepared for planting, and the three succeeding previous years. However, where such cost exceeds ` 10,000 per hectare [` 12,500 per hectare in respect of land situate in a hilly area, declared as such by the Board by a general or special order under section 33A(8)], the excess amount is to be ignored for the purpose of grant of the development allowance.

75. Other conditions under which development allowance is admissible are similar to those under which deduction for development rebate is granted. Broadly, these conditions are (*a*) that the development allowance will be granted only if an amount equal to 75% thereof is credited to a reserve account by debit to the profit and loss account, for being used for the purposes of the business over a period of 8 years, otherwise than for distribution as dividends or profits; (*b*) that the development allowance granted for a year will be withdrawn if the land is sold or otherwise transferred during the above-mentioned period of 8 years, except if the transfer is made to the Government, a local authority, a Government company or a corporation established under a Central or State enactment, or is made in connection with an amalgamation or succession referred to in sub-sections (5) and (6) of section 33A; and (*c*) that the unabsorbed amount of development allowance in respect of an assessment year will be carried forward for being set-off against the profits of subsequent years but not beyond 8 assessment years from the end of the relevant assessment year. Development allowance will be allowed as a deduction against the total income as computed after allowing all other deductions admissible under the Income-tax Act, including the deduction for development rebate.'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1966.*—By **the Finance Act, 1966** (13 of 1966), the following **amendments** (**w. e. f. 1-4-1966**) have been made—

—**section 33A(1)** has been **amended** at three places; and

—**section 33A(2)** has been **amended** at two places.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 4P, dated 21-7-1966*, as follows:—

'*Development allowance.*—**43.** Section 33A of the Income-tax Act (inserted by the Finance Act, 1965 (10 of 1965)) provides for a deduction for development allowance, in the computation of the profits of business of growing and manufacturing tea in India, at specified percentages of the actual cost of planting of tea bushes after 31-3-1965, on land newly brought under plantation, and also of the actual cost of planting tea bushes during the period from 1-4-1965, to 31-3-1970, in replacement of tea bushes on land already under plantation. The quantum of the development allowance under this provision, as it stood before its amendment by the Finance Act, 1966 (13 of 1966), was 40% of the actual cost of planting tea bushes on land newly brought under plantation (including land which had previously been abandoned), and 20% of such cost in a case of replantation of tea bushes on land already under plantation. Further, it was provided that the deduction for the development allowance would be allowed in computing the profits of the fourth previous year reckoned from the previous year in which the land was prepared for planting or replanting, as the case might be. The said provisions have been amended by the Finance Act, 1966 (13 of 1966), in order to provide a further encouragement to the tea industry for extending the area under tea plantation and renovating its existing plantations. In this behalf, the quantum of development allowance, in a case where new land or previously abandoned land is brought under plantation, has been increased from 40% to 50% of the actual cost of planting, and in a case where tea bushes are planted in replacement of dead or useless bushes on land already under plantation, from 20% to 30% of the actual cost of planting. Further, it has been provided that the deduction for development allowance will be granted in two stages, at first, in computing the profits of the second previous year reckoned from the previous year in which the land was prepared for planting or replanting, as the case may be, with reference to the actual cost of planting up to that year and, thereafter, in computing the profits of the fourth previous year reckoned from the previous year in which the land was prepared for planting or replanting. The quantum of the development allowance to be deducted at the second stage will be equal to the difference between (*a*) the

amount of development allowance computed in respect of the whole of the actual cost of planting incurred during the four previous years, and (*b*) the development allowance allowed at the first stage, *i.e.*, in respect of the second previous year.'.

II. *The Finance (No. 2) Act, 1967.*—By **the Finance (No. 2) Act, 1967** (20 of 1967), the following **amendments** have been made—

—**section 33A(2)** has been **amended** (**w. e. f. 1-4-1968**); and

—**section 33A(5)** has been **substituted** (**w. e. f. 1-4-1967**).

For the scope and effect of the amendment with effect from 1-4-1968, reference may be made to para. 91(*ii*) of the *Departmental Circular No. 5P, dated 9-10-1967*.

III. *The Finance Act, 1975.*—By **the Finance Act, 1975** (25 of 1975), ***Explanation* to section 33A** has been **inserted** (**w. r. e. f. 1-4-1965**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 169, dated 23-6-1975*, as follows:—

'*Modification of the provisions relating to the grant of development allowance to tea industry.*—**24.** Under section 33A, an assessee deriving income from the business of growing and manufacturing tea in India is entitled to a deduction, in the computation of the taxable profits, of a development allowance at a specified percentage of the actual cost of planting or replanting of tea bushes. This concession is admissible only in respect of tea bushes planted on land owned by the assessee and does not extend to cases where the land is held by the assessee under a lease or other right of occupancy. The Finance Act, 1975, has amended section 33A to secure that an assessee who carries on the business of growing and manufacturing tea in India is granted development allowance even in respect of tea bushes planted or replanted on land in respect of which he has a leasehold or other right of occupancy. Where the assessee has a leasehold or other right of occupancy in the land, the provisions of section 33A will apply in the same manner as they would have applied had the land been owned by him.

25. As a consequential measure, sub-section (5A) of section 155 has been amended with a view of enabling the withdrawal of development allowance in the case of assessee having leasehold or other rights of occupancy in land in the same circumstances as in the case of assessees owning land.

26. These amendments have come into force retrospectively from 1st April, 1965 [*i.e.*, the date on which sections 33A and 155(5A) were introduced in the Income-tax Act], and is accordingly applicable in relation to the assessment year 1965-66 and subsequent years. [*Sections 5 and 24(1)(a) of the Finance Act, 1975*]'.

IV. *The Finance Act, 1981.*—By **the Finance Act, 1981** (16 of 1981), a new **proviso and *Explanation* to section 33A(7)** have been **substituted** (**w. e. f. 1-4-1982**) for the then existing proviso to section 33A(7).

The scope and effect of the above substitution have been elaborated in the following portion of the *Departmental Circular No. 308, dated 29-6-1981*, as follows:—

'**9.** *Liberalisation of the provision relating to development allowance.*—**9.1** Under section 33A of the Income-tax Act, an assessee carrying on the business of growing and manufacturing tea in India is entitled to a deduction, in the computation of his taxable profits, by way of development allowance with reference to the actual cost of planting tea bushes. The development allowance is granted at the rate of 50 per cent of the cost of planting tea bushes on any land which had previously been abandoned or which is newly brought under plantation. The deduction in respect of the development allowance is granted in two stages. The deduction is first allowed in computing the profits of the second previous year reckoned from the previous year in which the land was prepared for planting, with reference to the actual cost of planting up to that year. The deduction is next allowed in computing the profits of the fourth previous year reckoned from the previous year in which the land was prepared for planting. The quantum of development allowance to be allowed in the second stage is equal to the difference between (*a*) the amount of development allowance computed in respect of the actual cost of planting incurred during the four accounting years and (*b*) the development allowance allowed at the first stage, *i.e.*, in respect of the second accounting year.

9.2 The actual cost of planting comprises the cost of preparing the land; the cost of seeds, cutting and nurseries; the cost of planting and replanting; and the cost of upkeep thereof for the previous year in which the land has been prepared for planting and three succeeding previous years. However, where such cost exceeds ` 10,000 per hectare for land in the plains or ` 12,500 per hectare in respect of land situated in hilly areas, the excess amount is ignored for the purpose of calculating the amount of development allowance.

9.3 Having regard to the considerable increase in the cost of planting tea bushes, the Finance Act, 1981, has raised the monetary ceiling limits of the cost of planting for the purposes of calculating the amount of development allowance in the following manner:

LexisNexis

(*i*)	for tea garden situate in the plains	30,000
(*ii*)	for tea garden in hilly areas other than Darjeeling District	35,000
(*iii*)	for tea gardens situate in hilly areas of the district of Darjeeling	40,000

For this purpose, the "district of Darjeeling" means the district of Darjeeling as it existed on the 28th February, 1981, being the date on which the Finance Bill, 1981, was introduced in the Lok Sabha.

9.4 This provision will take effect from 1st April, 1982, and will accordingly apply in relation to the assessment year 1982-83 and subsequent years. [*Section 6 of the Finance Act, 1981*]'.

V. *The Finance Act, 1988.*—By **the Finance Act, 1988** (26 of 1988), **section 33A(2) and the *Explanation* thereunder** have been **amended** (**w. e. f. 1-4-1988**).

VI. *The Finance Act, 1990.*—By **the Finance Act, 1990** (12 of 1990), **two new provisos to section 33A(1)** have been **substituted** (**w. e. f. 1-4-1990**) for the then existing 1st proviso to section 33A(1).

The scope and effect of the above substitution have been elaborated in the following portion of the *Departmental Circular No. 572, dated 3-8-1990*, as follows:—

'*Streamlining of tax structure.*—**13.** With the reduction in the rates of taxes in the case of domestic companies, registered firms and co-operative societies and on a review of some of the incentives and concessions available to taxpayers, the following incentives and concessions have been withdrawn or modified:—

* * *

(*c*) Under the provisions of section 33A of the Income-tax Act, an assessee carrying on the business of growing and manufacturing tea in India is entitled to a deduction in the computation of profits from that business, of a "development allowance" with reference to the actual cost of planting tea bushes. The amount to be so deducted is calculated at the rate of 50 per cent of such cost. This deduction is available for planting tea bushes on land which had been previously abandoned or which is newly brought under plantation.

The deduction under this provision will now be allowed only if the planting of tea bushes has been completed before the 1st day of April, 1990. [*Section 9 of the Finance Act, 1990*]'.

Relevant rule and forms.—Rule 8A of the Income-tax Rules, 1962, and **Form Nos. 4, 5 and 5A** appended thereto.

Persons entitled.—Any assessee owning (even holding on lease or other right of occupancy) land in India who carries on the business of growing and manufacturing tea in India, is entitled to a development allowance under section 33A. The word "and" clearly shows that the two conditions, namely, (*i*) growing tea, and (*ii*) manufacturing it, are cumulative. An assessee who simply grows tea but does not manufacture tea out of it will not be eligible for the development allowance [*CIT v. Puthuthotam Estates*, (1943) Ltd., (1981) 127 ITR 481 (Mad)].

In respect of what?—The development allowance is available in respect of planting of tea bushes on land in India owned by the eligible person. This allowance has come into force for and from assessment year 1965-66.

In the facts of *Debpara Tea Co. Ltd. v. CIT* [(1983) 143 ITR 947 (Cal)], the assessee was held entitled to development allowance in respect of expenditure on replantation of tea plants on virgin soil.

Section 33A provides certain reliefs, in the form of allowance, to an assessee, who is engaged in the tea plantation business. In order to claim the above benefit, the assessee is required to furnish the certificate from the Tea Board. The certificate is required to be obtained from an authority, *i.e.*, the Tea Board, over which the assessee has no control and on the other hand, there is a time limit for filing the return. In such a case, the rigour of the provisions may not be applicable [*George Williamson* (*A*) *Ltd. v. CIT*, (2006) 286 ITR 533 (Gauh)].

Rates of allowance.—In a case where tea bushes are planted, at any time between 1-4-1965 and 31-3-1990, on land which had been previously abandoned or which is newly brought under tea plantation, the rate of the allowance was 40% up to 31-3-1966 and is 50% on or after 1-4-1966, of the actual cost of planting. If, however, tea bushes are planted, at any time between 1-4-1965 and 31-3-1970, on land which was already under tea plantation in replacement of tea bushes that had died or had become permanently useless, the rate of this allowance was 20% up to 31-3-1966 and is 30% on or after 1-4-1966.

Actual cost of planting.—"Actual cost of planting", according to section 33A(7), is comprised of the aggregate of the following:—

(*i*) the cost of preparing the land;

LexisNexis

(*ii*) the cost of seeds, cutting and nurseries;

(*iii*) the cost of planting or replanting; and

(*iv*) the cost of upkeep of the area for a period of four years including the year in which the land was prepared,

minus, that portion of the cost, which has been met directly or indirectly by any other person or authority.

Actual cost of planting for the purpose of this allowance is, for and from assessment year 1982-83, subject to a ceiling of Rs. 40,000[16] per hectare for tea gardens situate in the hilly areas of the district of Darjeeling (Rs. 12,500 up to assessment year 1981-82), Rs. 35,000[17] per hectare for tea gardens in hilly areas other than Darjeeling district (Rs. 12,500 up to assessment year 1981-82), and Rs. 30,000[18] per hectare for tea gardens situate in the plains (Rs. 10,000 up to assessment year 1981-82).

Scheme of development allowance.—The scheme of development allowance was to encourage tea industry to expand. Unlike some other provisions in the Act, for expenditure incurred for planting tea bushes in one particular year, allowance under section 33A may be given in a subsequent year. In view of the specific provisions of section 33A, the grant of the allowance cannot be limited only to the year in which the expenditure was actually incurred or the immediate next year thereafter. This allowance is given 'in respect of planting of tea bushes on any land on which tea bushes had not been planted at any time earlier or on any abandoned land'. Development allowance is also permissible where fresh tea bushes are planted in replacement of useless tea bushes or tea bushes that have died. The basis for calculation of the allowance is a percentage of the 'actual cost of planting' of tea bushes which has been defined by section 33A(7). That definition, *inter alia*, makes it clear that if any financial assistance or subsidy or any other form of aid is received from the Government or any other agency or person, that will go to reduce the amount of costs which will form the basis of calculation of development allowance. All these things may not take place in one particular year [*CIT v. Kilkotagiri Tea & Coffee Estate Co. Ltd.,* (1996) 219 ITR 249, 254-55 (SC)].

Year and manner of allowance.—Originally, the allowance was to be granted in the fourth previous year reckoned from the previous year in which the land was prepared for planting or replanting, as the case might have been. The Finance Act, 1966 (13 of 1966), amended the provisions and made the allowance to be granted at two points of time. The development allowance is granted for the process of planting or replanting any land with tea bushes. The process is a continuous one, spread over a length of time, and involving alteration and readjustment of ideas and operations from time to time. The reckoning of the "actual cost" incurred for planting and replanting must, in the nature of things, await the finalisation of the plans and ideas and termination of the process of planting and replanting. Section 33A(1)(*a*) speaks of the computation "in the first instance" of the development allowance, meaning and implying that such computation is only tentative and not final. Section 33A(1)(*b*), therefore, provides that the "development allowance shall *again be computed* with reference to the actual cost of planting", etc. This recomputation covers the entire gamut of planting operations during the entire period of four years including the first two years for which a tentative computation under section 33A(1)(*a*) had already been made [*Kilkotagiri Tea & Coffee Estate Ltd. v. CIT,* (1978) 113 ITR 729 (Ker), **affirmed in** *CIT v. Kilkotagiri Tea & Coffee Estate Co. Ltd.,* (1996) 219 ITR 249, 254, 256 (SC)]. The circuitous language of clauses (*a*) and (*b*) of section 33A(1) may be better illustrated by an example. Suppose the land was prepared for planting, etc., in the previous year 1966-67. A tentative computation shall be made, under clause (*a*), of the allowance while assessing the income of the previous year 1967-68 (relevant to assessment year 1968-69) and this tentative amount, say "X" (which shall be the specific percentage of actual cost of planting for the two previous years 1966-67 and 1967-68), shall be allowed as a deduction from the total income. Clause (*b*) provides for a final computation to be made while assessing the income of previous year 1969-70 (assessment year 1970-71) based on the actual cost of planting incurred for all the four previous years (from 1966-67 to 1969-70) and finally ascertain the amount of allowance allowable on that basis, say the figure "Y". The allowance to be deducted from the profits of the previous year 1969-70 is the figure "Y" *minus* "X".

In *CIT v. Stanes Amalgamated Estates Ltd.* [(2001) 251 ITR 861, 863 (Mad)], the Tribunal was held right in holding that the assessee was entitled for the claim for deduction under clause (*ii*) of the proviso to section

LexisNexis

16. Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, these monetary limits are to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

17. Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, these monetary limits are to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

18. Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, these monetary limits are to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

33A(7) as amended (w. e. f. 1-4-1982) @ Rs. 35,000 per hectare, for the assessment year 1982-83. Similar view has been taken in *CIT v. Craigmore Plantations India Ltd.* [(2002) 253 ITR 447, 449 (Mad)].

Two stages for grant of development allowance.—The very definition of 'actual cost of planting' indicates that a span of four years has to be taken into account for the purpose of computation of development allowance. Section 33A(1)(*a*) and (*b*) makes it clear that deduction on account of development allowance will be granted in two stages. The **first stage** is under clause (*a*) under which the development allowance will have to be computed 'in the first instance' and will be limited to that portion of the actual cost of planting which was incurred during the previous year in which the land was prepared for planting or replanting, as the case may be. In computing the income of the previous year following the previous year in which the land was first prepared for planting or replanting, the actual cost will be calculated and in the assessment of the second year's income, development allowance will be granted to the assessee provided he has taken the other steps for claiming the allowance including creation of sufficient reserves. Where, in a given case, the assessee had made sufficient reserves for the claim he had made under section 33A(1)(*a*), merely because the assessee had not claimed the full amount of development allowance in the first instance, that will not disentitle him from claiming the outstanding amount at the **second stage** under clause (*b*). Development allowance under clause (*b*) has to be given by computing the actual cost of planting once again. Clause (*b*) states that 'development allowance shall again be computed with reference to the actual cost of planting.....'. That means, notwithstanding the computation made under clause (*a*) and grant of development allowance on the basis of that computation, the assessee will be entitled to compute the allowance once again on the basis of the actual cost of planting tea bushes at the second stage in the assessment of the third succeeding previous year reckoned from the previous year in which the land was prepared for planting or replanting. There is nothing in section 33A to suggest that development allowance for expenditure incurred in respect of the first two years must be calculated and claimed at the very first stage, *i.e.*, at the stage of the second year of assessment after planting of tea bushes. Because of the protracted work involved in the preparation of the land, planting of seeds, cutting and nurturing nurseries and also the cost of planting and replanting of tea bushes as well as the cost of upkeep thereof besides various other factors like setting off of subsidies or other grants from the Government or any other agencies, an assessee has been permitted to claim the deduction even up to the third succeeding year next following the previous year in which the land has been prepared for planting or replanting, as the case may be [*CIT v. Kilkotagiri Tea & Coffee Estate Co. Ltd.,* (1996) 219 ITR 249, 255-56 (SC)].

LexisNexis

Requisite conditions for allowance.—Section 33A(3) prescribes requisite conditions for allowance of development allowance, which are broadly on the lines of those prescribed for allowance of development rebate in sections 34(1) (operative upto 31-3-1988) and 34(3)(*a*). The prescribed particulars about the claim are to be furnished. A development allowance reserve in an amount equal to seventy-five per cent. of the development allowance to be actually allowed is to be created by debiting the amount to the profit and loss account of the year concerned. The amount in such reserve may be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking, but the same cannot be utilised, during the said eight-year period, for distribution by way of dividends or profits, or for remittance outside India as profits or for creation of any asset outside India. Of course, rule 8A prescribes other conditions about giving prior notice, etc. The relevant forms are Form Nos. 4, 5 and 5A.

The following departmental **circular** is relevant to section 33A(3):—

'Development allowance under section 33A—Creation of reserve—Instruction regarding.—Attention is invited to section 33A of the Income-tax Act, 1961, which provides for the grant of deduction by way of development allowance of a certain percentage of expenses incurred on planting of tea bushes on any land in India owned by an assessee who carries on the business of growing and manufacturing tea. Sub-section (3) of section 33A of the Income-tax Act stipulates certain conditions which must be fulfilled before the above-said deduction is allowed. One of the conditions is that a reserve of an amount equal to 75% of the development allowance 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 the period of eight years next following for the purpose of the business of the undertaking.

2. Clarifications have been sought from the Board regarding the manner in which the amount of reserve for claiming deduction on account of development allowance is to be calculated. In this connection, it is pointed out that the provisions of law require that the reserve should be equal to 75% of the "development allowance actually to be allowed". It is argued that since only 40% of the income of a tea company is chargeable to tax, the actual allowance on account of development allowance is only 40% of the amount calculated on the basis of specified percentage of the cost of planting tea bushes.

3. A similar question had been examined with regard to the quantum of reserve to be created for claiming deduction on account of development rebate in the cases of tea companies. *Vide* Board's Circular Letter F. No. 1(8)-58/TPL, dated 1st November, 1958, it was clarified that in the case of tea companies it would be sufficient compliance if the reserve created is equal to 75% of the amount actually allowed as development rebate. Since the conditions regarding the creation of reserve for the grant of development allowance under section 33A are identical to those prescribed with regard to the creation of reserve for claiming deduction on account of development rebate, it is clarified that the reserve required to be created for claiming development allowance should be calculated @ 75% of the amount which is actually allowed by way of development allowance, *i.e.*, 75% of 40% of the amount calculated on the basis of specified percentage of the cost of planting tea bushes.

4. The above clarification may please be brought to the notice of all the officers working in your charge.' [*Circular No. 325, dated 3rd February, 1982*].

Other conditions prescribed under rule 8A.—The other conditions referred to in section 33A(3)(*iii*), as per rule 8A of the Income-tax Rules, are as follows:—

1. The assessee is under an obligation to give notice, of his intention of commencing operations for planting or replanting, to the Tea Board in writing in Form No. 4. Such notice is to be given at least three months before commencing the operations (by 1-2-1968, where such operation commenced before 1-1-1968).
2. The assessee is under an obligation to afford opportunity and facility to the Tea Board or its authorised personnel to enter upon and inspect the area under planting or replanting.
3. The assessee is to furnish to the Tea Board the required particulars, documents or statements in relation to planting or replanting.
4. The assessee *shall* furnish to the Assessing Officer (upto 31-3-1988, Income-tax Officer), along with the return of income for the relevant year, a certificate from the Tea Board in Form No. 5 and a statement of particulars in Form No. 5A.

The object of section 33A would be defeated by the construction that the word "shall" in condition 4 above requires the certificate mandatorily to be filed along with the return of income and the non-compliance of this condition will disentitle the assessee to claim development allowance. Although the furnishing of the certificate is mandatory, the condition of filing it *along with the return of income* is not mandatory. This is so because the certificate has to be obtained from the Tea Board, which is not statutorily duty bound to issue certificates within a particular period of time [*CIT v. Malayalam Plantations Ltd.,* (1976) 103 ITR 835 (Ker)]. In that case, the certificate was produced by the assessee for the first time before the first appellate authority. It was held that no exception could be taken to the action of the appellate authority in sending the case back to the Income-tax Officer with a direction to consider the certificate.

LexisNexis

Unabsorbed allowance to be carried forward.—As in the case of development rebate, development allowance in a particular year, on fulfilment of all the requisite conditions, may be allowed to the extent as is sufficient to reduce the total income (computed after allowance of development rebate, etc., but without making any deduction for development allowance or any deduction under Chapter VI-A or upto 31-3-1988, section 280-O) to *nil*. The unabsorbed portion, if any, of allowable development allowance is to be carried forward, up to a period of next succeeding eight years, for set-off [**s. 33A(2)**].

Withdrawal of allowed allowance.—Even after allowance having been given, (*a*) if any such land is sold or otherwise transferred by the assessee, before the expiry of eight succeeding years from the end of the year of allowance, to any person other than the Government, a local authority, a corporation established by a Central, State or Provincial Act or to a Government company or in the course of an amalgamation or succession, or (*b*) where the sale or transfer of the land is made in connection with an amalgamation or succession and the amalgamated company or the successor commits any breach of requisite conditions (both about non-sale and about utilisation of the reserve) the allowance already allowed shall be treated as wrongly allowed and be withdrawn by way of rectification. Similarly, the withdrawal is possible if the development allowance reserve is utilised for prohibited purposes within the statutory period of 8 years [**ss. 33A(4), (5) and (6), 155(5A)**].

Notification under section 33A(8).—In pursuance of **s. 33A(8)** of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes have declared the areas mentioned below to be hilly areas for the purposes of the said section by *Notification No. S.O. 1526, dated 18-5-1966*, as subsequently amended:—

(1) Darjeeling District of West Bengal, excluding Siliguri Sub-Division; (2) Kangra District, Punjab; (3) Mandi District, Himachal Pradesh; (4) Trivandrum District, Kerala; (5) Quilon District, Kerala; (6) Kottayam District of Kerala [19][* * *]; (7) Ernakulam District, Kerala; (8) Trichur District, Kerala; (9) Palghat District, Kerala; (10)

19. The words "excluding Meenachhil, Kanjirapally and Changanacherry Talukas" were omitted by *Notification No. S.O. 265(E), dated March 28, 1977*.

Kozhikode District, Kerala; (11) Cannanore District, Kerala; (12) Kanya Kumari District, Madras[20], (13) Tirunelveli District, Madras[21], (14) Madurai District, Madras[22]; (15) Coimbatore District, Madras[23]; (16) Nilgiris District, Madras[24]; (17) Coorg District, Mysore[25]; (18) Hassan District, Mysore[26]; (19) Chickmagalur District, Mysore[27]; [28][(20) Pithoragarh, Almora and Nainital Districts (Kumaon region) of Uttar Pradesh; (21) Dehradun, Chamoli, Uttarkashi, Pauri Garhwal and Tehri Garhwal Districts (Garhwal region) of Uttar Pradesh].

LexisNexis

20. Now known as the State of Tamil Nadu (w. e. f. 14-1-1969).
21. Now known as the State of Tamil Nadu (w. e. f. 14-1-1969).
22. Now known as the State of Tamil Nadu (w. e. f. 14-1-1969).
23. Now known as the State of Tamil Nadu (w. e. f. 14-1-1969).
24. Now known as the State of Tamil Nadu (w. e. f. 14-1-1969).
25. Now known as the State of Karnataka (w. e. f. 1-11- 1973).
26. Now known as the State of Karnataka (w. e. f. 1-11- 1973).
27. Now known as the State of Karnataka (w. e. f. 1-11- 1973).
28. These entries have been inserted by *Notification No. S.O. 619(E), dated June 24, 1988*: (1989) 176 ITR (St.) 212.

Erstwhile provisions of section 33AB of the 1961 Act

TEA DEVELOPMENT ACCOUNT [For assessment years 1986-87 and 1987-88]

Applicability of provision.—At the time of insertion of **section 33AB of the 1961 Act** by **the Finance Act, 1985** (32 of 1985), **section 33AB(5) of the 1961 Act** enacted that the provisions of section would apply for assessment years 1986-87 to 1990-91. But subsequently by **the Finance Act, 1987** (11 of 1987), section had been amended to provide that the provisions would apply only for two assessment years, *i.e.*, 1986-87 and 1987-88.

Deduction of deposit made in Tea Development Account.—The provisions of **section 33AB(1) of the 1961 Act** were applicable to any assessee carrying on the business of growing and manufacturing tea in India and who has, during the previous year 1985-86 or 1986-87, deposited any amount or amounts in a Special account with the National Bank for Agricultural and Rural Development (NABARD) maintained by him with that Bank in accordance with a scheme approved in this behalf by the Tea Board [established under section 4 of the Tea Act, 1953 (29 of 1953)].

Such assessee was allowed a deduction of lesser of the following amounts:—

(*a*) Amount or aggregate of amounts so deposited during the previous year; or

(*b*) 20% of the profits of such business (computed under the head "Profits and gains of business or profession" before making any deduction under section 33AB of the 1961 Act).

Where the amount or the aggregate of the amounts deposited by the assessee in the Special account during the previous year exceeded the sum allowable as deduction, then such excess was treated as a deposit made by the assessee in previous year 1986-87.

Effect of utilization of deposits for business purposes [s. 33AB(3) of 1961 Act].—Where any amount, standing to the credit of the assessee in the Special account, was utilised by the assessee for the purposes of the business of growing and manufacturing tea in India in accordance with the approved scheme for acquiring any asset (being building, machinery, plant or furniture), the actual cost of such asset as determined under section 43(1) of the 1961 Act would, for the purposes of the 1961 Act, be reduced by the amount so utilised.

Similarly, if any such amount was utilised for incurring any expenditure for the purposes of such business, such expenditure would be reduced by the amount so utilised and the resultant sum, if any, would be taken into account for the purposes of the 1961 Act.

Effect of non-utilization of deposits for business purposes in the year of withdrawal [s. 33AB(4) of 1961 Act].—Where any amount, standing to the credit of the assessee in the Special account, which was released during any previous year by the NABARD for being utilised by the assessee for the purposes of the business of growing and manufacturing tea in India in accordance with the approved scheme was not so utilised, either wholly or in part, within that previous year, the whole of such amount or, as the case may be, part thereof which was not so utilised would be deemed to be profits and gains of business and, accordingly, chargeable to income-tax as the income of that previous year.

LexisNexis

Omitted/Phased-out provisions of section 33AC of the 1961 Act

[1][**S. 33AC. Reserves for shipping business.—**](1) [2][In the case of an assessee, being a Government company or a public company formed and registered in India with the main object of carrying on the business of operation of ships, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount not exceeding fifty per cent of profits derived from the business of operation of ships (computed under the head "Profits and gains of business or profession" and before making any deduction under this section), as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account, to be utilised in the manner laid down in sub-section (2):]

[3][*Provided* that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the aggregate of the amounts of the paid-up share capital, the general reserves and amount credited to the share premium account of the assessee, no allowance under this sub-section shall be made in respect of such excess:]

[4][*Provided further* that for five assessment years commencing on or after the 1st day of April, 2001, and ending before the 1st day of April, 2006, the provisions of this sub-section shall have effect as if for the words "an amount not exceeding fifty per cent of profits", the words "an amount not exceeding the profits" had been substituted:]

[5][*Provided also* that no deduction shall be allowed under this section for any assessment year commencing on or after the 1st day of April, 2005.]

(2) The amount credited to the reserve account under sub-section (1) shall be utilised by the assessee before the expiry of a period of eight years next following the previous year in which the amount was credited—

(*a*) for acquiring a new ship for the purposes of the business of the assessee; and

(*b*) until the acquisition of a new ship, for the purposes of the business of the assessee other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

(3) Where any amount credited to the reserve account under sub-section (1),—

(*a*) has been utilised for any purpose other than that referred to in clause (*a*) or clause (*b*) of sub-section (2), the amount so utilised; or

(*b*) has not been utilised for the purpose specified in clause (*a*) of sub-section (2), the amount not so utilised; or

(*c*) has been utilised for the purpose of acquiring a new ship as specified in clause (*a*) of sub-section (2), but such ship is [6][sold or otherwise transferred, other than in any scheme of demerger] by the assessee to any person at any time before the expiry of [7][three years] from the end of the previous year in which it was acquired, the amount so utilised in acquiring the ship,

shall be deemed to be the profits,—

(*i*) in a case referred to in clause (*a*), in the year in which the amount was so utilised; or

(*ii*) in a case referred to in clause (*b*), in the year immediately following the period of eight years specified in sub-section (2); or

(*iii*) in a case referred to in clause (*c*), in the year in which the sale or transfer took place,

LexisNexis

---

1. Section 33AC has been inserted by the Direct Tax Laws (Second Amendment) Act, 1989 (36 of 1989), s. 5 (w. e. f. 1-4-1990).

2. Subs. by the Finance Act, 1995 (22 of 1995), s. 8 (w. e. f. 1-4-1996), for the following:—

'In the case of an assessee, being a government company or a public company formed and registered in India with the main object of carrying on the business of operation of ships, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount, not exceeding the total income (computed before making any deduction under this section and Chapter VI-A), as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account to be utilised in the manner laid down in sub-section (2):'.

In the above portion, the words 'a government company or' were inserted by the Finance Act, 1992 (18 of 1992), s. 12(*a*) (w. e. f. 1-4-1993).

3. Subs. by the Finance Act, 2002 (20 of 2002), s. 15 (w. e. f. 1-4-2003), for the following:—

'*Provided* that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital (excluding the amounts capitalised from reserves) of the assessee, no allowance under this sub-section shall be made in respect of such excess.'.

4. Ins. by the Finance Act, 2000 (10 of 2000), s. 15 (w. e. f. 1-4-2001).

5. Ins. by the Finance (No. 2) Act, 2004 (23 of 2004), s. 9 (w. e. f. 1-4-2005).

6. Subs., for "sold or otherwise transferred", by the Finance Act, 1999 (27 of 1999), s. 14 (w. e. f. 1-4-2000).

7. Subs., for "eight years", by the Finance Act, 2003 (32 of 2003), s. 17(*a*) (w. e. f. 1-4-2004).

and shall be charged to tax accordingly.

[8][(4) Where the ship is sold or otherwise transferred (other than in any scheme of demerger) after the expiry of the period specified in clause (*c*) of sub-section (3) and the sale proceeds are not utilised for the purpose of acquiring a new ship within a period of one year from the end of the previous year in which such sale or transfer took place, [9][so much of such sale proceeds which represent the amount credited to the reserve account and utilised for the purposes mentioned in clause (*c*) of sub-section (3)] shall be deemed to be the profits of the assessment year immediately following the previous year in which the ship is sold or transferred.]

Explanation.—For the purposes of this section,—

(*a*) "public company" shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956)[10];

[11][(*aa*) "Government company" shall have the meaning assigned to it in section 617 of the Companies Act, 1956 (1 of 1956)[12];]

(*b*) "new ship" shall have the same meaning as in clause (*ii*) of sub-section (2) of section 32AB.]

Introduction under 1961 Act.—*The Direct Tax Laws (Second Amendment) Act, 1989.*—By **the Direct Tax Laws (Second Amendment) Act, 1989** (36 of 1989), **section 33AC** has been **inserted** (**w. e. f. 1-4-1990**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 554, dated 13-2-1990*, as follows:—

'**9.** *Tax incentives to the Indian shipping companies.*—**9.1** With a view to provide tax incentives to the public companies engaged in the business of operation of ships for generation of resources internally to augment their fleet, a new section 33AC has been inserted in the Income-tax Act, 1961 (43 of 1961). This section provides for deduction in computing the income from business of any amount credited to a reserve account. This deduction is not to exceed the total income of such companies as computed before making any deduction under this section and Chapter VI-A of the Income-tax Act. In case the accumulated credits to the aforesaid reserve account exceed twice the amount of the paid-up capital of the company, the excess will be disregarded for the purpose of allowance of deduction under this provision. For the above purpose, the paid-up capital of the company shall exclude the amounts capitalised from reserves. The reserve so credited will have to be utilised for the purchase of a new ship for the assessee's own business within a period of eight years next following the previous year in which the reserve was created. If such reserve is not so utilised, it shall be deemed to be the income of the assessee in the year immediately following the period of eight years and charged to tax accordingly. Within the aforesaid period of eight years and before the acquisition of a new ship, the amount credited to the reserve account can be utilised for the business of the assessee, except for distribution of dividends or profits or for remittance outside India either as profits or for creation of any asset. In cases where the amount of reserve is utilised in violation of the aforesaid condition, it will be deemed to be the income of the assessee for the year in which the amount has been so misutilised. Further, if a new ship acquired out of the reserve account is sold or otherwise transferred by the assessee within the period of eight years from the end of the previous year in which it was so acquired, the amount utilised out of the reserve account for the acquisition of the ship shall be deemed to be the income in the year in which the sale or the transfer takes place.

9.2 For the purposes of section 115J of the Income-tax Act, the book profits of a company are, *inter alia*, increased by amounts carried to any reserves by whatever name called, the only exception being the reserves created by hotels and tour-operators under section 80HHD. Section 115J of the Income-tax Act, 1961 (43 of 1961), has been amended to provide that reserve created by the shipping companies under section 33AC will also not go to increase the book profits. Section 115J has further been amended to provide that the amounts deemed to be income under section 33AC, as discussed in the preceding paragraph, will, however, go to increase the book profits of a shipping company.

9.3 Under section 80CC of the Income-tax Act, 1961 (43 of 1961), a deduction of 50% of the cost of acquisition of shares forming part of the eligible issue of capital is allowed from the gross total income. The maximum deduction eligible under this section is ₹ 10,000. Hitherto, the issue of equity shares by shipping companies did not qualify for deduction under section 80CC. Further, the deduction under this section was available on the acquisition of shares only if such shares formed part of the issue of capital made by a company for the first time. This section has now been amended to provide that the acquisition of equity

LexisNexis

8. Sub-section (4) has been inserted by Act 32 of 2003, s. 17(*b*) (w. e. f. 1-4-2004).
9. Subs., for "such sale proceeds", by the Finance Act, 2005 (18 of 2005), s. 9 (w. r. e. f. 1-4-2004).
10. Repealed and replaced by Act 18 of 2013.
11. Clause (*aa*) has been inserted by the Finance Act, 1992 (18 of 1992), s. 12(*b*) (w. e. f. 1-4-1993).
12. Repealed and replaced by Act 18 of 2013.

shares whether forming part of the first issue or a further issue of a shipping company will also qualify for deduction under this section. The benefit of deduction on the amount of acquisition of the equity shares of shipping companies will, however, be subject to the other conditions prescribed in section 80CC.

9.4 The above amendments shall come into force with effect from 1-4-1990, and will, accordingly, apply to the assessment year 1990-91 and subsequent years. [*Sections 5, 8 and 12 of the Second Amending Act, 1989*]'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1992.*—By **the Finance Act, 1992** (18 of 1992), the following **amendments** (**w. e. f. 1-4-1993**) have been made—

—**section 33AC(1)** has been **amended**; and

—***Explanation (aa)* to section 33AC** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 636, dated 31-8-1992*, as follows:—

'*Extension of benefit of section 33AC to Government shipping companies.*—**27.** Under the provisions of section 33AC of the Income-tax Act, before being amended by the Finance Act, 1992 (18 of 1992), a deduction of an amount credited to a reserve account for the purpose of utilisation in a specified manner was allowed, subject to certain conditions, in case of a public company formed and registered in India with the main object of carrying on the business of operation of ships. This deduction was not available to a Government company.

27.1 An amendment has been made to section 33AC which extends the benefit of deduction to a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956).

27.2 The amendment will take effect from 1-4-1993, and will, accordingly, apply in relation to the assessment year 1993-94 and subsequent assessment years. [*Section 12*].'.

II. *The Finance Act, 1995.*—By **the Finance Act, 1995** (22 of 1995), **section 33AC** has been **amended** (**w. e. f. 1-4-1996**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 717, dated 14-8-1995*, as follows:—

'**24.** *Amendment of section 33AC to limit deduction to 50 per cent. only in respect of income derived from the carrying on of shipping operations.*—**24.1** Section 33AC of the Income-tax Act, 1961 (43 of 1961), was inserted by the Direct Tax Laws (Second Amendment) Act, 1989 (36 of 1989), with effect from 1-4-1990, with a view to provide a tax incentive to public/Government companies engaged in the business of operation of ships. This deduction is available to the extent of the total income provided the amount is credited to a reserve account and is utilised for the purchase of a new ship within the specified period.

24.2 It was noticed that shipping companies have diversified into trading, real estate business, etc., and are claiming deduction under this section even in respect of their income from activities other than shipping. There is no justification for allowing 100 per cent. deduction with reference to income from activities other than operation of ships.

24.3 Section 33AC has been amended to restrict the deduction to 50 per cent. of the income derived from the business of operation of ships only. This takes outside the purview of the deduction any income arising from businesses other than shipping business, or from sources other than business.

24.4 The amendment will take effect from 1-4-1996, and will, accordingly, apply in relation to the assessment year 1996-97 and subsequent years. [*Section 8*]'.

III. *The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 33AC(3)(*c*)** has been **amended** (**w. e. f. 1-4-2000**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 779, dated 14-9-1999*, as follows:—

'**56.** *Business re-organization—extensive amendments in relation to amalgamation, demerger and slump sale.*—**56.1** The business and economic environment of the country has thrown up the need for simplification and rationalisation of laws relating to business re-organization for rationalisation of the production system and better utilization of resources which have become necessary with a view to enabling the Indian industry to restructure itself to become globally competitive. It was in this background that the tax concessions to conversion of firms into companies or proprietary concerns into companies were provided in the Finance (No. 2) Act, 1998, and were widely welcomed. Following this up, the Finance Act, 1999, has carried out a number of amendments for the entire gamut of business reorganization. These include rationalisation of the existing provisions relating to amalgamation of companies, new provisions relating to demerger of companies and sale or transfer of business as a going concern through slump sale.

56.2 Amalgamation in relation to the companies has been defined under the existing provisions of the Income-tax Act to mean the merger of one or more companies with another company or the merger of two or

LexisNexis

more companies to form one company. There are a number of provisions in the Income-tax Act having bearing on amalgamation. Demerger is relatively a new phenomenon in the Indian corporate sector. A demerger is a reorganization of a company where all the existing assets and liabilities are divided into one or more additional entities leading to resulting companies. While there are no specific provisions under the Companies Act governing demergers, some transactions of this nature do take place through schemes of compromise or arrangement under sections 391 to 394 of the Companies Act and these are sanctioned by the High Courts. A slump sale is a form of reorganization where an undertaking or a division is transferred from one person to another for a lump sum consideration without values being assigned to the individual assets and liabilities transferred.

56.3 *Extensive amendments in the Income-tax Act have been carried out on the basis of the following broad principles*:

(*a*) The restructuring shall not attract additional liabilities to tax and also not result in the withdrawal of relief and concessions available to the existing unit.

(*b*) The tax benefits and concessions available to an undertaking of a company shall continue to be available to the undertaking on transfer of the same while concessions and benefits that are available to the transferor company as an entity and not to the undertaking of the company proposed to be transferred, should remain with the transferor-company.

(*c*) Tax benefits to such business reorganizations should be limited to the transfer of business as a going concern and not to the transfer of specific assets which would amount to sale of assets and not a business reorganization.

* * *

56.4 (*ix*) The Finance Act, 1999 (27 of 1999), has amended section 33AC of the Income-tax Act which allows deduction of 50% of profits from shipping business to be credited to a reserve account which has to be utilised in a prescribed manner. There is a stipulation that the ship acquired out of the reserve is not transferred within eight years. The amended section provides that transfer of a ship pursuant to a scheme of demerger shall not constitute a transfer. [*Section 14*]

* * *

56.5 These amendments will take effect from 1st day of April, 2000 and will, accordingly, apply to the assessment year 2000-01 and subsequent years. [*Section 58*]'.

IV. *The Finance Act, 2000.*—By **the Finance Act, 2000** (10 of 2000), **2nd proviso to section 33AC(1)** has been **inserted** (**w. e. f. 1-4-2001**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 794, dated 9-8-2000*, as follows:—

'**23.** *Incentives for shipping industry,*—**23.1** Under the existing provisions of section 33AC of the Income-tax Act, a Government company or a public company with the main object of carrying on the business of operation of ships is allowed a deduction of an amount not exceeding 50 per cent. of profits derived from the business of operation of ships, subject to certain conditions.

23.2 In order to enable the shipping industry to go in for fleet expansion, acquisition and modernisation, the Finance Act, 2000 (10 of 2000), has enhanced the existing deduction up to the whole of the profits derived from such business for a period of five years.

23.3 This amendment will take effect from the 1-4-2001, and will, accordingly, apply in relation to the assessment years 2001-2002 to 2005-2006. [*Section 15*]'.

V. *The Finance Act, 2002.*—By **the Finance Act, 2002** (20 of 2002), **1st proviso to section 33AC(1)** has been **substituted** (**w. e. f. 1-4-2003**).

The scope and effect of the above substitution have been elaborated in the following portion of the *Departmental Circular No. 8 of 2002, dated 27-8-2002*, as follows:—

'**28.** *Fiscal incentives for modernisation and fleet expansion of the shipping business.*—**28.1** Under the existing provisions of section 33AC of the Income-tax Act, a Government company or a public company formed and registered in India with the main object of carrying on the business of operation of ships is allowed a deduction of an amount not exceeding hundred per cent. of the profits derived from the business of operation of ships and carried to a reserve account, subject to certain conditions. The first proviso to sub-section (1) of the said section, however, provides that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital (excluding the amounts capitalised from the reserve) of the assessee, no allowance shall be made in respect of such excess.

28.2 In order to help the shipping industry modernise and expand its fleet, the Finance Act, 2002 (20 of 2002), has expanded the scope of the reserve to provide that only in case the aggregate of the amounts carried

LexisNexis

to the reserve account exceeds twice the aggregate of the amounts of the paid-up share capital, the general reserves and amount credited to the share premium account of the assessee, no allowance shall be made in respect of such excess.

28.3 The amendment will take effect from the 1-4-2003, and will, accordingly, apply in relation to the assessment year 2003-2004 and subsequent years. [*Section 15*]'.

VI. *The Finance Act, 2003.*—By **the Finance Act, 2003** (32 of 2003), the following **amendments** (**w. e. f. 1-4-2004**) have been made—

—**section 33AC(3)(*c*)** has been **amended**; and

—**section 33AC(4)** has been **inserted** before the *Explanation*.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 7 of 2003, dated 5-9-2003*, as follows:—

'**27.** *Incentive for modernization and fleet expansion of shipping business.*—**27.1** Under the existing provisions of section 33AC of the Income-tax Act, a Government company or a public company formed and registered in India with the main object of carrying on the business of operation of ships, is allowed a deduction of 100% of the profits of such business, subject to certain conditions. Clause (*c*) of sub-section (3) provides that if an assessee sells or otherwise transfers a ship acquired by utilizing the amount withdrawn from the reserve before the expiry of 8 years from the end of the previous year in which it was acquired, the amount of reserve utilized for acquiring a ship shall be deemed to be the profits of the year in which the sale or transfer took place. This clause, hence, imposes a lock-in period of 8 years on the sale of any ship acquired by utilizing the reserve under section 33AC.

27.2 With a view to rationalize the provisions of the section, the Finance Act, 2003 (32 of 2003), has amended clause (*c*) of sub-section (3) of the said section so as to reduce the existing lock-in period from 8 years to 3 years. A new sub-section (4) has also been inserted in the said section to provide that sale proceeds of the ship would be required to be utilized for the purchase of a new ship within one year from the end of the previous year in which the ship was sold or otherwise transferred. In case a new ship is not acquired within such period, the sale proceeds shall be deemed to be the profits in the year immediately following the previous year in which the ship was sold or otherwise transferred and taxed accordingly.

27.3 The amendments will take effect from 1-4-2004, and will apply in relation to the assessment year 2004-05 and subsequent years. [*Section 17*]'.

VII. *The Finance (No. 2) Act, 2004.*—By **the Finance (No. 2) Act, 2004** (23 of 2004), **3rd proviso to section 33AC(1)** has been **inserted** (**w. e. f. 1-4-2005**).

For the scope and effect of the above insertion, reference may be made to paras. 44.33 and 44.34 of the *Departmental Circular No. 5 of 2005, dated 15-7-2005*.

VIII. *The Finance Act, 2005.*—By **the Finance Act, 2005** (18 of 2005), **section 33AC(4)** has been **amended** (**w. r. e. f. 1-4-2004**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 3 of 2006, dated 27-2-2006*, as follows:—

'*Reserves to be added to profits and not the sale proceeds on sale of a ship.*—'**3.7** The existing sub-section (4) of section 33AC contains provisions dealing with the sale or transfer of a ship after the expiry of three years' lock-in period. Where a company sells or transfer the ship after three years' lock-in period and the sale proceeds are not utilised for the purpose of acquiring a new ship within a period of one year from the end of the previous year in which such sale or transfer took place, the sale proceeds are deemed to be the profits of the assessment year immediately following the previous year in which the ship was sold or transferred.

A new ship is acquired by a shipping company not only by utilising the reserves but also by resorting to loans and other finances. When a ship so acquired is sold or transferred, taxation of the whole of the sale proceeds would imply taxation of loans and other finances which has never been the intention. The legislative intention, in essence, has always been to tax only reserves utilised for acquiring the ship. The Finance Act, 2005 (18 of 2005), has amended the said sub-section (4) so as to provide that only so much of the sale proceeds which represent the amount credited to the reserve account and utilised for acquisition of the ship would be deemed as profits.

Applicability: With retrospective effect from the assessment year 2004-05 and subsequent assessment years. [*Section 9*]'.

Introduction.—Section 33AC, relating to reserves for shipping business, has newly been **inserted** by **the Direct Tax Laws (Second Amendment) Act, 1989** (36 of 1989), with effect from 1-4-1990, *i.e.*, for and from assessment year 1990-91. This new section 33AC grants benefit to the shipping companies on the same lines as provided for in section 36(1)(*viii*). This concession would help the shipping industry to augment its fleet and make investments in shares of such companies more attractive.

LexisNexis

Eligible assessee.—The concession granted by section 33AC shall be available, for and from assessment year 1990-91, to a public company [having the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956)[13]] formed and registered in India with the main object of carrying on the business of operation of ships.

The amendments to section 33AC made by the Finance Act, 1992 (18 of 1992) (w. e. f. 1-4-1993) extend, for and from assessment year 1993-94, the benefit of deduction under section 33AC to a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[14].

Deduction, in respect of what.—An eligible assessee is entitled, for assessment years 1990-91 to 1995-96, to a deduction equal to an amount, not exceeding the total income (computed before making any deduction under **section 33AC** and Chapter VIA, containing sections 80A to 80U), as is—

—debited to the profit and loss account of the previous year in respect of which such deduction is to be allowed and

—credited to a reserve account to be utilised in the manner laid down under section 33AC(2).

As a result of the **amendment** (w. e. f. 1-4-1996) of **section 33AC(1)** by **the Finance Act, 1995** (22 of 1995), an eligible assessee is entitled, for and from assessment year 1996-97, to a deduction of an amount not exceeding 50% of profits derived from the business of operation of ships (computed under the head 'Profits and gains of business or profession' and before making any deduction under section 33AC) as is—

—debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and

—credited to a reserve account to be utilised in the manner laid down in section 33AC(2).

As a result of the **insertion** (w. e. f. 1-4-2001) of a **new second proviso to section 33AC(1)** by **the Finance Act, 2000** (10 of 2000), the quantum of deduction has been enhanced from 50 per cent. to 100 per cent. in relation to 5 assessment years from 2001-02 to 2005-06.

Section 33AC, condition precedent.—Under section 33AC(1) as applicable to assessment year 1994-95, it is stated that the only requirement prescribed was that the assessee must be a Government company or a company formed and registered in India with the main object of carrying on the business of operation of ships. If this condition was satisfied, the assessee would be entitled to deduction of an amount not exceeding the total income as was debited to the profit and loss account of the previous year in respect of which the deduction was to be allowed and credited in the manner laid down in section 33AC(2) [*Gal Offshore Services Ltd. v. CIT*, (2009) 309 ITR 125 (Bom)].

Deduction/allowance under section 33AC.—The reasons as furnished by the AO to reopen the assessment do not indicate that there was failure on the part of the petitioner to fully & truly disclose any material fact in regard to the nature of its business so as to claim deduction under section 33AC [*United Shippers Ltd. v. Asst. CIT*, (2015) 371 ITR 441, 452 (Bom) = 275 CTR (Bom) 397].

Ceiling limit.—The **proviso to section 33AC(1)** lays down a ceiling limit. That proviso takes care of a situation where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital (excluding the amounts capitalised from reserves) of the eligible assessee. In such a situation, no allowance under section 33AC(1) is to be made in respect of such excess.

As a result of the **insertion** (w. e. f. 1-4-2001) of a **new second proviso to section 33AC(1)** by **the Finance Act, 2000** (10 of 2000), the proviso to section 33AC(1) has become the first proviso thereto.

The **said first proviso to section 33AC(1)** has been **substituted** (w. e. f. 1-4-2003) by a new first proviso thereto by **the Finance Act, 2002** (20 of 2002).

Reserve account, how to be utilised.—According to **section 33AC(2)**, the amount credited to the reserve account under section 33AC(1) is to be utilised by the assessee before the expiry of a period of eight years next following the previous year in which the amount was so credited—

(*a*) for acquiring a new ship for the purposes of the business of the assessee; and

(*b*) until the acquisition of a new ship, for the purposes of the business of the assessee other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

These purposes are hereinafter referred to as the specified purposes.

The expression "new ship", as per **section 33AC, *Explanation* (*b*)** read with section 32AB(2)(*ii*), includes a ship which before the date of acquisition by the assessee was used by any other person, if it was not at any time previous to the date of such acquisition owned by any person resident in India.

---

13. Repealed and replaced by Act 18 of 2013.
14. Repealed and replaced by Act 18 of 2013.

LexisNexis

Consequences of non-utilisation of the reserve account for the specified purposes.—Under **section 33AC(3)**, where the amount of the reserve account has been utilised for any purpose other than any of the specified purposes, the amount so utilised is to be deemed to be the profits in the year in which the amount was so utilised and is to be charged to tax accordingly [**s. 33AC(3)(*a*)/(*i*)**].

Where the amount of the reserve account has not been utilised for any of the specified purposes, the amount not so utilised is to be deemed to be the profits in the year immediately following the period of eight years next following the previous year in which the amount was credited in the reserve account and is to be charged to tax accordingly [**s. 33AC(3)(*b*)/(*ii*)**].

Where the amount of the reserve account has been utilised for the purpose of acquiring a new ship for assessee's business, but such ship is sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired, the amount so utilised in acquiring the ship is to be deemed to be the profits in the year in which the sale or transfer took place and is to be charged to tax accordingly [**s. 33AC(3)(*c*)/(*iii*)**].

It is pertinent to note that as a result of the **amendment** (w. e. f. 1-4-2000) of **section 33AC(3)(*c*)** by **the Finance Act, 1999** (27 of 1999), a transfer of a ship pursuant to a scheme of demerger shall not constitute a 'transfer' so as to attract the consequences as contemplated in section 33AC(3)(*c*)/(*iii*).

Further, as a result of the **amendment** (w. e. f. 1-4-2004) of **section 33AC(3)(*c*)** by **the Finance Act, 2003** (32 of 2003), the period of 'eight years' has been reduced to 'three years' in relation to the sale, etc., of the ship concerned.

Consequences of non-utilisation, within one year as contemplated in section 33AC(4), of the sale proceeds of the ship sold after three years as contemplated by section 33AC(3)(*c*).—The **newly inserted** (w. e. f. 1-4-2004) **section 33AC(4)** by **the Finance Act, 2003** (32 of 2003) and, **subsequently, amended** (w. r. e. f. 1-4-2004) by **the Finance Act, 2005** (18 of 2005), envisages a situation where—

—the ship is sold or otherwise transferred (other than in any scheme of demerger) after the expiry of the period specified in section 33AC(3)(*c*),

and

—the sale proceeds are not utilised for the purpose of acquiring a new ship within a period of one year from the end of the previous year in which such sale or transfer took place.

In such a situation, [(upto 31-3-2004) such sale proceeds] [(w. r. e. f. 1-4-2004) so much of such sale proceeds which represent the amount credited to the reserve account and utilized for the purposes mentioned in section 33AC(3)(*c*)] shall be deemed to be the profits—

—of the assessment year immediately following the previous year in which the ship is sold or transferred.

Deduction, operative from.—The deduction under section 33AC is operative for and from assessment year 1990-91.

No deduction to be allowed under section 33AC for and from assessment year 2005-06.—As a result of the **insertion** (w. e. f. 1-4-2005) of a **new third proviso to section 33AC(1)** by **the Finance (No. 2) Act, 2004** (23 of 2004), no deduction shall be allowed under section 33AC for and from assessment year 2005-06. In this regard, for and from assessment year 2005-06, the provisions of the newly inserted (w. e. f. 1-4-2005) Chapter XII-G (containing sections 115V to 115VZC) are apposite.

LexisNexis

Omitted/Phased-out provisions of section 33B of the 1961 Act

[1][**S. 33B. Rehabilitation allowance.—**Where the business of any industrial undertaking carried on in India is discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business as a direct result of—

(*i*) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or

(*ii*) riot or civil disturbance; or

(*iii*) accidental fire or explosion; or

(*iv*) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

and, thereafter, at any time before the expiry of three years from the end of such previous year, the business is re-established, reconstructed or revived by the assessee, he shall, in respect of the previous year in which the business is so re-established, reconstructed or revived, be allowed a deduction of a sum by way of rehabilitation allowance equivalent to sixty per cent of the amount of the deduction allowable to him under clause (*iii*) of sub-section (1) of section 32 in respect of the building, machinery, plant or furniture so damaged or destroyed:

[2][*Provided* that no deduction under this section shall be allowed in relation to the assessment year commencing on the 1st day of April, 1985, or any subsequent assessment year.]

Explanation.—In this section, "industrial undertaking" means any undertaking which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining.]

Introduction under 1961 Act.—*The Finance (No. 2) Act, 1967*.—By **the Finance (No. 2) Act, 1967** (20 of 1967), **section 33B** has been **inserted** (**w. e. f. 1-4-1967**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 5P, dated 9-10-1967*, as follows:—

'*Tax concessions for facilitating re-establishment, or revival of the business of an industrial undertaking which has been discontinued because of damage to, or destruction of, its capital assets in specified circumstances.*—**43.** The Finance (No. 2) Act, 1967 (20 of 1967), has made provisions in the Income-tax Act with effect from 1-4-1967 (i.e., for and from the assessment year 1967-68), granting certain tax concessions to facilitate the revival or re-construction of the business of an industrial undertaking carried on in India which has been discontinued in specified circumstances. These tax concessions are available only where the business of an industrial undertaking carried on in India by any assessee was discontinued because of extensive damage to, or destruction of, its capital assets (building, machinery, plant or furniture owned by the assessee and used for the purpose of the business) as a direct result of specified causes and is, thereafter, re-established, reconstructed or revived by the same assessee within a specified time-limit. The specified causes referred to above are:—

(*i*) flood, typhoon, hurricane, earthquake, cyclone or other convulsion of nature; or

(*ii*) riot or civil disturbance; or

(*iii*) accidental fire or explosion; or

(*iv*) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war).

The business has to be re-established, reconstructed or revived by the assessee at any time before the expiry of three years from the end of the previous year in which it was discontinued, *i.e.*, during the previous year in which it was discontinued or during any of the three succeeding previous years. The tax concessions are available in relation to the business which has been so re-established, revived, etc. The concessions extend only to industrial undertakings whose business consists mainly of generation or distribution of electricity or any other form of power, construction of ships, manufacture or processing of goods or mining. The above-mentioned conditions for eligibility to the tax concessions under reference have been specified in the new section 33B of the Income-tax Act relating to the grant of 'rehabilitation allowance' in such cases.

LexisNexis

1. Section 33B has been inserted by the Finance (No. 2) Act, 1967 (20 of 1967), s. 11 (w. r. e. f. 1-4-1967).
2. Ins. by the Finance Act, 1984 (21 of 1984), s. 5 (w. e. f. 1-4-1985).

Other tax concessions in such cases have been provided by making certain amendments to some of the existing provisions in the Income-tax Act. The substance of the new provisions is as follows:—

(*i*) Under the new section 33B of the Income-tax Act, an assessee who re-establishes, reconstructs or revives the business of the industrial undertaking as stated above will be entitled to a deduction by way of 'rehabilitation allowance' in the computation of his business income in respect of the previous year in which the business is re-established, reconstructed, etc. The rehabilitation allowance is to be computed in a sum equal to 60% of the 'terminal allowance', if any, admissible to him under section 32(1)(*iii*) of the Income-tax Act in respect of the capital assets (building, machinery, plant or furniture) of the industrial undertaking, which had been damaged or destroyed due to any of the specific causes mentioned above.....

Where an assessee is not entitled to such terminal allowance, the 'rehabilitation allowance' in his case will be '*nil*'.

An assessee may be carrying on more than one business relating to separate industrial undertakings; in such a case, he will be entitled to rehabilitation allowance in relation to the particular business which was discontinued due to the specified causes and has subsequently been revived or reconstructed. Discontinuance of the business of an industrial undertaking implies the complete cessation of that business and not merely a cessation of some of the activities of that business or the closing down of a few units or sub-units of the industrial undertaking.

It may be stated that unlike the deduction on account of development rebate or development allowance, which is limited to the assessable profits of the relevant year, the deduction on account of rehabilitation allowance is to be allowed in full in computing the business profits; where the deduction results in a loss or an increase in the amount of the loss otherwise computed, the resultant loss is to be treated in the same manner as any other business loss for the purpose of setting it off against other profits of the assessee during the relevant year and for carrying forward the unabsorbed loss to subsequent years for being set-off against the profits of those years.

(*ii*) The unabsorbed business loss of the undertaking which is discontinued in the circumstances stated hereinabove, including the past business losses of that undertaking brought forward from earlier years, is eligible for being carried forward and set-off against profits of the re-established, reconstructed or revived business up to a period of 8 years, reckoned from the year in which the business was re-established, reconstructed or revived by the assessee. [*New proviso to section 72(1) of the Income-tax Act*]

(*iii*) The condition specified in section 84(2)(*i*) of the Income-tax Act to the effect that an industrial undertaking will not be eligible for the 'tax holiday' concession (*i.e.*, exemption from tax of profits up to 6% per annum of the capital employed in the industrial undertaking for the initial five years) if it is formed by splitting up or reconstruction of a business already in existence, will not apply in the case of an industrial undertaking which was discontinued in any one of the specified circumstances and is subsequently re-established, reconstructed or revived within the specified period. [*Newly added first proviso to section 84(2) and the proviso to sub-section (4) of the new section 80J which replaces section 84 with effect from 1-4-1968*]'.

Legislative amendment under 1961 Act.—I. *The Finance Act, 1984.*—By **the Finance Act, 1984** (21 of 1984), **proviso to section 33B** has been **inserted** (**w. e. f. 1-4-1985**) before the *Explanation*.

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 387, dated 6-7-1984*, as follows:—

'(*iii*) *Withdrawal of rehabilitation allowance.*—**9.1** Section 33B of the Income-tax Act, 1961 (43 of 1961), provides for a deduction by way of "rehabilitation allowance" for facilitating the re-establishment, re-construction or revival of the business of an industrial undertaking in India which is discontinued because of extensive damage to or destruction of its building, machinery, plant or furniture as a direct result of natural calamities (such as flood, cyclone, earthquake), riot or civil disturbance, accidental fire, explosion or enemy action. This deduction is allowed in cases where such business is re-established, re-constructed or revived by the assessee within a period of three years from the end of the year in which it was discontinued. The deduction is allowed, in the computation of the profits of the year in which the business is so re-established, re-constructed or revived, in a sum equal to 60 per cent. of the "terminal allowance" admissible to the assessee under section 32(1)(*iii*) of the Income-tax Act in respect of the damaged or destroyed assets of the assessee's business. The expression "terminal allowance" means the deduction allowable in the year in which the building, machinery, plant or furniture used in a business is sold, discarded, demolished or destroyed. The allowance is equal to the amount by which the salvage value or the insurance money receivable in respect of such assets falls short of their written down value.

9.2 Having regard to the fact that most of the industrial undertakings are adequately insured, the insurance money received by an assessee on the destruction of his industrial assets would ordinarily be more than their written down value. In such cases, no terminal allowance will be admissible to the assessee and he will, therefore, also not be entitled to any rehabilitation allowance under section 33B of the Income-tax Act. Besides, the deduction under section 33B can be availed of by an assessee only when he starts earning profits from the industrial undertaking after it has been re-established, re-constructed or revived. The cash benefit of this concession is, therefore, deferred until the industrial undertaking starts earning adequate profits. Thus, the provision in section 33B does not confer any significant benefit on the assessees.

9.3 In view of the aforesaid considerations and with a view to simplifying the tax law by reducing the number of tax concessions which are not essential, the Finance Act, 1984 (21 of 1984), has inserted a proviso to section 33B of the Income-tax Act to the effect that no deduction will be allowed under the said section in relation to the assessment year 1985-86 and subsequent years.'.

Provisions of section 33B of 1961 Act.—The circumstances requisite for invoking the provisions of section 33B were:—

(*a*) Assessee was carrying on, in India, the business of any *industrial undertaking* [*i.e.*, any undertaking which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining].

(*b*) Business was discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business. Discontinuance of the business of an industrial undertaking implies the complete cessation of that business and not merely a cessation of some of the activities of business or the closing down of a few units or sub-units of the industrial undertaking,

(*c*) Such damage or destruction of building, machinery, plant or furniture was caused as a direct result of:—

(*i*) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or

(*ii*) riot or civil disturbance; or

(*iii*) accidental fire or explosion; or

(*iv*) action by an enemy or action taken in combating an enemy (whether with or without declaration of war).

(*d*) Thereafter, at any time before the expiry of 3 years from the end of the previous year [referred to in clause (*b*) above], the business is re-established, reconstructed or revived by the assessee.

LexisNexis

In such a case, the assessee was allowed, in respect of the previous year in which the business is so re-established, reconstructed or revived, deduction of a sum by way of rehabilitation allowance equivalent to 60% of the terminal depreciation allowance under section 32(1)(*iii*) of the 1961 Act in respect of building, machinery, plant or furniture so damaged or destroyed.

It cannot be contended on the basis of the phraseology used in section 32(1)(*iii*) of the 1961 Act that the rehabilitation allowance cannot be claimed in case of 'extensive damage' to the asset concerned. Acceptance of such a contention would render the provisions of section 33B of the 1961 Act nugatory in the context of 'extensive damage' to the assets which is specifically made a ground for putting up the claim for rehabilitation allowance when it is caused directly as a result of flood, etc., due to which the business of the industrial undertaking was discontinued.

Reference to section 32(1)(*iii*) of the 1961 Act is made in section 33B of the 1961 Act for the purpose of fixing the parameters for working out the rehabilitation allowance on the basis of the amount that would be allowable under section 32(1)(*iii*) of the 1961 Act, both in respect of 'extensive damage' and 'destruction to the asset'. Therefore, in case where the 'extensive damage' to the asset is caused and it falls under section 33B of the 1961 Act, the amount of deduction will have to be worked out on the basis of the same formula, as is provided for the assets destroyed, namely, of *minusing* (*minus*) the 'moneys payable' [as explained in the then *Explanation* to section 32(1)(*iii*) of the 1961 Act] and scrap value, if any, from the written down value of the damaged asset. On the amount so worked out, rehabilitation allowance under section 33B of the 1961 Act at 60% thereof will be allowable. It is obvious that the rehabilitation allowance under section 33B of the 1961 Act is independent of other allowances permissible under the other provisions [*Klin Industrial Pvt. Ltd. v. CIT*, (2003) 261 ITR 338, 345 (Guj)]. In the facts of that case, it has been held that the Tribunal was not right in withdrawing the entire rehabilitation allowance of ` 26,910 granted by the first appellate authority under section

33B of the 1961 Act without working out the amount of deduction on the basis of the formula, namely, the written down value *minus* the 'moneys payable' and 'scrap value', if any, as contemplated by section 32(1)(*iii*) of the 1961 Act which was applicable even in respect of the assets extensively damaged leading to discontinuance of business under section 33B of the 1961 Act, for ascertaining the rehabilitation allowance of 60% of the amount of deduction so worked out.

Full amount to be allowed even though it may result in a loss.—Unlike the deduction on account of development rebate, investment allowance or development allowance, which is limited to the assessable income of the relevant year, the deduction on account of rehabilitation allowance is to be allowed in its entirety in computing the business profits even though it may result in a loss figure. Such loss is to be treated as a business loss for the purpose of carry forward and set-off.

Provisions of section 33B of 1961 Act are inoperative.—The provisions of section 33B of the 1961 Act remained operative for assessment years 1967-68 to 1984-85. Still, there are certain references of section 33B in other sections of the 1961 Act which are still alive and therein the provisions of section 33B of the 1961 Act will apply with full force.

LexisNexis

Omitted/Phased-out provisions of section 34 of the 1961 Act

S. 34. Conditions for depreciation allowance and development rebate.—[1][(1) * * * *]

[2][(2) * * * *]

(3) (*a*) The deduction referred to in section 33 shall not be allowed unless an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of [3][any previous year in respect of which the deduction is to be allowed under sub-section (2) of that section or any earlier previous year (being a previous year not earlier than the year in which the ship was acquired or the machinery or plant was installed or the ship, machinery or plant was first put to use)] 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—

(*i*) for distribution by way of dividends or profits; or

(*ii*) for remittance outside India as profits or for the creation of any asset outside India:

Provided that this clause shall not apply where the assessee is a company, being a licensee within the meaning of the Electricity (Supply) Act, 1948 (LIV of 1948)[4], or where the ship has been acquired or the machinery or plant has been installed before the 1st day of January, 1958:

---

1. Sub-section (1) has been omitted by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), s. 6 (w. e. f. 1-4-1988). Prior to its omission, sub-section (1) stood as follows:—

'(1) The deductions referred to in sub-section (1) [a][or sub-section (1A)] of section 32 shall be allowed only if the prescribed particulars have been furnished; and the deduction referred to in section 33 shall be allowed only if the particulars prescribed for the purpose of clause (*i*) and clause (*ii*) of sub-section (1) of section 32 have been furnished by the assessee in respect of the ship or machinery or plant.'.

a. Ins. by the Taxation Laws (Amendment) Act, 1970 (42 of 1970), s. 6(*a*) (w. e. f. 1-4-1971).

2. Sub-section (2) has been omitted by Act 46 of 1986, s. 6 (w. e. f. 1-4-1988). Prior to its omission, sub-section (2) stood as follows:—

'(2) For the purposes of section 32—

(*i*) the aggregate of all deductions in respect of depreciation made under sub-section (1) [a][or sub-section (1A)] of section 32 or under the Indian Income-tax Act, 1922 (XI of 1922), or under any Act repealed by that Act or under the Indian Income-tax Act, 1886 (II of 1886), shall, in no case, exceed the actual cost to the assessee of the building, machinery, [b][plant, furniture, structure or work], as the case may be.

[c][*Explanation*.—Where a capital asset is transferred—

(*i*) by a holding company to its subsidiary company or by a subsidiary company to its holding company, or

(*ii*) by a company to another company in a scheme of amalgamation,

and the conditions specified in clause (*iv*) or clause (*v*) or, as the case may be, clause (*vi*) of section 47 are satisfied, then, in determining the aggregate of all deductions in respect of depreciation under this clause, account shall also be taken of the deductions in respect of depreciation allowed in the case of the company from which the asset has been transferred;]

(*ii*) nothing in clause (*i*) or clause (*ii*) [d][or clause (*iia*)] or clause (*iv*) [e][or clause (*v*) or clause (*vi*)] of sub-section (1) of section 32 shall be deemed to authorise the allowance for any previous year of any sum in respect of any building, machinery, plant or furniture sold, discarded, demolished or destroyed in that year;

[f][(*iii*) nothing in clause (*i*) of sub-section (1A) of section 32 shall be deemed to authorise the allowance for any previous year of any sum in respect of any structure or work in or in relation to a building referred to in that sub-section which is sold, discarded, demolished or destroyed or is surrendered as a result of the determination of the lease or other right of occupancy in respect of the building in that year.]'.

a. Ins. by Act 42 of 1970, s. 6(*b*)(*i*)(A) (w. e. f. 1-4-1971).

b. Subs., for 'plant or furniture', by Act 42 of 1970, s. 6(*b*)(*i*)(B) (w. e. f. 1-4-971).

c. Subs. by the Finance (No. 2) Act, 1967 (20 of 1967), s. 12 (w. e. f. 1-4-1967), for the following:—

"*Explanation.*—Where a capital asset *is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company, then, if the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied,* in determining the aggregate of all deductions in respect of depreciation under this clause, account shall also be taken of the deductions in respect of depreciation allowed in the case of the company from which the asset has been transferred;".

The words in italics in the above *Explanation* were substituted for the words, etc. "is transferred by a company to a subsidiary company, then, if the conditions of clause (*iv*) of section 47 are satisfied" by the Finance Act, 1965 (10 of 1965), s. 10 (w. e. f. 1-4-1965).

d. Ins. by the Finance (No. 2) Act, 1980 (44 of 1980), s. 35(*i*) (w. e. f. 1-4-1981).

e. Ins. by the Direct Taxes (Amendment) Act, 1974 (26 of 1974), s. 4 (w. e. f. 1-4-1975).

f. Ins. by the Taxation Laws (Amendment) Act, 1970 (42 of 1970), s. 6(*b*)(*ii*) (w. e. f. 1-4-1971).

3. Subs., for "the relevant previous year", by the Finance Act, 1990 (12 of 1990), s. 11(*i*) (with retrospective effect from 1-4-1962).

4. Act 54 of 1948 has been repealed by Act 36 of 2003.

LexisNexis

[5][*Provided further* that where a ship has been acquired after the 28th day of February, 1966, this clause shall have effect in respect of such ship as if for the words "seventy-five", the word "fifty" had been substituted.]

[6][* * * * *]

(*b*) If any ship, machinery or plant is sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired or installed, any allowance made under section 33 or under the corresponding provisions of the Indian Income-tax Act, 1922 (11 of 1922), in respect of that ship, machinery or plant shall be deemed to have been wrongly made for the purposes of this Act, and the provisions of sub-section (5) of section 155 shall apply accordingly:

Provided that this clause shall not apply—

(*i*) where the ship has been acquired or the machinery or plant has been installed before the 1st day of January, 1958; or

(*ii*) where the ship, machinery or plant is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[7]; or

(*iii*) where the sale or transfer of the ship, machinery or plant is made in connection with the amalgamation or succession, referred to in sub-section (3) or sub-section (4) of section 33.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1965.*—By **the Finance Act, 1965** (10 of 1965), ***Explanation* to section 34(2)(*i*)** has been **amended** (**w. e. f. 1-4-1965**).

II. *The Finance Act, 1966.*—By **the Finance Act, 1966** (13 of 1966), the following **amendments** have been made—

—**2nd proviso to section 34(3)(*a*)** has been **inserted** (**w. e. f. 1-4-1966**); and

—***Explanation* to section 34(3)(*a*)** has been **inserted** (**w. r. e. f. 1-4-1962**).

For the scope and effect of the above insertions, reference may be made to paras. 39 to 42 of the *Departmental Circular No. 4P, dated 21-7-1966*.

III. *The Finance (No. 2) Act, 1967.*—By **the Finance (No. 2) Act, 1967** (20 of 1967), ***Explanation* to section 34(2)(*i*)** has been **substituted** (**w. e. f. 1-4-1967**).

For the scope and effect of the above substitution, reference may be made to paras. 55 to 58 of the *Departmental Circular No. 5P, dated 9-10-1967*.

IV. *The Taxation Laws (Amendment) Act, 1970.*—By **the Taxation Laws (Amendment) Act, 1970** (42 of 1970), the following **amendments** (**w. e. f. 1-4-1971**) have been made—

—**section 34(1)** has been **amended**;

—**section 34(2)(*i*)** has been **amended** at two places; and

—**section 34(2)(*iii*)** has been **inserted**.

For the scope and effect of the above amendments, reference may be made to paras. 56 and 57 of the *Departmental Circular No. 56, dated 18-3-1971*.

V. *The Direct Taxes (Amendment) Act, 1974.*—By **the Direct Taxes (Amendment) Act, 1974** (26 of 1974), **section 34(2)(*ii*)** has been **amended** (**w. e. f. 1-4-1975**).

For the scope and effect of the above amendment, reference may be made to paras. 9 to 17 of the *Departmental Circular No. 145, dated 9-9-1974*.

VI. *The Finance (No. 2) Act, 1980.*—By **the Finance (No. 2) Act, 1980** (44 of 1980), **section 34(2)(*ii*)** has been **amended** (**w. e. f. 1-4-1981**).

For the scope and effect of the above amendment, reference may be made to paras. 9 to 9.4 of the *Departmental Circular No. 281, dated 22-9-1980*.

LexisNexis

---

5. Ins. by the Finance Act, 1966 (13 of 1966), s. 9(*i*) (w. e. f. 1-4-1966).

6. The *Explanation* has been omitted by Act 12 of 1990, s. 11(*ii*) (with retrospective effect from 1-4-1962). Originally, the *Explanation* was inserted by the Finance Act, 1966 (13 of 1966), s. 9(*ii*) (with retrospective effect from 1-4-1962). Prior to its omission, the *Explanation* stood as follows:—

'*Explanation.*—For the removal of doubts, it is hereby declared that the deduction referred to in section 33 shall 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 reserve account aforesaid exceeds the amount of the profit of such previous year (as arrived at without making the debit aforesaid) in accordance with the profit and loss account.'.

7. Repealed and replaced by Act 18 of 2013.

VII. *The Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986.*—By **the Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986** (46 of 1986), **sections 34(1) & (2)** have been **omitted** (**w. e. f. 1-4-1988**).

For the scope and effect of the above omissions, reference may be made to paras. 6 to 6.6 of the *Departmental Circular No. 469, dated 23-9-1986*.

VIII. *The Finance Act, 1990.*—By **the Finance Act, 1990** (12 of 1990), the following **amendments** (**w. r. e. f. 1-4-1962**) have been made—

—**section 34(3)(*a*)** has been **amended**; and

—***Explanation* to section 34(3)(*a*)** has been **omitted**.

For the scope and effect of the above amendments, reference may be made to paras. 18 to 18.4 of the *Departmental Circular No. 572, dated 3-8-1990*.

1922 Act.—The position of the corresponding provisions of the 1922 Act is thus:—

1961 Act	*1922 Act*
s. 34(1)(operative up to 31-3-1988)	s. 10(2)(*vi*), proviso (*a*) & s. 10(2)(*vi-b*), 1st proviso, cl. (*a*)
s. 34(2)(*i*) (operative up to 31-3-1988)	s. 10(2)(*vi*), proviso (*c*)
s. 34(2)(*i*), Expln. (operative up to 31-3-1988)	s. 12B(1), 2nd proviso
s. 34(2)(*ii*) (operative up to 31-3-1988)	s. 10(4B)
s. 34(2)(*iii*) (operative up to 31-3-1988)	None
s. 34(3)	s. 10(2)(*vi-b*), 1st proviso, cl. (*b*).

DEPRECIATION ALLOWANCE—CONDITIONS FOR

Omitted section 34(1).—Section 34(1), prior to its omission by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), with effect from 1-4-1988, stood as follows:—

'(1) The deductions referred to in sub-section (1) [8][or sub-section (1A)] of section 32 shall be allowed only if the prescribed particulars have been furnished; and the deduction referred to in section 33 shall be allowed only if the particulars prescribed for the purpose of clause (*i*) and clause (*ii*) of sub-section (1) of section 32 have been furnished by the assessee in respect of the ship or machinery or plant.'.

LexisNexis

Prescribed particulars to be furnished.—Section 34(1) made depreciation allowable "only if the prescribed particulars have been furnished". The requisite particulars were, up to assessment year 1980-81, made a part of the form of return itself. For assessment years 1981-82 to 1987-88, such particulars were detailed in rule 5AA of the Income-tax Rules, 1962, which was inserted by the Income-tax (First Amendment) Rules, 1981, with effect from 1-4-1981. Rule 5AA has been reproduced, *ante,* in connection with section 32A. Unless such particulars were properly given [duly filled in the return form for assessment years up to 1980-81, and in a columnar form as per rule 5AA for assessment years 1981-82 to 1987-88], the depreciation claimed might not be allowed [*Hopeville Estate v. State of Tamil Nadu,* (1978) 112 ITR 861 (Mad); *Muthukaruppan Chettiar v. CIT,* (1939) 7 ITR 76 (Mad—FB); *Rao Bahadur S. Ramanatha Reddiar v. CIT,* (1928) 3 ITC 10 (Mad); *CIT v. Friends Corporation,* (1989) 180 ITR 334, 335 (Punj)]. In other words, these provisions prescribed two pre-conditions to the allowance for the depreciation. The first, which was implicit, was that the assessee should have asked for it. The second, which was explicit, was that the prescribed particulars should have been furnished. If either of these conditions was not fulfilled, the deduction could not be allowed by the Income-tax Officer [*CIT v. Shri Someshwar Sahakari Sakhar Karkhana Ltd.,* (1989) 177 ITR 443, 447 (Bom), **followed in,** *CIT v. Kolhapur Oxygen Acetyline Pvt. Ltd.,* (1991) 190 ITR 574 (Bom); *CIT v. Arun Textile,* (1991) 192 ITR 700, 708 (Guj); *Godavari Sugar Mills Ltd. v. CIT,* (1994) 208 ITR 801, 804 (Bom); *CIT v. Herdillia Chemicals Ltd.,* (1995) 216 ITR 742, 749 (Bom), holding that where the assessee had not supplied the particulars for grant of depreciation as required by section 34, the ITO was not entitled in law to allow depreciation]. These particulars must be furnished in the return or as annexure to the return, as was clear from the language "have been furnished" used in section 34(1) requiring furnishing of the particulars. The Madras High Court, in *Radhika Mills Ltd. v. CIT* [(1969) 74 ITR 661, 665 (Mad)], has held that such particulars should be furnished at least before the assessment was completed for the year in respect of which the claim for the allowance was made. The Allahabad High Court in *Ascharajlal Ram Parkash v. CIT* [(1973) 90 ITR 477] has held that even though necessary particulars were not furnished in the return, etc., and the assessee had not claimed any depreciation, if the Income-tax Officer, in the assessment proceedings, came to know of the relevant particulars necessary for the grant of deduction for depreciation, he was bound to give effect to it and allow depreciation. Ascharajlal's

8. Ins. by the Taxation Laws (Amendment) Act, 1970 (42 of 1970), s. 6(*a*) (w. e. f. 1-4-1971).

case was **followed in** *Dasaprakash Bottling Co. v. CIT* [(1980) 122 ITR 9 (Mad)] but the principle thereof was not accepted in *Chokshi Metal Refinery v. CIT* [(1977) 107 ITR 63, 75 (Guj)].

Also see, *CIT v. Mahendra Mills,* SLP (Civil) No. 12902 of 1994 : (1994) 210 ITR (St.) 2-3 (SC).

In the facts of the *Indian Bank Ltd. v. CIT* [(1985) 153 ITR 282 (Mad)], depreciation was held allowable on proportionate basis even though item-wise particulars of the assets were not available because indisputably such assets were used for business purposes. This Madras decision [153 ITR 282 (Mad)] has been **followed in** *CIT v. Indian Overseas Bank Ltd.* [(1995) 211 ITR 661, 664-65 (Mad)].

However, in *Beco Engineering Co. Ltd. v. CIT* [(1984) 148 ITR 478 (Punj)], claim for depreciation and extra-shift allowance was not made in the revised return although such claim was made in the original return. It was held that the Income-tax Officer was not statutorily bound to grant depreciation and extra-shift allowance. This is so in view of the language of section 32(1)(*ii*) and section 34(1) read with the departmental circular No. 29D, dated 31-8-1965, which has been reproduced under section 32(1), *ante.* Also see, *Beco Engineering Co. Ltd. v. CIT,* (1998) 143 Taxation 333, 338-39 (Punj) = (1999) 236 ITR 344, 348 (Punj). Similarly, in *CIT v. Shri Someshwar Sahakari Sakhar Karkhana Ltd.* [(1989) 177 ITR 443 (Bom)], the assessee claimed depreciation in the original return but did not claim any depreciation in the revised return, also enclosing a covering letter stating that the depreciation claim made in the original return was withdrawn. It was held that the Income-tax Officer was not justified in granting deduction for depreciation on the basis of the information gathered from the original return. The Bombay decision [177 ITR 443 (Bom)] has been **followed in** *Chief CIT v. Machine Tool Corporation of India Ltd.* [(1993) 201 ITR 101, 103-04 (Karn)]. Also see, *CIT v. Nath Pulp and Papers Mills Ltd.,* SLP (C) No. 22625 of 1997 : (1998) 229 ITR (St.) 76-77.

But, in the facts of *CIT v. Andhra Cotton Mills Ltd.* [(1996) 219 ITR 404, 407 (AP)], it has been held that an assessee cannot be allowed to withdraw the claim for depreciation allowance, by filing a revised return [which was, in the facts of that case, found not a valid one] when particulars are available in accordance with the provisions of the then section 34(1) as per the original return, only for the purpose of setting off of the loss of the earlier years. In such circumstances, the ITO was held bound to allow the deduction of depreciation in computing the income from business.

Where the assessee neither claimed any depreciation nor furnished the prescribed particulars, the Tribunal was held justified in upholding the orders of the CIT(A) directing withdrawal of the deduction by way of depreciation allowed by the Income-tax Officer for assessment years 1980-81 and 1981-82. Such view was taken in view of section 34(1) and the circular dated 31-8-1965 [*CIT v. Andhra Cotton Mills Ltd.,* (1997) 228 ITR 30, 34 (AP)].

LexisNexis

The above **controversy** has been **set at rest** by the Supreme Court in *CIT v. Mahendra Mills* : *Arun Textile* : *Humphreys & Glasgow Consultants* [(2000) 243 ITR 56, 78-79, 89 (SC)], where the Supreme Court has ruled that the language of the provisions of sections 32 and 34 is specific and admits of no ambiguity. Section 32 allows depreciation as deduction subject to the provisions of section 34. Section 34 provided, in its sub-section (1), that deduction under section 32 shall be allowed only if prescribed particulars have been furnished. The then rule 5AA [which was operative between 1-4-1981 and 1-4-1987] provided for the particulars required for the purpose of deduction under section 32. Even in the absence of that rule 5AA, the return of income in the form prescribed itself requires particulars to be furnished if the assessee claims depreciation. These particulars are required to be furnished in great detail. There is a circular of the Board, dated 31-8-1965, which provides that depreciation could not be allowed where the required particulars have not been furnished by the assessee and no claim for the depreciation has been made in the return. The Income-tax Officer in such a case is required to compute the income without allowing depreciation allowance. The circular of the Board, dated 11-4-1955 imposes merely a duty on the Officers of the Department to assist the tax-payers in every reasonable way, particularly, in the matter of claiming and securing relief. The Officer is required to do no more than to advise the assessee. It does not place any mandatory duty on the Officer to allow depreciation if the assessee does not want to claim that. The provisions for claim of depreciation are certainly for the benefit of the assessee. If it does not wish to avail that benefit for some reason, benefit cannot be forced upon him. It is for the assessee to see if the claim of depreciation is to his advantage. Income under the head 'Profits and gains of business or profession' is chargeable to income-tax under section 28 and that income under section 29 is to be computed in accordance with the provisions contained in sections 30 to 43A. The argument that since section 32 provides for depreciation it has to be allowed in computing the income of the assessee cannot in all circumstances be accepted in view of the bar contained in the then section 34(1). If that section 34(1) is not satisfied and the particulars are not furnished by the assessee, his claim for depreciation under section 32 cannot be allowed. Section 29 is thus to be read with reference to other provisions of the Act it is not in itself a complete code.

If the revised return is a valid return and the assessee has withdrawn the claim of depreciation it cannot be granted relying on the original return when the assessment is based on the revised return.

Allowance of depreciation is calculated on the written down value of the assets, which written down value would be the actual cost of acquisition less the aggregate of all deduction 'actually allowed' to the assessee for the past years. 'Actually allowed' does not mean 'notionally allowed'. If the assessee has not claimed deduction of depreciation in any past year it cannot be said that it was notionally allowed to him. A thing is 'allowed" when it is claimed. A subtle distinction is there when one examines the language used in section 16 and that of sections 34 and 37 of the Act. It is rightly said that a privilege cannot be to a disadvantage and an option cannot become an obligation.

In taking the above view, the Supreme Court [243 ITR 56 (SC)] has—

—**affirmed** *CIT v. Arun Textile* [(1991) 192 ITR 700 (Guj);

—**approved** *Beco Engineering Co. Ltd. v. CIT* [(1984) 148 ITR 478 (Punj)]; *CIT v. Andhra Cotton Mills Ltd.* [(1996) 219 ITR 404 (AP)]; *CIT v. Andhra Cotton Mills Ltd.* [(1997) 228 ITR 30 (AP)]; *CIT v. Friends Corporation* [(1989) 180 ITR 334 (Punj)]; *CIT v. J.K. Industries Ltd.* [(2000) 241 ITR 537 (Cal)]; *CIT v. Shri Someshwar Sahakari Sakhar Karkhana Ltd.* [(1989) 177 ITR 443 (Bom)] and *Chief CIT v. Machine Tool Corporation of India Ltd.* [(1993) 201 ITR 101 (Karn)];

—**overruled** *Ascharajlal Ram Parkash v. CIT* [(1973) 90 ITR 477 (All)]; *CIT v. Gujarat State Warehousing Corporation* [(1976) 104 ITR 1 (Guj)]; *CIT v. Southern Petro Chemical Industries Corporation Ltd.* [(1998) 233 ITR 400 (Mad)] and *Dasaprakash Bottling Co. v. CIT* [(1980) 122 ITR 9 (Mad)].

The above Supreme Court ruling [243 ITR 56 (SC)] has been **followed in** *CIT v. Agya Wanti* [(2001) 248 ITR 641, 645 (J&K)]; *Ram Nath Jindal v. CIT* [(2001) 252 ITR 590, 593 (Punj)]; *CIT v. Sree Senhavalli Textiles P. Ltd.* [(2003) 259 ITR 77, 78 (Mad)]; *CIT v. Kerala Electric Lamp Works Ltd.* : *Crompton Greaves Ltd.* [(2003) 261 ITR 721, 731 (Ker)].

The following decisions are **in consonance** with the Supreme Court ruling [243 ITR 56 (SC)]:

(1) *CIT v. Kerala Electric Lamp Works Ltd.*, (2000) Tax LR 239 (Ker), special leave petition dismissed by the Supreme Court : (2000) 245 ITR (St.) 69 (SC).

(2) *CIT v. J.K. Industries Ltd.*, (2000) 158 CTR (Cal) 68, 69.

Reference may also be made to *CIT v. Vikrant Tyres Ltd.* [CA No. 652 of 1999 : (1999) 236 ITR (St.) 231-14 (SC)]; *CIT v. Kerala Electrical Lamps Works Ltd.* [SLP (C) No. 13555 of 2000 : (2001) 247 ITR (St.) 3 (SC)]; *Deputy CIT v. Uvifort Metalizers* [SLP (C) No. 9433 of 2002 : (2002) 256 ITR (St.) 49 (SC)].

The effect of the above Supreme Court ruling [243 ITR 56 (SC)] has **statutorily** been **superseded** as a result of the **insertion** (w. e. f. 1-4-2002) of a **new *Explanation 5* to section 32(1)(*ii*)** by **the Finance Act, 2001** (14 of 2001). Under the said *Explanation 5*, for the removal of doubts, it is hereby declared that—

—the provisions of section 32(1) shall apply

whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income. The provisions of the said *Explanation 5* are operative for and from assessment year 2002-03.

Thus, by virtue of the provisions contained in the said *Explanation 5*, the deduction in respect of depreciation has been made mandatory, for and from assessment year 2002-03, even though the assessee has not claimed such deduction.

It is no doubt true that the said *Explanation 5* appears to have been added 'for the removal of doubts'. However, the fact remains that prior to the insertion (w. e. f. 1-4-2002) of the said *Explanation 5*, there was no express provision by which depreciation could be fictionally deemed to have been claimed and granted [*Ram Nath Jindal v. CIT*, (2001) 252 ITR 590, 593 (Punj)].

The said *Explanation 5* cannot be regarded as taking away the effect of the Supreme Court judgment [243 ITR 56 (SC)] for the years prior to the date of introduction of that *Explanation*. The law declared by the Supreme Court cannot be regarded as having merely raised doubts. The interpretation of the relevant provisions of the Act by the apex court settles the law, and unless the subsequent amendment to the statute is expressly given retrospective effect, the law laid down by the apex court will remain the binding law for the period prior to the amendment. The newly added *Explanation 5* takes effect only on and from 1-4-2002, *i.e.*, for and from assessment year 2002-03, and will not be applicable to assessment years upto and including assessment year 2001-02 [see, *CIT v. Sree Senhavalli Textiles P. Ltd.*, (2003) 259 ITR 77, 78, (Mad)].

The said *Explanation 5* has no retrospective effect so as to apply to any assessment year prior to assessment year 2002-03 [see, *CIT v. Kerala Electric Lamp Works Ltd.* : *Crompton Greaves Ltd.*, (2003) 261 ITR 721, 731, 729 (Ker)].

It may be noted that as a result of the **omission** of **section 34(1)** by **the Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986** (46 of 1986), the furnishing of prescribed particulars as per rule 5AA

[which has also been omitted by the Income-tax (Third Amendment) Rules, 1987, with effect from 2-4-1987] is not needed for and from assessment year 1988-89.

Omitted section 34(2).—Section 34(2), prior to its omission by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 (46 of 1986), with effect from 1-4-1988, stood as follows:—

'(2) For the purposes of section 32—

(*i*) the aggregate of all deductions in respect of depreciation made under sub-section (1) [9][or sub-section (1A)] of section 32 or under the Indian Income-tax Act, 1922 (XI of 1922), or under any Act repealed by that Act or under the Indian Income-tax Act, 1886 (II of 1886), shall, in no case, exceed the actual cost to the assessee of the building, machinery, [10][plant, furniture, structure or work], as the case may be.

[11][*Explanation*.—Where a capital asset is transferred—

(*i*) by a holding company to its subsidiary company or by a subsidiary company to its holding company, or

(*ii*) by a company to another company in a scheme of amalgamation,

(*iii*) and the conditions specified in clause (*iv*) or clause (*v*) or, as the case may be, clause (*vi*) of section 47 are satisfied, then, in determining the aggregate of all deductions in respect of depreciation under this clause, account shall also be taken of the deductions in respect of depreciation allowed in the case of the company from which the asset has been transferred;]

(*ii*) nothing in clause (*i*) or clause (*ii*) [12][or clause (*iia*)] or clause (*iv*) [13][or clause (*v*) or clause (*vi*)] of sub-section (1) of section 32 shall be deemed to authorise the allowance for any previous year of any sum in respect of any building, machinery, plant or furniture sold, discarded, demolished or destroyed in that year;

[14][(*iii*) nothing in clause (*i*) of sub-section (1A) of section 32 shall be deemed to authorise the allowance for any previous year of any sum in respect of any structure or work in or in relation to a building referred to in that sub-section which is sold, discarded, demolished or destroyed or is surrendered as a result of the determination of the lease or other right of occupancy in respect of the building in that year.]'.

Aggregate of depreciation allowance not to exceed actual cost.—Section 34(2)(*i*) made it clear that allowance of depreciation was always subject to a ceiling. Actual cost *minus* depreciation allowed for the respective year was the written down value of the asset carried forward to the next succeeding year and so on. No depreciation could be allowed so as to make the written down value into a negative result. In other words, the aggregate of all allowances in respect of depreciation could not exceed the actual cost to the assessee of the depreciable asset [*Asoka Mills Co. Ltd. v. CIT,* (1958) 33 ITR 377, 380 (Bom)].

No depreciation for the year in which the asset was sold, etc.—Clauses (*ii*) and (*iii*) of section 34(2) made it clear that no depreciation shall be allowed for the previous year, in respect of a depreciable asset, in which the asset was sold, discarded, demolished or destroyed. This was so because for such year, if it was not the year of purchase, the excess over its written down value might have been charged to tax as the balancing charge under the then section 41(2) or 41(2A) and the deficit might have been deducted in the computation of the total income as terminal allowance under the then section 32(1)(*iii*) or 32(1A)(*ii*). If an asset was sold, etc., in the same previous year in which it was purchased and brought into use, there was no question of a balancing charge because no depreciation was allowed, and the deficit, if any, resulting was also specifically excluded from terminal allowance under the then section 32(1)(*iii*) or 32(1A)(*ii*). In this regard, reference may be made to *Gujarat Mineral Development Corporation Ltd. v. CIT* [(1983) 143 ITR 822 (Guj)].

---

9. Ins. by Act 42 of 1970, s. 6(*b*)(*i*)(A) (w. e. f. 1-4-1971).

10. Subs. for 'plant or furniture' by Act 42 of 1970, s. 6(*b*)(*i*)(B) (w. e. f. 1-4- 1971).

11. Subs. by the Finance (No. 2) Act, 1967 (20 of 1967), s. 12 (w. e. f. 1-4-1967), for the following:—

"*Explanation.—Where a capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company, then, if the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied,* in determining the aggregate of all deductions in respect of depreciation under this clause, account shall also be taken of the deductions in respect of depreciation allowed in the case of the company from which the asset has been transferred;".

The words in italics in the above *Explanation* were substituted for the words, etc. "is transferred by a company to a subsidiary company, then, if the conditions of clause (*iv*) of section 47 are satisfied" were substituted by the Finance Act, 1965 (10 of 1965), s. 10 (w. e. f. 1-4-1965).

12. Ins. by the Finance (No. 2) Act, 1980 (44 of 1980), s. 35(*i*) (w. e. f. 1-4-1981).

13. Ins. by the Direct Taxes (Amendment) Act, 1974 (26 of 1974), s. 4 (w. e. f. 1-4-1975).

14. Ins. by the Taxation Laws (Amendment) Act, 1970 (42 of 1970), s. 6(*b*)(*ii*) (w. e. f. 1-4- 1971).

LexisNexis

In view of the provisions contained in section 34(2)(*ii*), the assessee was held not entitled to depreciation on an asset, which was not in existence [*E.I.D. Parry Ltd. v. CIT,* (1997) 226 ITR 836, 841 (Mad)].

From a reading of section 34(2)(*ii*), it was evident that that section 34(2)(*ii*) was *non obstante vis-a-vis* clauses other than clause (*iii*) of section 32(1). In other words, that section 34(2)(*ii*) did not override terminal allowance allowable under section 32(1)(*iii*) [*CIT v. Orkay Knitting Industries,* (1992) 107 CTR (Bom) 176, 177].

There was no provision similar to section 34(2)(*ii*) with regard to development rebate allowable under section 33 [*CIT v. Smt. Tara Sarup,* (1991) 188 ITR 783, 787 (Bom)].

The definition of the expression 'transfer' as contained in section 2(47) is only in relation to a 'capital asset' as defined under section 2(14). In other words, the said term 'transfer' is in relation to the computation of 'Capital gains' coming under Chapter IV-E of the Act. That term is not relevant for the purpose of section 34(2)(*ii*) since the term 'transferred' is not used in that section and it has used only the words 'sold, discarded, demolished or destroyed' [*A.M. Ponnurangam Mudaliar v. CIT,* (1997) 228 ITR 454, 458 (Mad)].

In *CIT v. Ramlubhaiya R. Malhotra* [(2002) 254 ITR 165, 167 (Guj)], the Tribunal was held justified in law in upholding the claim of the assessee for depreciation under section 34(2)(*ii*) in a case where the proprietary business was converted into a partnership firm during the relevant accounting period. This is so because the settled legal position is that, under the partnership law, when the assets of a proprietary business are brought as capital contribution in the partnership firm, there is no sale inasmuch as the proprietary-assessee, who becomes a partner of the firm, retains his interest in the assets. Thus, the situation envisaged by the use of the term 'sold' cannot be applied to the case of the assessee. Further, the extended definition of 'transfer', as contained in section 2(47), which is applicable only in the case of a transfer of a capital asset for the purposes of computation of capital gains, cannot be made applicable to a case concerning allowance of depreciation.

It may be noted that **section 34(2)** has been **omitted** by **the Taxation Laws (Amendment & Miscellaneous Provisions) Act, 1986** (46 of 1986), with effect from 1-4-1988.

ALLOWANCE FOR DEVELOPMENT REBATE—CONDITIONS FOR

I. Prescribed particulars to be furnished.—This is the same as that in case of depreciation (see, under section 34, *ante*).

II. Creation of development rebate reserve.—*Provisions.*—An essential condition specified in section 34(3)(*a*) (as amended retrospectively by the Finance Act, 1990 (12 of 1990)) for allowance of development rebate is that an amount equal to 75 per cent. (50 per cent. in the case of ships acquired after 28-2-1966) of the development rebate to be actually allowed should be debited to the profit and loss account of—

—any previous year in respect of which the deduction is to be allowed under section 33(2) or

—any earlier previous year not being a previous year earlier than the year in which the ship was acquired or the machinery or plant was installed or the ship, machinery or plant was first put to use

and the same is credited to a reserve account.

Reserve.—The word 'reserve' is not defined in the Act and one must resort to the ordinary natural meaning as understood in common parlance. The dictionary meaning of the word 'reserve' is:

"**1.** (*a*) To keep for future use or enjoyment; to store up for some time or occasion; to refrain from using or enjoying at once.

(*b*) To keep back or hold over to a later time or place or for further treatment....

6. To set apart for some purpose or with some end in view; to keep for some use....

11. To retain or preserve for certain purposes" (*Oxford Dictionary, Vol. VIII, p. 513*).

In *Webster's New International Dictionary,* tenth edition, page 1813, 'reserve' is defined as follows:—

"1. To keep in store for future or special use; to keep in reserve; to retain, to keep, as for one's self.

2. To keep back; to retain or hold over to a future time or place.....

4. To set aside or apart; to keep.....

7. To preserve....."

The reserve may be a general reserve or a specific reserve, but in order to constitute a 'reserve' there must be a clear indication to show whether it was a reserve either of the one or the other kind. The fact that it constituted a mass of undistributed profits on any day cannot make it a 'reserve' [*CIT v. Century Spng. & Mfg. Co. Ltd.,* (1953) 24 ITR 499, 503, 504 (SC); *Aluminium Industries Ltd. v. CIT,* (1968) 68 ITR 125, 127 (Ker)].

Creation of the reserve essential for the development rebate allowance.—An assessee is not entitled to the allowance of development rebate if the necessary reserve in accordance with the provisions of section 34(3)(*a*) has not been made. Where the assessee has failed to satisfy the conditions requisite for obtaining the allowance,

LexisNexis

it will not be for the Court to embark upon what the general object of the exemption is, and whether the conditions imposed are of a theoretical or technical nature, which, in the interest of justice, should be dispensed with [*CIT v. Veeraswami Nainar,* (1965) 55 ITR 35 (Mad)]. The grant of this allowance being made subject to the conditions prescribed in section 34(3)(*a*) the creation of reserve is a condition precedent for obtaining allowance of development rebate [*Indian Overseas Bank Ltd. v. CIT,* (1970) 77 ITR 512 (SC)], a *sine qua non* for the allowance [*Radhika Mills Ltd. v. CIT,* (1969) 74 ITR 661 (Mad). Also see, *Metal Box Co. of India Ltd. v. Their Workmen,* (1969) 73 ITR 53, 60-61 (SC); *Barar Lion Buttons* (*P.*) *Ltd v. CIT,* (1973) 87 ITR 44 (Punj); *Steelsworth Pr. Ltd. v. CIT,* (1976) 103 ITR 20 (Gauh); *CIT v. Kamalpur* (*Assam*) *Tea Estate P. Ltd.,* (1977) 109 ITR 419 (Gauh); *CIT v. Indian Iron & Steel Co. Ltd.,* (1978) 111 ITR 843, 846 (Cal); *Addl. CIT v. Shri Subhlaxmi Mills Ltd.,* (1975) 100 ITR 188 (Guj); *CIT v. Burmah-Shell Oil Storage and Distribution Co. of India Ltd.,* (1978) 115 ITR 891, 905 (Cal); *Addl. CIT v. Nagardas Bechardas & Bros. Pr. Ltd.,* (1976) 104 ITR 123, 129 (Guj); *Triveni Engineering Works Ltd. v. CIT*, (1998) 232 ITR 639, 642-43 (Del)].

An essential condition for allowance of development rebate is, that an amount equal to 75% (50% in the case of certain ships) of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year[15] and credited to a reserve account [*Radhika Mills Ltd. v. CIT,* (1969) 74 ITR 661, 665 (Mad)]. Thus, if the reserve is not created in the relevant previous year[11], the assessee has been held not entitled to claim deduction for development rebate [*CIT v. Malayala Manorama & Co. Ltd.,* (1983) 143 ITR 29 (Ker)].

The sale of the cops and bobbins as scrap by weight by the assessee before the expiry of the 8 year period constituted a transfer of a part of the plant and machinery and would attract the provisions of section 34(3) resulting in the pro rata withdrawal of the development rebate allowed in respect of such part [*CIT v. Modipon Ltd.*, (2008) 303 ITR 438 (Del)].

In *CIT v. Nagaland Roller Flour Mills Ltd.* [(2010) 329 ITR 631 (Gauh)], it has been held that the Legislature amended sections 32A and 34 to ensure that the condition of creation of a reserve fund even in a year of loss or insufficient profit will not be mandatory in respect of both development rebate and investment allowance.

Point of time by which the requisite reserve to be created.—In *Indian Overseas Bank Ltd. v. CIT* [(1970) 77 ITR 512, 514 (SC)], the Supreme Court, while **approving** *CIT v. Veeraswami Nainar* [(1965) 55 ITR 35 (Mad)], repeated the observations in the Veeraswami's case to the effect: "It is also clear from the terms of the proviso" [(*b*) to section 10(2)(*vi-b*) of the 1922 Act corresponding to section 34(3)(*a*) of the 1961 Act] "that the transfer to the reserve fund should be made at the time of making up the profit and loss account". Treating these observations as the exposition of the relative law, the principle was **followed in** *Surat Textile Mills Ltd. v. CIT* [(1971) 80 ITR 1 (Guj)], *R. Venkatasubramaniam v. CIT* [(1973) 91 ITR 220 (Mad)], *Keshavlal Vithaldas v. CIT* [(1976) 105 ITR 601 (Guj)], where it was held that the debit to the profit and loss account against credit to the development rebate reserve account must be made at the time when the profit and loss account is made or finalised.

Thus, where development rebate reserve was created after distribution of the net profit amongst the partners by passing subsequent adjustment entries, the development rebate claim was held not allowable [*Keshavlal Vithaldas v. CIT,* (1976) 105 ITR 601 (Guj)]. It is not competent even to the Tribunal to give a direction to the Income-tax Officer that the assessee, who had not made the necessary entries about reserve by the time he produced his accounts before the Income-tax Officer, be allowed to rewrite his accounts by making necessary entries [*CIT v. Veeraswami Nainar,* (1965) 55 ITR 35 (Mad)].

Some other High Courts held the view that the Supreme Court's observations in the Indian Overseas Bank's case are merely obiter and that decision did not lay down the point of time by which the reserve should be created [see, *CIT v. Sardar Singh Sachdeva,* (1972) 86 ITR 387, 390 (Punj); *CIT v. Modi Spng. & Wvg. Mills Co. Ltd.,* (1973) 89 ITR 304, 310-11 (All); *Tata Iron & Steel Co. Ltd. v. N.C. Upadhyaya,* (1974) 96 ITR 1, 9-10 (Bom)].

It was thus held that belated creation of the reserve in the same books even after finalisation of the profit and loss account shall entitle the assessee to successfully claim the rebate [*CIT v. Modi Spng. & Wvg. Mills Co. Ltd.,* (1973) 89 ITR 304 (All). Also see, *Addl. CIT v. Kishore Chand Shiv Charanlal,* (1979) 8 CTR (All) 209]. The Allahabad decision [(1973) 89 ITR 304 (All)] has been **affirmed** by the Supreme Court in *CIT v. Modi Spinning and Weaving Mills Co. Ltd.* [(1991) 187 ITR 51 (SC)]. The same result will follow even where the reserve was created after filing the original return but before filing a revised return [*CIT v. Narula Cold Storage & Ice Factory,* (1976) 104 ITR 148 (Ori); *CIT v. Rijhumal Relumal,* (1983) 139 ITR 897 (MP); *CIT v. Janardhan Zarapkar,* (1982) 138 ITR 482 (Bom)]. This could be done before the finalisation of the assessment by the Income-tax Officer [*Veerabhadra Iron Foundry v. CIT,* (1968) 69 ITR 425 (AP); *CIT v. Mazdoor Kisan Sahakari Samiti,* (1970) 75 ITR 253 (Raj); *CIT v. Sardar Singh Sachdeva,* (1972) 86 ITR 387 (Punj); *CIT v. Rita Mechanical Works,* (1977) 108 ITR 552 (Punj); *CIT v. Haryana State Minor Irrigation & Tubewell*

15. Now, in this regard, the retrospective amendment made by the Finance Act, 1990, is relevant.

LexisNexis

Corporation Ltd., (1983) 140 ITR 437 (Punj); *CIT v. Hamdard Printing Press,* (1989) 179 ITR 413 (Punj); *Tata Iron & Steel Co. Ltd. v. N. C. Upadhyaya,* (1974) 96 ITR 1, 13 (Bom); *CIT v. Mutual Steel Industries,* (1991) 187 ITR 292 (Bom); *CIT v. Sri Venkatesa Mills Ltd.*, (1999) 235 ITR 665, 674 (Mad)] or in the course of rectification proceedings where the same are resorted to [*Addl. CIT v. Saran Engineering Co. Ltd.,* (1978) 115 ITR 270 (All)] but not in the course of appellate proceedings [*Addl. CIT v. South India Carbonic Gas Industries Ltd.,* (1977) 109 ITR 700 (Mad)]. In *CIT v. National Industrial Corporation* [(1982) 137 ITR 586 (Del)], the reserve was not created in the final accounts. When these were presented to the annual general meeting of the shareholders, they resolved and directed creation of reserve. It was held that such resolution should be construed to amount to creation of reserve and rebate was allowable.

Following *CIT v. Modi Spinning & Weaving Mills Co. Ltd.* [(1991) 187 ITR 51 (SC)] it has been held, in *CIT v. Span Industries* [(2001) 249 ITR 333, 335 (Del)], that the Tribunal was correct in law in holding that the entry made for development rebate reserve after the end of the accounting year would meet the requirements of section 34(3).

These above cases are to be read subject to the observations of the Supreme Court in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193, 196 (SC)] to the effect that 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'.

Insufficiency of profits—postponement of reserve-creation and development-rebate-claim to a profit-earning year—whether possible?—Normally, the allowance of the rebate and creation of the reserve must be in the year of installation or the first year of use, as the case may be. But if, in that year, there are no, or deficient, profits, is the assessee still under an obligation to create a reserve before he could ask for determination of the allowable amount and then to avail it, either whole or by parts, when his profits allow him to create the necessary reserve? Prior to the Supreme Court decision in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193 (SC), decided on 28-3-1989] and the retrospective amendment of section 34(3)(*a*) by the Finance Act, 1990 (12 of 1990), there was a difference of judicial opinion on the point. One view was that the Income-tax Officer should, in such year, determine the amount of rebate allowable since the allowance, and not the determination, has been made dependent on the creation of the reserve. This was so because the law has placed a ceiling on allowance of only so much rebate as would reduce the profit to nil, and has also made provisions for a carry forward of unabsorbed depreciation [see, *CIT v. Orissa Flour Mills P. Ltd.,* (1976) 104 ITR 682 (Ori)]. In other words, if in the year of installation or use, the total income of the assessee was not a positive figure, he could not naturally be expected to have credited an actual and non-illusory reserve equivalent to 75% (or 50%) of the development rebate to be allowed. Such a reserve could only be made out of the profits, else it will be forcing the assessee to create a reserve out of its capital or by borrowings, either of which events would defeat the object of enabling the assessee to accumulate funds to be utilised for its development [*Addl. CIT v. Vishnu Industrial Enterprise,* (1980) 122 ITR 919 (All)]. There could be no obligation on the part of the assessee to create a reserve as a condition merely for carrying over the development rebate without it being actually allowed to him by setting off the rebate against the assessed profits [*Indian Oil Corporation Ltd. v. S. Rajagopalan, ITO,* (1973) 92 ITR 241, 250 (Bom); *Tata Iron & Steel Co. Ltd. v. N.C. Upadhyaya,* (1974) 96 ITR 1 (Bom)]. The whole object of granting development rebate would have failed if creation of the reserve account was insisted on in the year of installation of the new plant or machinery whether or not the assessee had funds to create such an account [*West Laikdihi Coal Co. Ltd. v. CIT,* (1973) 87 ITR 501 (Cal)]. Carrying forward of the development rebate was allowed if the failure to create a reserve on the part of the assessee is on account of the fact that there was no income available in the assessee's hands in the relevant assessment year out of which the requisite reserve or any part of it could actually be created [*Radhika Mills Ltd. v. CIT,* (1969) 74 ITR 661 (Mad)]. Paragraph 1(*b*) of departmental circular F. No. 10/49/65-IT(AI), dated 14-10-1965, provides that "in a case where the total income computed before allowing the development rebate is a loss, there was no obligation on the assessee to create any statutory reserve in that year, as no development rebate would actually be allowed in that year". This view has again been reiterated in departmental circular No. 189, dated 30-1-1976. In consonance with this view, an assessee having no positive income in a year was not bound to create the development rebate reserve in that year [*CIT v. Agro Insecticides & Allied Industries,* (1981) 127 ITR 796 (AP); *CIT v. T. S. Venkiteswaran,* (1979) 120 ITR 675 (Ker); *Dodballapur Spng. Mills Ltd. v. CIT,* (1980) 121 ITR 94 (Karn)]. According to this view, preponderance of judicial opinion was that non-creation of the requisite reserve in the previous year, which had resulted in loss, would not disentitle the assessee to carry forward the allowable development rebate to a subsequent profit-earning year. The creation of the requisite reserve in such subsequent year would suffice for allowance in that year [*Addl. CIT v. Markanda Engineers,* (1982) 136 ITR 111 (Del); *CIT v. U.P. Hotel & Restaurants Ltd.,* (1984) 145 ITR 598 (All); *CIT v. Metal Forging Pr. Ltd.,* (1984) 149 ITR 259 (Del); *Addl. CIT v. Indo-Austro Corporation Pr. Ltd.,* (1984) 149 ITR 329 (Del); *Acropolymers Pr. Ltd. v. CIT,* (1985) 151 ITR 158 (Punj); *CIT v. Durga Enterprises Pr. Ltd.,* (1985) 154 ITR 585 (Del); *CIT v. Kelvin Jute Co. Ltd.,* (1986) 159 ITR 770 (Cal); *CIT v. Tata Robins Fraser Ltd.,* (1987) 163 ITR 886 (Pat); *CIT v. Amaravathi Sri Venkatesa Paper Mills Ltd.,* (1987) 164 ITR 229 (Mad); *CIT v. Khandelwal Ferro Alloys Ltd.,* (1989) 177 ITR

LexisNexis

10 (Bom); *CIT v. Colour Shade Pvt. Ltd.,* (1990) 185 ITR 594 (Bom); *CIT v. Dabriwal Engg. Co. Ltd.,* (1989) 178 ITR 507 (Punj); *CIT v. Caristrap Ltd.,* (1990) 186 ITR 642 (Bom); *CIT v. Dekka Chemicals* (*India*), (1990) 186 ITR 427 (Bom); *CIT v. Shree Bajrang Electric Steel Co.* (*P.*) *Ltd.,* (1991) 188 ITR 467 (Cal); *CIT v. L.P. Gas Transport and Bottling Co. P. Ltd.,* (1990) 184 ITR 572 (Bom); *CIT v. Texmaco Ltd.,* (1994) 209 ITR 620, 626 (Cal).

The Gujarat High Court, in *Addl. CIT v. Shri Subhlaxmi Mills Ltd.* [(1975) 100 ITR 188], has, however, disagreed with the view expressed in the above cases and has held that the reserve must be created before finally making up the profit and loss account of the relevant previous year in which the machinery or plant was installed or the ship was acquired. If it is not so created by debiting the profit and loss account and crediting the necessary reserve account, the benefit of the development rebate cannot be allowed and once it is found that it cannot be allowed in the relevant previous year#, in the year of assessment relevant for the previous year in which the machinery or plant was installed or the ship was acquired, it cannot be allowed to be carried forward in any subsequent year. This view has been shared in *CIT v. Mihir Textiles Ltd.,* (1976) 104 ITR 167 (Guj); *Addl. CIT v. Nagardas Bechardas & Bros. P. Ltd.,* (1976) 104 ITR 123 (Guj); *CIT v. Kamalpur* (*Assam*) *Tea Estate* (*P.*) *Ltd.,* (1977) 109 ITR 419 (Gauh); *CIT v. Shri Subhlaxmi Mills Ltd.,* (1983) 143 ITR 863 (Guj).

The **above controversy was set at rest** by the Supreme Court ruling in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193 (SC)] which has **affirmed** the judgment of the Gujarat High Court in *Addl. CIT v. Shri Subhlaxmi Mills Ltd.* [(1975) 100 ITR 188 (Guj)]; has **overruled** *Addl. CIT v. Vishnu Industrial Enterprises* [(1980) 122 ITR 919 (All)], *CIT v. U.P. Hotel & Restaurants Ltd.* [(1984) 145 ITR 598 (All)] and *Indian Oil Corporation Ltd. v. S. Rajagopalan,* ITO [(1973) 92 ITR 241 (Bom)]; and has **not approved** *Dodballapur Spinning Mills Ltd. v. CIT* [(1980) 121 ITR 94 (Karn)]. The Supreme Court has ruled that in order to claim the deduction on account of development rebate under section 33(1), 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 section 33(1) 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 want, or insufficiency, of profit in such previous year has been removed by the *Explanation*[16] to section 34(3)(*a*) [*Shri Shubhlaxmi Mills Ltd. v. Addl. CIT,* (1989) 177 ITR 193, 197 (SC)]. **Commenting** on the departmental circulars F. No. 10/49/65-IT(AI), dated 14-10-1965 and No. 189, dated 30-1-1976, the Supreme Court observed: "We have carefully considered the matter and we do not think that the circulars affect the true position in law.".

The effect of the above Supreme Court ruling [(1989) 177 ITR 193 (SC)] has **statutorily** been **superseded** as a result of the **amendment** of **section 34(3)(*a*) and the omission of the *Explanation* to section 34(3)(*a*) by the Finance Act, 1990** (12 of 1990), with retrospective effect from 1-4-1962. The net effect of such retrospective amendments is that the condition of creation of development rebate reserve even in a year of loss as laid down by the Supreme Court in the abovesaid ruling will not be mandatory retrospectively for and from assessment year 1962-63. As a result of such amendments, the creation of such reserve has been made permissible in—

—any previous year in respect of which the deduction is to be allowed uner section 33(2) or

—any earlier previous year not being a previous year earlier than the year in which the ship was acquired or the machinery or plant was installed or the ship, machinery or plant was first put to use.

In view of the retrospective amendment of section 34(3)(*a*) by the Finance Act, 1990 (12 of 1990), the assessee has been held entitled to the allowance of development rebate for assessment years 1964-65 and 1966-67 [*Chowgule Real Estate and Construction Co. v. CIT,* (1991) 189 ITR 625 (Bom)] or assessment years 1968-69 and 1969-70 and allowed to be carried forward for subsequent years, even though the necessary reserve was not created in the relevant previous years under section 34(3) [*CIT v. Premier Automobiles Ltd.,* (1991) 190 ITR 155 (Bom). Also see, *CIT v. International Tractor Co. of India Ltd.,* (1991) 189 ITR 798 (Bom)]. In the facts of *CIT v. Automobile Products of India Ltd.* [(1991) 190 ITR 641 (Bom)], the Tribunal was held right in directing the ITO to verify the admissibility of the development rebate to the amalgamating company for the assessment years 1966-67 to 1968-69. The retrospectively amended law has also been **applied in** *CIT v. Raza Buland Sugar Co. Ltd.* [(1993) 202 ITR 191 (All)].

In *CIT v. Beco Engineering Co.* [(1997) Tax LR 1045, 1048-49 (Punj) = (1998) 232 ITR 102, 108 (Punj), a case relating to assessment year 1973-74], the Tribunal was held correct in holding that the assessee was not required to create development rebate reserve during the relevant accounting year even though it had sufficient business income during this year which was reduced to nil on account of brought forward losses from the earlier year.

In *CIT v. Bharat Heavy Electricals Ltd.* [(2002) 254 ITR 447, 448 (Del)], it has been held that on the question relating to carry forward of development rebate in case of amalgamation of companies, the Tribunal

16. Now, in this regard, the retrospective amendments made by the Finance Act, 1990, are relevant.

had to decide as to the effect of the retrospective amendment of section 34(3)(*a*) by the Finance Act, 1990 (12 of 1990), and the relevance thereof to the dispute at hand.

Prior to such legislative intervention, the following departmental **instructions** were issued:—

'*Reserve required to be created in respect of claim for Development Rebate—Circular No. 259, dated 11-7-1979—Supreme Court's decision in the case of Shri Shubhlaxmi Mills Limited v. Additional Commissioner of Income-tax (177 ITR 193).*—The Supreme Court recently on March 28, 1989, in the case of *Shri Shubhlaxmi Mills Limited v. Additional Commissioner of Income-tax, Gujarat* (177 ITR 193) has pronounced a very important judgment on the point of allowance of development rebate and the creation of reserve necessary therefor. The Supreme Court has held that in order to claim the deduction on account of development rebate under sub-section (1) of section 33, it is obligatory that the debit entry in the profit and loss account and the credit entry in a reserve account should be made in the relevant previous year[17] in which the machinery or plant is installed or first put to use. Existence of sufficient profits in that year is not necessary.

2. The Supreme Court's decision in the case of *Shri Shubhlaxmi Mills Limited* (*supra*) referred to above is at variance with the legal position explained by the C.B.D.T. in its circular No. 259, dated 11-7-1979. However, the impact of the Supreme Court's decision on the provisions relating to investment allowance[18] is being examined separately by the Board.

3. In the meantime, no assessments already completed where development rebate or investment allowance has been allowed, should be re-opened in view of the decision of the Supreme Court in *Shubhlaxmi's* case unless some proceedings are going to be time-barred. In that event, the initiated proceedings may be completed but the matter relating to payment of demand arising on this account, if any, may not be pressed for recovery.

4. These instructions may be brought to the notice of all officers working in your region.' [*Instruction No. 1830, F. No. 133/250/89-TPL, dated 28th September, 1989*].

One thing is certain. The failure to create a reserve in spite of there being sufficient profits available, confiscates the right to claim development rebate [*Radhika Mills Ltd. v. CIT,* (1969) 74 ITR 661, 666-67 (Mad)]. The extent of confiscation will be the amount of development rebate that could have been allowed *vis-a-vis* his "total income" as reduced by the development rebate actually allowed as a deduction as per the amount of reserve created.

In *CIT v. Narasimha Mills P. Ltd.* [(1981) 129 ITR 589 (Mad)], the assessee had unabsorbed and current development rebates much exceeding his profits. The assessed total income was Rs. 2,11,730. It had created a reserve of Rs. 78,922 so as to merit an allowance of Rs. 1,05,229. The assessee conceded that the balance Rs. 1,06,501 [2,11,730—1,05,229] out of his balance of the allowable rebate could be confiscated. The Income-tax Officer was of the opinion that the available profit with the assessee was to the tune of Rs. 1,32,808 [Rs. 2,11,730—Rs. 78,922]. This entire amount ought to have been used up in the creation of the reserve entitling him to a rebate of Rs. 1,77,077. Therefore, according to the Income-tax Officer, the confiscation was to the extent of Rs. 1,77,077. The High Court, upholding the view of Appellate Tribunal, accepted the assessee's contention.

Genuine deficiencies to be condoned if supplementary reserve is created in the year when assessment is framed.—Paragraph 1(*c*) of the departmental circular F. No. 10/49/65-IT(AI), dated 14-10-1965, provides that "where there was no deliberate contravention of the provisions, the Income-tax Officer may condone genuine deficiencies subject to the same being made good by the assessee through creation of adequate additional reserve in the current year's books in which the assessment is farmed". It has been clarified in the subsequent departmental circular No. 189, dated 30-1-1976 (reproduced hereunder), that the instructions do stand and are still good.

These instructions are binding so far as income-tax authorities are concerned and they are to give effect to these [see, *Tata Iron & Steel Co. Ltd. v. N. C. Upadhyaya,* (1974) 96 ITR 1 (Bom); *Addl. CIT v. Vishnu Industrial Enterprises,* (1980) 122 ITR 919 (All); *International Instruments P. Ltd. v. CIT,* (1980) 123 ITR 11 (Karn); *Bharat Vijay Mills Ltd. v. ITO: Gurjargravures Pr. Ltd. v. ITO,* (1985) 154 ITR 786 (Guj)].

It is pertinent to note that the Supreme Court, in *Shri Shubhlaxmi Mills Ltd. v. Addl. CIT* [(1989) 177 ITR 193, 197 (SC)], has **not followed** the said circular dated 14-10-1965, as also circular No. 189, dated 30-1-1976, observing: "We have carefully considered the matter and we do not think that the circulars affect the true position in law". In *CIT v. Malayala Manorama & Co. Ltd.* [(1983) 143 ITR 29, 38 (Ker)], it has been observed: "Certainly, a circular issued by the Board would be binding on all officers and persons employed under section 119 of the Act, but no instruction or circular can go against the provisions of the Act. While the Board can relax the rigour of the law or grant relief which is not to be found in the terms of the statute, such circulars making for a just and fair administration of the law, no instruction which will be *ultra vires* the provisions of the statute could be issued.".

---

17. Now, in this regard, the retrospective amendments made by the Finance Act, 1990, are relevant.

18. The Finance Act, 1990, has amended section 32A(4)(*ii*) and omitted section 32A(9), with retrospective effect from 1-4-1976.

Circular No. 189, dated 30-1-1976, referred to above, is as follows:—

'Allowance of development rebate—Clarification regarding.—Reference is invited to Board's Circular F. No. 10/49/65-IT(AI), dated 14th October, 1965, which, *inter alia*, explained the position regarding the creation of statutory reserve for allowance of development rebate as follows:—

(*a*) In the case of certain industrial undertakings, particularly those in which there is Government participation either by way of capital, loan or guarantee, and where there are certain obligations by law or agreement about the maintenance of reserve for development purposes, the development rebate reserve may be treated as included in the said reserve though not specifically created as a development rebate reserve.

(*b*) In a case where the total income computed before allowing the development rebate is a loss, there was no legal obligation to create any statutory reserve in that year, as no development rebate would actually be allowed in that year.

(*c*) Where there was no deliberate contravention of the provisions, the Income-tax Officer may condone genuine deficiencies subject to the same being made good by the assessee through creation of adequate additional reserve in the current year's books in which the assessment is framed.

2. The Supreme Court, in the case of *Indian Overseas Bank Ltd. v. Commissioner of Income-tax*[19] had occasion to consider the validity of the position as explained at (*a*) above. In that case, the bank had not created any development rebate as such, although the books of accounts disclosed a substantial reserve under section 17 of the Banking Companies Act of 1949. On the claim of the bank that reserve had been created for purposes of claiming development rebate, the Supreme Court held that the reserve contemplated under the Income-tax Act was altogether an independent reserve and since the taxpayer had not complied with the requirements for the creation of special development rebate reserve, it was not entitled to claim the allowance in question. The Supreme Court also observed that the entries in the account books were not idle formalities. Thus, the instructions of the Board set out above in so far as part (*a*) is concerned became inoperable. However, the position explained in parts (*b*) and (*c*) above were not specifically considered by the Supreme Court in that decision. Taking note of the decision of the Supreme Court in *Indian Overseas Bank*[20] as well as a subsequent pronouncement of the Gujarat High Court in the case of *Surat Textile Mills Ltd.*[21] the Board had withdrawn in 1972 the aforesaid Circular dated 14th October, 1965, to the extent it was superseded by the aforesaid Supreme Court decision and the judgment of the Gujarat High Court in *Surat Textile Mills Ltd.*[22]

3. It was also directed that past assessments be reviewed and suitable action taken to retrieve loss of revenue including securing of necessary disallowance by way of enhancement, etc., in appeals relying on the aforesaid judicial pronouncements. It would appear that this has been interpreted by the field officers as having withdrawn not only part (*a*), but parts (*b*) and (*c*) of para. 1 above also, and rectificatory/revisionary action has been initiated in a number of cases.

4. It has been represented to the Board that their earlier instruction dated 14th October, 1965, represented the correct position in law and that its withdrawal to the extent it was presumed to be overruled by the Supreme Court in the *Indian Overseas Bank's* case[23] created unnecessary hardship to assessees. Some of the rectificatory action taken had also reached the High Court for decision and in two separate decisions the Bombay High Court struck down the rectificatory order under section 154 in the case of *Tata Iron and Steel Co. Ltd. v. N.C. Upadhyaya*[24] and in a more detailed discussion on merits in the writ petition of the *Indian Oil Corporation Ltd. v. S. Rajagopalan.*[25]

5. The Board have re-examined the issues involved and are of the view that except the clarification given in part (*a*) of para. 1 above, which stands superseded by the aforesaid decision of the Supreme Court, the clarifications given in paras. (*b*) and (*c*) of para. 1 above hold good.' [*Circular No. 189, dated 30th January, 1976*].

In the facts of *Prakash Cotton Mills Pvt. Ltd. v. CIT* [(1993) 203 ITR 75, 79 (Bom)], it has been held that paragraph (*c*) of the above circular No. 189, dated 30-1-1976, is not attracted in a situation where the entire basis of calculation adopted by the assessee was wrong.

The requirement of section 33(2)(*i*) is that so much of the allowable development rebate shall be given deduction in a year as would reduce the "total income" of that year to nil. Another logical conclusion is that so

---

19. (1970) 77 ITR 512 (SC).
20. (1970) 77 ITR 512 (SC).
21. (1971) 80 ITR 1 (Guj).
22. (1971) 80 ITR 1 (Guj).
23. (1970) 77 ITR 512 (SC).
24. (1974) 96 ITR 1 (Bom).
25. (1973) 92 ITR 241 (Bom).

LexisNexis

much reserve may be created as the profits of a year may allow. Suppose an assessee, on making up a sketch of his profit and loss account, finds that the book profit for the first year when he could create a reserve is Rs. 75,000. He makes a reserve of Rs. 56,250.

He claims that out of Rs. 1,75,000 development rebate allowable to him, Rs. 75,000 may be deducted this year and the balance Rs. 1,00,000 be carried forward. At the time his assessment comes to be made, the assessed income is computed at Rs. 1,80,000. The Income-tax Officer allows a deduction of Rs. 75,000 by way of development rebate, but does not carry forward Rs. 1,00,000 because, according to him, the assessee could have created a reserve of Rs. 1,31,250 for an allowance of Rs. 1,75,000 this very year.

This is a case of genuine difficulty without any fault on the part of the assessee. This situation is covered by paragraph 1(*c*) of Circular No. 189, dated 30-1-1976. The Income-tax Officer, must, after assessment, give an opportunity to the assessee to make up the deficiency by making a supplementary reserve, and if the assessee does so, he is entitled to the full allowance of Rs. 1,75,000 by way of development rebate.

The provisions of the *Explanation* to section 32A(4), which is in relation to investment allowance, may be compared where statutory provision has been made on these lines in a modified form.

Reserve created for a lesser amount—effect.—Where the reserve amount is found to fall short of the amount requisite under the law, the development rebate should be allowed to the extent covered by the reserve amount. In *Steelsworth* (*P.*) *Ltd. v. CIT* [(1976) 103 ITR 20 (Gauh)], the Income-tax Officer, without marking that the reserve fell short, allowed the full claim for development rebate. Afterwards, on discovering the mistake, he rectified the assessment by confining the allowance to the extent covered by the reserve amount. The action of the Income-tax Officer was upheld. A contrary view has, however, been taken by the Gujarat High Court in *Addl. CIT v. Nagardas Bechardas & Bros. P. Ltd.* [(1976) 104 ITR 123 (Guj)] to the effect that it is not open to an assessee first to create a reserve in an amount he thinks proper, and then to ask the assessing authority to allow only such rebate which is found just sufficient to cover the reserve so created. As the creation of necessary reserve is a condition precedent, the claim fails if that condition is found not to have been fulfilled. In such a case, the assessee shall not be entitled to claim that the shortfall should be made good by drawing the requisite deficit from an excess reserve created in the year following [*CIT v. Mihir Textiles Ltd.,* (1976) 104 ITR 167 (Guj)].

LexisNexis

As to whether an assessee, having created a larger than requisite reserve in connection with an earlier year's claim, could claim that the shortfall this year be made up from the excess of the earlier year, has also been a point where there is no consensus. One view is that such request may be allowed and this year's claim be granted [*CIT v. Caltex Oil Refining* (*India*) *Ltd.,* (1979) 119 ITR 216 (Bom), where the assessee, in its books made necessary entries showing the excess of last year in this year's profit and loss account; *International Instruments P. Ltd. v. CIT,* (1980) 123 ITR 11 (Karn)]. The other view is that the requisite condition being unfulfilled this year, the claim cannot be allowed [*CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad); *CIT v. Arasan & Co.,* (1985) 152 ITR 206 (Mad), special leave petition granted by the Supreme Court : (1991) 187 ITR (St.) 47 (SC); *Addl. CIT v. India Tin Industries Pr. Ltd.,* (1987) 166 ITR 454 (Karn)]. Also see, *CIT v. Burmah-Shell Oil Storage & Distribution Co. of India Ltd.,* (1978) 115 ITR 891 (Cal), which has been **affirmed in** *Burmah Shell Oil Storage & Distributing Co. of India Ltd. v. CIT,* (1995) 211 ITR 218, 225-26 (SC). Such a conflict of views has also been stated in *CIT v. Sakthi Sugars Ltd.* [(1999) 240 ITR 868, 876 (Mad)].

A reading of the Board's circular, dated 14-10-1965 [which has been reproduced under section 34, *ante,* as a part of circular No. 189, dated 30-1-1976] and circular, dated 11-7-1979 [which has been reproduced under section 34. *post.*] shows that the stand taken by the Board, is not consistent [*CIT v. Sakthi Sugars Ltd.*, (1999) 240 ITR 868, 876 (Mad)].

Creation of reserve in excess of book-profit.—By the Finance Act, 1966 (13 of 1966), an *Explanation*[26] was inserted, with retrospective effect from 1-4-1962, at the end of section 34(3)(*a*) providing that the claim for development rebate shall not be denied merely because the amount debited to the profit and loss account and credited to the reserve account exceeds the amount of book profit. In view of these provisions, it is clear that a development rebate reserve may be created by mere book entries [*CIT v. Mihir Textiles Ltd.,* (1976) 104 ITR 167 (Guj)]. What is contemplated by the *Explanation*‡ 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, one fails to see how the deduction on account of development rebate can be claimed at all [*Shri Shubhlaxmi Mills Ltd. v. Addl. CIT,* (1989) 177 ITR 193, 196 (SC)].

26. This *Explanation* has been omitted by the Finance Act, 1990, with retrospective effect from 1-4-1962.

Development rebate reserve to be separate and distinct.—The assessee might be required to keep a portion of its profits as reserve under any other statutory provision. Nevertheless, the requirement of section 34(3)(*a*) is to create a development rebate reserve which shall be separate and distinct, and in addition to any other reserve [*Indian Overseas Bank Ltd. v. CIT,* (1970) 77 ITR 512 (SC); *Calcutta Tramways Co. Ltd. v. CIT,* (1978) 112 ITR 1041 (Cal)]. At the same time, there is, in section 34(3)(*a*), no statutory obligation cast that the reserve account should be distinctly named "Development Rebate Reserve Account" [*CIT v. Calcutta Tramways Co. Ltd.,* (1978) 112 ITR 643 (Cal), **dissented from in**, *CIT v. Malayala Manorama & Co. Ltd.,* (1983) 143 ITR 29, 36 (Ker)]. It may be noted that section 32A(4)(*ii*), in respect of investment allowance, specifies that the reserve must be named as "Investment Allowance Reserve Account".

Where a reserve need not be created.—The first proviso to section 34(3)(*a*) excepts out of the general provisions for creation of a development rebate reserve, etc., the case of a company assessee which is a licensee within the meaning of the Electricity (Supply) Act, 1948 (LIV of 1948) [*CIT v. Punjab State Electricity Board,* (1980) 124 ITR 894 (Punj) holding the respondent to be such a licensee], or where the ship has been acquired or the machinery or plant has been installed before 1-1-1958. No development rebate reserve is essential for such assessees and for such acquisition or installation. It may be noted that the requirement of creation of reserve by a company assessee which is a licensee under the Electricity (Supply) Act, 1948 (54 of 1948) [**repealed** by Act 36 of 2003], has not been dispensed with where the company claims an investment allowance.

In *CIT v. M.P. Electricity Board* [(1987) 166 ITR 24 (MP)], the State Electricity Board has been held to be covered by the first proviso to section 34(3)(*a*) and, therefore, exempt from creating and maintaining a development rebate reserve. Also see, *CIT v. M.P. State Electricity Board,* (1987) 166 ITR 26 (MP)].

Whether books of account necessary.—In *CIT v. S. Kuppa Ammal* [(1972) 85 ITR 633 (Mad)], the court held that *Explanation 2* to section 10(2)(*vib*) of the 1922 Act does not insist on the existence or maintenance of regular books of account as such. Therefore, the profit and loss account produced by the assessee, the genuineness or accuracy of which has not been disputed, has to be taken as entitling the assessee to the benefit of that provision, if the profit and loss account shows the creation of necessary development rebate reserve. Also see, *CIT v. T. S. Venkiteswaran,* (1979) 120 ITR 675 (Ker).

Debit to profit and loss account essential—Board's instructions about.—The following portion of the **departmental circular** explains the position as follows:—

"**40.** One of the conditions laid down in section 34(3)(*a*) of the Income-tax Act for the allowance of the deduction for development rebate is that an amount equal to 75% 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 for being utilised during a period of 8 years next following for the purposes of the business of the undertaking, other than for distribution by way of dividends or profits, etc. This requirement of creating a development rebate reserve of 75% of the amount of development rebate often rendered it difficult for shipping enterprises making a substantial addition to their shipping fleet, to maintain a reasonable level of distribution of dividends to their shareholders. The quantum of the development rebate reserve has, therefore, been reduced in respect of ships acquired after 28-2-1966, from 75% to 50% of the development rebate to be actually allowed.

41. While some companies have been creating the development rebate reserve by debiting the amount thereof in the 'above-the-line' section of the profit and loss account in which the profits of the relevant year are arrived at, others have been making the debit in the 'below-the-line' section of the profit and loss account, often referred to as the Profit and Loss Appropriation Account, which, *inter alia*, contains credits for the profits, if any, brought forward from the earlier years or amounts transferred from various reserve accounts of the company. The provisions in Part II of Schedule VI to the Companies Act, 1956 (1 of 1956)[27], in regard to the requirement as to the profit and loss account do not make a distinction between the 'above-the-line' and 'below-the-line' sections of the profit and loss account. The debit for development rebate reserve in the 'below-the-line' section of profit and loss account is, therefore, to be regarded as adequate compliance with the condition in section 34(3)(*a*) of the Income-tax Act that the debit should be made to the profit and loss account of the relevant previous year[28]....." [*Circular No. 4-P* (*LXXVI-61*) *of 1966, dated 21-7-1966*].

Creating a bigger than requisite reserve.—Circular No. 7-P (XIX) of 1968, extracted below, clarifies that deduction for development rebate shall not be denied by reason only of the fact that the amount credited to the development rebate reserve is greater than that prescribed.

Allowance of development rebate in cases where the development rebate reserve created is in excess of the statutory percentage—Instructions regarding.—"In para. 3 of Board's Circular No. 2-P (XV-6) of 1968, dated 5-2-1968[29] relating to computation of the capital of a company for the purposes of super profit tax, it was stated

27. Repealed and replaced by Act 18 of 2013.

28. Now, in this regard, the retrospective amendments made by the Finance Act, 1990, are relevant.

29. This Circular No. 2-P (XV-6) of 1968, dated 5-2- 1968 [(1968) 69 ITR (St.) 25], has been superseded by another Circular No. 53, dated 11-1-1971 [(1971) 79 ITR (St.) 73-4].

that a development rebate reserve which is either less than the statutory percentage [specified in section 10(2)(*vib*) of the Income-tax Act, 1922 (11 of 1922), and section 34(3) of the Income-tax Act, 1961 (43 of 1961)] or, in excess of the prescribed percentage could not be said to have been created in compliance with the statutory provisions in the Income-tax Act, and, therefore, could not be treated as a 'reserve' for the purpose of computing the capital of the company under Rule 1 of the Second Schedule to the Super Profits Tax Act, 1963 (14 of 1963). These observations in the circular, were not made with reference to the question of admissibility of the development rebate itself but wholly in the context of the computation of capital for the purpose of Super Profits Tax.

It has come to the notice of the Board that the above observations in the circular dated 5-2-1968 have been interpreted in some quarters to imply that the deduction for development rebate should be entirely denied or withdrawn in a case where the amount credited to the development rebate reserve is in excess of the statutory requirement. This interpretation is not correct. The allowance of development rebate is not to be denied in cases where the reserve created is in excess of the statutory requirement, because this does not result in any violation of the requirement of creation of a reserve equal to the statutory percentage of the development rebate to be actually allowed." [*Circular No. 7-P* (*XIX*) *of 1968, dated 8-8-1968*].

Adequacy of the reserve created—departmental circular.—While considering the adequacy of the reserve created, the following **instructions** are apposite:—

"Allowance of development rebate—Creation of reserve under section 34(3)(a) of the Income-tax Act—Clarification regarding.—The Board had an occasion to consider the question whether the development rebate reserve created in respect of a particular machinery or plant in the year of installation or use and/or in the year or years subsequent thereto, to the extent of availability of book profits, can be taken into account for the purposes of section 34(3)(*a*) of the Income-tax Act, 1961, in the year or years of actual allowance of the development rebate.

2. Sub-sections (1)(*a*) and (1A)(*c*) of section 33 provide for deduction of development rebate, subject to fulfilment of certain conditions in respect of previous year in which the ship was acquired or the plant and machinery was installed or, if it is first put to use in the immediately succeeding previous year, then, in respect of that previous year. According to sub-section (2) of the said section, the actual allowance in the relevant assessment year is to the extent to reduce the total income as referred to therein, to *nil* and the balance, if any, is allowed in the same way in the following year or years but no portion of the unabsorbed rebate is to be carried forward for more than eight assessment years immediately succeeding the relevant assessment year. Section 34(3)(*a*), *inter alia*, provides that deduction of development rebate under section 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[30] and credited to the reserve account.

3. After considering various aspects of the matter, the Board have decided that the requirements of the provisions of sections 33 and 34(3)(*a*) will be considered to have been satisfied if the accumulated reserve in respect of the said machinery or plant up to the year or years of actual allowance is equal to 75 per cent. of the amount of development rebate to be actually allowed. This would mean that the condition for creation of requisite reserve would stand satisfied if the sum total of the reserve created either in the year of installation or use or in the subsequent year or years is equal to the requisite amount of 75 per cent. of the actual allowance of development rebate in any year or years.

4. Necessary instructions may be issued to the Income-tax Officers to complete the pending assessments on the lines indicated above. Past assessments should also be reviewed and the above noted stand be taken in the pending appeals." [*Circular No. 259, dated 11th July, 1979*].

Development rebate reserve amount should be available for use in the business of the assessee for a period of eight years.—The amount in the reserve account is to be utilised by the assessee, during a period of eight years next following, for the purposes of the business of the assessee. This reserve amount cannot be diverted for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of an asset outside India [*CIT v. Calcutta Tramways Co. Ltd.,* (1978) 112 ITR 643, 648 (Cal); *Vikram Mills Ltd. v. ITO,* (1976) 105 ITR 423, 429 (Guj)]. As the reserve is to be created at the end of the year when accounts are finalised, any remittance within the year at any time prior to the creation of reserve does not constitute a breach [*CIT v. International Computers Ltd.,* (1981) 131 ITR 1 (Bom)].

It is obvious that the object of the legislature is to allow development of the assessee's business from out of the reserve fund. The entries in the account books required by the section are not an idle formality. The assessee being obliged to credit the reserve fund for a specific purpose, he cannot draw upon the same for purposes other than those of the business [*CIT v. Veeraswami Nainar,* (1965) 55 ITR 35, 39 (Mad); *Indian Overseas Bank Ltd. v. CIT,* (1970) 77 ITR 512 (SC)]. In other words, the amount in reserve should be available to be ploughed back

LexisNexis

30. Now, in this regard, the retrospective amendments made by the Finance Act, 1990, are relevant.

in the business of the assessee's industrial undertaking for a period of at least eight years so as to help producing 'income', whereby the benefit allowed by the revenue, to an extent, comes back to the revenue, and, in addition, the pace of industrialisation increases.

For instance, the reserve may well be utilised for the purpose of repayment of loan taken for purchase of machinery, etc. [*CIT v. Indian Iron & Steel Co. Ltd.,* (1978) 111 ITR 843 (Cal); *CIT v. Indian Iron & Steel Co. Ltd.,* (1978) 113 ITR 810 (Cal)]. Similarly, transfer of the assessee's undertaking itself does not involve utilisation for a purpose other than that of the undertaking so as to entail withdrawal [*Addl. CIT v. Dalmia Magnesite Corporation,* (1979) 117 ITR 930, 942 (Mad), **affirmed in** *CIT v. Dalmia Magnesite Corporation*, (1999) 236 ITR 46 (SC). *Contra:* on its own facts, *Lakshmi Paper Industries v. CIT,* (1977) 109 ITR 447 (Mad)] nor does distribution of surplus assets of a partnership on its dissolution involve utilisation for a prohibited purpose [*Abdul Rehman Haji Miya v. V. P. Minocha,* (1977) 106 ITR 821 (Guj); *Bharat Petroleums v. CIT,* (1979) 116 ITR 75 (Guj)]. Further, a mere merger of the amount standing to the credit of the development rebate reserve with the amount in general reserves does not, by itself, constitute a breach of conditions entailing withdrawal [*Vikram Mills Ltd. v. ITO,* (1976) 105 ITR 423 (Guj); *CIT v. Ganges Manufacturing Co. Ltd.,* (1982) 133 ITR 404 (Cal); *CIT v. Karamchand Premchand Pvt. Ltd.,* (1993) 200 ITR 281, 315-16 (Guj); *CIT v. Karamchand Premchand Pvt. Ltd.,* (1994) 208 ITR 561, 563 (Guj), special leave petition dismissed by the Supreme Court: (1997) 228 ITR (St.) 160 (SC); *Synbiotics Ltd. v. CIT,* (1993) 110 CTR (Guj) 207; *CIT v. Suhrid Geigy Ltd.,* (1993) 110 CTR (Guj) 215; *CIT v. Sarabhai M. Chemicals Pvt. Ltd.,* (1993) 112 Taxation 288 (Guj); *CIT v. Ahmedabad Sarangpur Mills Co. Ltd.,* (1993) 113 Taxation 404 (Guj); *CIT v. Karamchand Premchand Pvt. Ltd.,* (1994) 120 Taxation 88 (Guj); *CIT v. Suhrid Geigy Ltd.,* C.A. Nos. 6532-33 of 1999 : (2000) 241 ITR (St.) 21 (SC)]. Similarly, where development rebate reserve was created in excess of the requisite amount, utilisation of the excess would not tantamount to breach of condition [*CIT v. Malayalam Plantations Ltd.,* (1980) 125 ITR 353 (Ker)]. But where the development rebate reserve was transferred, on the last day of the 8-year-period to the accounts of the partners, it was held that a breach had been committed because the reserve was not kept intact for the full period of eight years [*Leader Engineering Works v. CIT,* (1980) 124 ITR 44 (Punj)].

Where it is shown from the evidence on record that any equivalent or higher amount far in excess of the charged amount found in the development rebate reserve account was in fact utilised at the relevant time by the assessee for permissible business purposes, the mere absence of entries in the development rebate reserve account cannot be held to go against the assessee for negativing his claim for development rebate [*CIT v. Karamchand Premchand Pvt. Ltd.,* (1993) 200 ITR 281, 317 (Guj)]. In the facts of that case, it has been held that the Tribunal was not justified in holding that on acquisition of assets of the value of more than the development rebate reserve, without making any entry in the development rebate reserve account, it could not be held that the same was utilisation of development rebate reserve for the said purpose. Also see*, Synbiotics Ltd. v. CIT,* (1993) 110 CTR (Guj) 207; *CIT v. Sarabhai M. Chemicals Pvt. Ltd.,* (1993) 112 Taxation 288 (Guj); *CIT v. Ahmedabad Sarangpur Mills Co. Ltd.,* (1993) 113 Taxation 404 (Guj).

Period of keeping the development rebate reserve created under the 1922 Act.—Originally, section 10(2)(*vib*) of the 1922 Act enacted that the development rebate reserve should be kept as such for a period of ten years from the end of the relevant previous year. When the provisions were enacted in section 34(3)(*a*) of the 1961 Act, the requisite period of ten years was reduced to a period of eight years only, even in the case of running reserve. The following departmental **circular** clarifies the point:

Development rebate reserve—Utilisation for distribution by way of dividend—Section 34 of the Income-tax Act, 1961 (43 of 1961).—"Section 34(3)(*a*) of the Income-tax Act, 1961 (43 of 1961), provides that the development rebate reserve created by the assessee should not be utilised during a period of eight years next following, for the purpose of distribution by way of dividends or profits, or for remittance outside India or for the creation of any asset outside India. The period of restriction for the use of the development rebate reserve for purposes of distribution of dividends, etc., which is 8 years under the Income-tax Act, 1961 (43 of 1961), was fixed at ten years under the Income-tax Act, 1922 (11 of 1922).

2. A question has been raised whether the limit of eight years prescribed under the Income-tax Act, 1961 (43 of 1961), would also apply in cases where the development rebate reserve was created prior to 1-4-1962 when the Income-tax Act, 1922 (11 of 1922), was operative, and under which Act the period for the retention of the development rebate reserve was ten years.

3. The answer to the above question is provided by section 155(5) of the Income-tax Act, 1961 (43 of 1961), itself. It will be seen that that section, *in terms,* postulates the withdrawal of development rebate if the assessee commits a default of the stipulated conditions within 8 years of the period specified in that sub-section in *all cases,* that is, irrespective of the assessment year in which the development rebate had been allowed. As such, the conditions subject to which development rebate had been granted under the Act of 1922 need to be fulfilled only for a period of 8 years and not for a period of 10 years as specified in section 10(2)(*vib*) of the Act of 1922." [*Circular No. 8-P* (*XIX-18*) *of 1968, dated 17-8-1968*].

Questions of law.—These were held to be questions of law:—

(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in affirming the order of the Appellate Assistant Commissioner directing the Income-tax Officer to allow development rebate even when no development rebate reserve had been created by the assessee?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in directing that the development rebate should be computed and carried forward to be allowed as a deduction in the year in which there are profits? [*CIT v. Dabriwala Steel & Engineering Co. Ltd.,* (1989) 177 ITR 290 (Punj)].

Withdrawal of the allowed development rebate.—Apart from the condition of creation of a development rebate reserve for proper allowance and deduction of the admissible rebate, there are two further conditions prescribed in section 34(3). Firstly, the ship or the machinery or plant in respect of which development rebate has been allowed is not sold or otherwise transferred by the assessee within a period of eight years from the end of the relevant previous year of acquisition or installation, as the case may be. *Secondly,* the development rebate reserve amount is allowed, for a similar period of eight years next following the relevant previous year wherein the reserve was created, to stand as such and be available to the business of the assessee.

In the facts of *CIT v. Smt. Tara Sarup* [(1991) 188 ITR 783, 786 (Bom)], the provisions of section 34(3)(*b*) were held not attracted.

In case there is a breach by the assessee of any of these two conditions, that is,—

—either the assessee sells or otherwise transfers the asset within the prescribed period, or

—utilises the amount credited to the reserve account for distribution by way of dividends or profits; or for remittance outside India as profits or for creation of any asset outside India; or for any purpose other than that for the business of the undertaking,

section 155(5), which is a procedural provision, provides that the development rebate originally allowed shall be deemed to have been wrongly allowed. In such circumstances, the Assessing Officer (upto 31-3-1988, Income-tax Officer) shall recompute the total income of the assessee, for the relevant previous year or years and make necessary rectification of the assessment. Such rectification may be made within a period of four years from the end of the previous year in which the sale or transfer took place or the money was so utilised, as the case may be [*Malabar Fisheries Co. v. CIT,* (1979) 120 ITR 49, 54 (SC)].

If, however, before the actual allowance, the Income-tax Officer comes to know that the asset has been sold or otherwise transferred in contravention of section 34(3)(*b*), the Income-tax Officer, instead of allowing it and then by rectification withdrawing the same, may outright refuse to allow it [*CIT v. Sayaji Mills Ltd.,* (1974) 94 ITR 26 (Guj); *CIT v. Indian Motors Transport Co. (P.) Ltd.,* (1974) 95 ITR 73 (Punj); *N. Ramaswami Udayar v. CIT,* (1979) 116 ITR 493 (Mad)]. The purpose of the sale or transfer is not relevant in this context [*Surrendra Overseas Ltd. v. CIT,* (1979) 120 ITR 872 (Cal)]. The decision in *CIT v. Indian Motors Transport Co.* (*P.*) *Ltd.* [(1974) 95 ITR 73 (Punj)] has been **affirmed** by the Supreme Court in *Indian Motors Transport P. Ltd. v. CIT* [(1985) 156 ITR 489 (SC)], where it has been held that if before the completion of the assessment the asset concerned is sold or otherwise transferred, the Income-tax Officer can outright refuse to allow the development rebate instead of first allowing and then withdrawing. In view of the above Supreme Court ruling, the Gujarat ruling in *Bharat Petroleums v. CIT* [(1979) 116 ITR 75 (Guj)] is no more good law.

Similarly, where the utilisation by the assessee for the purposes of the undertaking becomes impossible, before assessment, due to supervening circumstances, the Income-tax Officer may outright disallow the claim [*Addl. CIT v. Dalmia Magnesite Corporation,* (1979) 117 ITR 930, 944 (Mad), **affirmed in** *CIT v. Dalmia Magnesite Corporation*, (1999) 236 ITR 46 (SC)]. The conversion of a proprietary business owning assets into a company is one such supervening circumstance [*CIT v. Somendra Kumar Neogi,* (1981) 131 ITR 592 (Cal)], as also where the firm was dissolved and machinery was sold to some of the partners [*Lakshmi Paper Industries v. CIT,* (1977) 109 ITR 447 (Mad)].

A contrary view has, however, been taken by the Gujarat High Court in *Bharat Petroleums v. CIT* [(1979) 116 ITR 75 (Guj)], where it has been held that the development rebate must be allowed once and thereafter it may be withdrawn.

In the context of the provisions of sections 33 and 34, the contention on behalf of the assessee that unless there is a transfer of a specific asset in respect of which development rebate was availed of by the assessee, the provisions of section 34(3)(*b*) are not attracted in the case of transfer of undertaking as a whole, is not well founded. The analogy of provisions of section 41(2) (operative upto assessment year 1987-88) or section 269C cannot be pressed into service. The provision of section 34(3)(*b*) is not confined to transfer by sale necessarily linked with consideration. For attracting the provisions of section 34(3)(*b*), it is enough that the ownership of the assessee in the asset is transferred to any other person subject to exceptions carved out in the statute at any time before the expiry of the period of eight years [*Kalindi Investment P. Ltd. v. CIT,* (1995) 213 ITR 207, 216 (Guj), **followed in** *CIT v. Fabriquip P. Ltd.,* (2003) 260 ITR 207, 211 (Guj)].

LexisNexis

In fact, the transfer of the amounts standing to the credit of development rebate reserve to the share capital account, does not involve any disbursement of money by the company. Nothing comes out of the till of the company to the shareholder. The entire amount of money shown as development rebate reserve is retained by the company in another account. It cannot be said that by the issue of bonus shares, the company had distributed its reserve fund to the shareholders even though it had retained the entire amount with it in the share capital account. Further, issuance of bonus shares by the company does not amount to distribution of accumulated profit of a company. The shareholder derives some benefit by the process of capitalising of the accumulated profits but at the same time, the value of his original shareholding goes down. Viewed from any angle, it cannot be said that in this case, the assessee-company had distributed any part of its development rebate reserve fund when it issued the bonus shares. The accumulated profit lying to the credit of the development rebate reserve has been retained by the company. The amount has been transferred to the share capital account. If that was not done the intrinsic value of the shares held by the shareholders would have been more. After the issue of the bonus shares, the intrinsic value of the original shares has gone down rateably. The accumulated profits of the company have remained with the company in one account or another. In that view of the matter, the issue of bonus shares in the facts of this case did not amount to distribution of accumulated profits of the company shown as development rebate reserve fund [*Hunsur Plywood Works Ltd. v. CIT,* (1998) 229 ITR 112, 118, 119, 120 (SC), **reversing** *CIT v. Hunsur Plywood Works Pr. Ltd.,* (1986) 161 ITR 639 (Karn)].

Utilisation must be by the same assessee.—Having regard to the words 'which is owned by the assessee and is wholly used for the purposes of the business carried on by him', in section 33(1)(*a*), it must be held that the benefit of development rebate is available only to the assessee, which is owning the machinery or plant and is using it wholly for the purpose of the business carried on by him. Similarly, in section 34(3)(*a*), the words used are 'to be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking'. The grant of development rebate under section 33(1)(*a*) is subject to the conditions laid down in section 34(3)(*a*), which means that the assessee who has obtained the development rebate under section 33(1)(*a*) must also be the assessee who should utilise the amount credited to the reserve account during the period of eight years next following for the purpose of the business of the undertaking for which the development rebate was given. In other words, the expression 'by the assessee' in these provisions refers to the **same assessee**. The condition for grant of rebate under section 33 read with section 34(3)(*a*) would not be satisfied if the assessee who has availed of the rebate ceases to exist before the expiry of the period of eight years [*South India Steel Rolling Mills v. CIT,* (1997) 224 ITR 654, 660-61 (SC) **affirming** *South India Steel Rolling Mills v. CIT,* (1982) 135 ITR 322 (Mad)]. In the facts of this case, it has been held that since the firm which had been granted the development rebate had been dissolved and ceased to exist before the expiry of eight years, the development rebate was liable to be withdrawn even though the business of the dissolved firm was continued by a new firm constituted by the surviving partner and the legal representative of the deceased partner. Also see, *CIT v. S. Balasubramanian,* (1998) 230 ITR 934, 942-43 (SC).

Sale, etc., entails withdrawal only where it is voluntary.—The words used in section 34(3)(*b*) and section 155(5) are "sold or otherwise transferred by the assessee". These words make it clear that the sale or transfer shall entail withdrawal of rebate only where it is voluntarily made by the assessee himself. Transfers effected under court orders or similar compulsion do not entail the harm of withdrawal [*Addl. CIT v. Dalmia Magnesite Corporation,* (1979) 117 ITR 930, 941-42 (Mad), **affirmed in** *CIT v. Dalmia Magnesite Corporation*, (1999) 236 ITR 46 (SC)]. It may, however, be noted that "compulsory acquisition.....under any law" has specifically been included in the definition of "transfer" in section 2(47).

Sold or otherwise transferred—implication of.—The expression "sold" as used here has no special definition. It is, therefore, to be understood in its legal meaning, that is, as defined in section 54 of the Transfer of Property Act, 1882 (4 of 1882). The expression "transfer" has been defined in section 2(47) of the 1961 Act. Therefore, where the occurrence is on or after 1-4-1962, "transfer" in these provisions carries the extended connotation as per section 2(47) [*CIT v. C.M. Kunhammed,* (1974) 94 ITR 179, 184-85 (Ker)].

The expression 'otherwise transferred' is a very wide expression and takes within its sweep transfer of the assets from the assessee to some other person by any means or mode whatsoever. In that view of the matter, where the machineries are transferred to the purchaser of the whole business as a going concern, the provisions of section 34(3)(*b*) read with section 155(5) are attracted so as to justify withdrawal of the development rebate allowed to the assessee-vendor in respect of such machineries [*S.M. Chemicals & Electronics Pvt. Ltd. v. CIT,* (1995) 215 ITR 943, 948-49 (Bom)].

The words 'otherwise transferred' occurring in section 34(3)(*b*) should bear an appropriate meaning, in the context of the main provision, section 33(1)(*a*). Section 34(3)(*b*) is closely linked to section 33(1)(*a*). Keeping in view the purpose for which the relief by way of development rebate is afforded under section 33(1)(*a*), in cases

where the machinery or plant is not wholly used by the assessee for the purpose of business carried on by him, for the specified period, and such user is given over to another, it can be safely stated that the machinery or plant is 'otherwise transferred' by the assessee to another person [*CIT v. Narang Dairy Products,* (1996) 219 ITR 478, 484 (SC)].

Destruction does not involve transfer.—For transfer, the asset must exist on the date when the transfer is said to have taken place. In the event of destruction, the third party, *viz.*, insurance company, does not come into the picture till the destruction has taken place. After the destruction, there is nothing available to transfer. Hence, it is difficult to hold that in the case of destruction or damage, complete or partial or loss of the property, there can be any transfer by the assessee in favour of the third party [*CIT v. Hardelia Chemical Ltd.,* (1995) 212 ITR 68, 71 (Bom)]. In that case, it has been held that development rebate cannot be withdrawn where the plant has been destroyed by fire and the assessee has received compensation for the loss from the insurance company. This was so held **relying on** the Supreme Court ruling in *Vania Silk Mills P. Ltd. v. CIT* [(1991) 191 ITR 647 (SC)].

Illustrations.—*Asset held sold or otherwise transferred.*—(1) Asset owned by a company was transferred to a firm constituted of the shareholders of the company [*Chittoor Motor Transport Co. P. Ltd. v. ITO,* (1966) 59 ITR 238 (SC)].

(2) Asset belonging to a partnership was transferred to some only of its partners [*A. S. Krishna Setty & Sons v. Addl. CIT,* (1975) 100 ITR 587 (Karn)].

(3) Individual owner brings his own asset to the firm whereof he becomes a partner [*A. Abdul Rahim v. CIT,* (1977) 110 ITR 595 (Ker—FB); *Addl. CIT v. M. A. J. Vasanaik,* (1979) 116 ITR 110 (Karn); *CIT v. Suresh Chandra Jain,* (1989) 178 ITR 241 (AP)].

(4) A machinery belonging to the sole proprietor becoming property of the firm as a result of conversion of sole proprietary concern into a partnership [*Baldevji v. CIT,* (1985) 156 ITR 776 (Mad); *CIT v. Shantilal Rugnathji Desai,* (1987) 163 ITR 245 (Guj)]. *Contra*: *CIT v. Vijaya Productions Pr. Ltd.* [(1985) 152 ITR 613 (Mad), special leave petition granted by the Supreme Court: (1984) 146 ITR (St.) 4 (SC), **reversed in** *CIT v. Vijaya Production* (*P.*) *Ltd.*, (2000) 243 ITR 181, 182 (SC)], where the Supreme Court has ruled that conversion of a proprietary concern into a partnership involve a transfer so as to entitle the Officer to withdraw the development rebate allowed], where it was held that such conversion did not involve a transfer.

(5) A lease of the trawler was held resulting in a transfer of a right or interest in the trawler [*Blue Bay Fisheries* (*P.*) *Ltd. v. CIT,* (1987) 166 ITR 1 (Ker), **approved in** *CIT v. Narang Dairy Products,* (1996) 219 ITR 478, 484 (SC)].

(6) After the death of the sole proprietor of a business some of his heirs carried on that proprietary business as a partnership business. Held, there was involved a 'transfer' of the proprietary business within the meaning of section 2(47) so as to attract the withdrawal provisions contained in section 34(3)(*a*) read with section 155(5) [*CIT v. Smt. Malatibai M. Karajgar,* (1993) 202 ITR 835, 839 (Bom)].

(7) All assets including the machineries and all liabilities of a two-partner firm were taken over by and vested in a three-partner firm, wherein the earlier two partners continued—held, transfer was involved so as to permit withdrawal of development rebate [*Asmaco v. CIT,* (1995) 216 ITR 67, 71 (Bom)].

(8) Machinery given on hire does amount to transfer within the meaning of section 34(3)(*b*) so as to justify withdrawal of development rebate [*CIT v. Narang Dairy Products,* (1996) 219 ITR 478, 484 (SC)].

(9) Where the assets belonging to the assessee-HUF were taken over by the partnership firm, there was transfer otherwise as contemplated under sections 34(3)(*b*) and 155(5) resulting in the withdrawal of development rebate already granted in favour of the HUF [*CIT v. P.K. Ramaswamy Raja,* (1997) 223 ITR 324, 332 (Mad)].

(10) Machinery, in respect of which development rebate was granted to the HUF, was allotted to a coparcener as a result of a partial partition and the machinery so allotted to the coparcener was sold by him to the third party within 8 years, held withdrawal of development rebate was justified [*CIT v. S. Balasubramanian,* (1998) 230 ITR 934, 942-43 (SC), **reversing** *CIT v. S. Balasubramanian,* (1982) 138 ITR 815 (Mad)]. In view of the above Supreme Court ruling, the decision in *CIT v. M.V.S. Sastry* [(1986) 157 ITR 543 (Mad)] **does not lay down the correct law on the point.**

Also see, *CIT v. Gears and Pinions P. Ltd.,* SLP (Civil) No. 5965 of 1984: (1991) 187 ITR (St.) 70 (SC).

Asset held not to have been sold or otherwise transferred.—(1) Partnership was constituted of three kartas, two families whereof were partitioned. The firm was accordingly reconstituted having the old one *karta* and the separated members of the two families—Held, the asset belonging to the old firm having now come to the reconstituted firm did not involve a transfer [*CIT v. Sree Kaliswari Colour Match Works,* (1978) 112 ITR 346 (Mad)].

LexisNexis

(2) Distribution, division or allotment of assets of a firm amongst partners consequent upon the dissolution of the firm does not amount to "transfer" because it does not result in any "extinguishment of the firm's right" in the partnership assets [*Malabar Fisheries Co. v. CIT,* (1979) 120 ITR 49 (SC); *CIT v. Nataraj Motor Service,* (1972) 86 ITR 109 (Ker); *Meghdoot Electrical Corporation v. Addl. CIT,* (1979) 116 ITR 400 (Karn); *Loksatta Karyalaya v. T. K. Jorge Kutty,* (1979) Tax LR 1208 (Guj); *Abdul Rehman Haji Miya v. V.P. Minocha,* (1977) 106 ITR 821 (Guj); *Laxmi Weaving Factory v. Addl. CIT,* (1979) 116 ITR 80 (Guj); *Bharat Petroleums v. CIT,* (1979) 116 ITR 75 (Guj); *G. N. Khanna v. CWT,* (1980) 122 ITR 932 (All); *CIT v. Shobhana Silk Mills,* (1992) 196 ITR 775, 776 (Bom); *CIT v. Layallpur Engineering Co.,* (1993) 202 ITR 332, 339 (All); *CIT v. Jain Bros.,* (1994) 73 Taxman 523, 524 (Bom)]. Also see, *CIT v. Fluid Controls Mfg. Co.,* (2006) 280 ITR 86 (Guj).

(3) Partition of HUF assets does not involve 'transfer' [*CIT v. S. Balasubramanian,* (1998) 230 ITR 934, 940-41 (SC); *CIT v. S. Krishna Rao,* (1985) 154 ITR 643 (AP); *CIT v. N. T. Ramarao* (*HUF*), (1987) 163 ITR 453 (AP)]. But, any subsequent sale or transfer by the divided member to whom the asset was allotted is material or relevant for the purpose of withdrawal of the rebate [*CIT v. S. Balasubramanian,* (1998) 230 ITR 934, 942-43 (SC), **reversing** *CIT v. S. Balasubramanian,* (1982) 138 ITR 815 (Mad)].

Also see, *CIT v. Lakshmi Flour Mills,* SLP (Civil) Nos. 9084-9092 of 1982: (1984) 150 ITR (St.) 80 (SC).

It may be noted that reconstitution of a firm by retirement of a partner is not the same thing as the dissolution of a firm and, if development rebate-granted assets are allotted to the retiring partner, that would constitute a "transfer" as it results in the extinguishment of the rights of the firm in these assets.

Partner bringing in or taking out an asset into or from the firm—whether sale?—Under the general principles of law, when a partner brings in, or takes out, any asset into or from his partnership firm no sale is involved [see, *CIT v. Dewas Cine Corporation,* (1968) 68 ITR 240 (SC); *CIT v. Bankey Lal Vaidya,* (1971) 79 ITR 594 (SC); *CIT v. Hind Construction Ltd.,* (1972) 83 ITR 211 (SC); *CIT v. Nataraj Motor Service,* (1972) 86 ITR 109 (Ker); *Kay Engineering Co. v. CIT,* (1971) 82 ITR 950 (Punj); *Abdul Rehman Haji Miya v. V.P. Minocha,* (1977) 106 ITR 821 (Guj)]. But the 1961 Act introduced a definition for the word 'transfer', in section 2(47), to include "the sale, exchange or relinquishment of the asset or *the extinguishment of any right therein* or the compulsory acquisition thereof under any law". As this definition came into effect on and from 1-4-1962, transactions done before that date do not come within this definition and are governed by the general principles of law [*CIT v. C. M. Kunhammed,* (1974) 94 ITR 179 (Ker)]. Transactions whereby a partner brings in, or takes away, a capital asset, into or from the partnership firm on or after 1st April, 1962, may be construed as transfers to or by the firm [*A. Abdul Rahim v. CIT,* (1977) 110 ITR 595 (Ker—FB); *CIT v. Kartikey V. Sarabhai,* (1981) 131 ITR 42 (Guj), **affirmed, on this point in** (1985) 156 ITR 509 (SC)].

Thus, on conversion of a proprietary concern of the assessee into a firm, there is involved a transfer. In that view of the matter, withdrawal of development rebate already granted in respect of machinery and plant employed in the proprietary concern of the assessee which the assessee brought into the partnership within the period of eight years has been held justified by invoking the provisions of section 155(5) [*D.S. Joshi v. CIT,* (1991) 191 ITR 302, 304-05 (Bom), **applying,** *Sunil Siddharthbhai v. CIT,* (1985) 156 ITR 509 (SC); *Tarun Bhai v. CIT,* (1992) 193 ITR 543 (All)].

Circumstances providing exceptions to the rule of withdrawal.—The rule of withdrawal of the allowed development rebate shall not, however, come into operation in the extenuating circumstances specified in the proviso to section 34(3) and section 155(5). They are as follows:—

I. In case the asset is sold or otherwise transferred by the assessee within the requisite period of eight years, if the sale, etc., is to—

—the Government,

—a local authority,

—a corporation established by a Central, State or Provincial Act, or

—a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956)[31];

and also

—if the sale, etc., is in connection with any amalgamation or succession referred to in sections 33(3) and 33(4), respectively [see, *Kay Engineering Co. v. CIT,* (1971) 82 ITR 950 (Punj)].

Also see, *CIT v. Hindustan Petroleum Corporation Ltd.,* SLP (Civil) Nos. 8226-8232 of 1987: (1989) 180 ITR (St.) 38 (SC) (a Government undertaking taking over the business of the assessee).

II. In case the amount of the development rebate reserve is, at any time within the requisite period of eight years, utilised by the assessee not—

—for distribution by way of dividends or profit, or

31. Repealed and replaced by Act 18 of 2013.

LexisNexis

—for remittance outside India as profits, or

—for the creation of any asset outside India,

but for the purposes of the business of the undertaking from out of which income the allowance was originally made.

In either of the two circumstances, the rule of withdrawal of the allowed development rebate shall not come into operation.

In *CIT v. Hemantpat Singhania* (*HUF*) [(1991) 188 ITR 618, 620-21 (All)], the transfer of the development rebate reserve to the capital account has been held to be for purposes of the assessee's business, not amounting to violation of any of the conditions prescribed in section 34(3)(*a*).

In *CIT v. Shobhana Silk Mills* [(1992) 196 ITR 775, 776 (Bom)], it has been held that the division of the development rebate reserve among the partners on the dissolution of the firm did not amount to utilisation thereof for a purpose which was not the purpose of the business of the undertaking within the meaning of section 155(5)(*ii*)(*c*).

The following two **departmental circulars** are relevant on the point:—

I. *Development rebate allowed in respect of asset sold to Government.*—"There is an impression that the development rebate allowed in respect of an asset sold to the Government will not be withdrawn even if the vendor credits to the Profit and Loss Account the reserve which he had originally created to qualify for the grant of the rebate. This is wrong as clarified below.

2. Section 34(3)(*a*) of the Income-tax Act, 1961, provides, *inter alia*, that development rebate shall be allowed only if in addition to certain other requirements, the following two conditions are also satisfied:—

(*i*) An amount equal to 75% of the development rebate to be actually allowed is debited to the Profit and Loss Account and credited to a reserve account. The reserve so created is not to be utilised for a period of 8 years either for distribution by way of dividends or profits, or for remittance outside India as profits, or for creation of any asset outside India, and

(*ii*) the machinery or plant in respect of which development rebate has been allowed is not to be sold or otherwise transferred for a period of 8 years.

3. Under proviso to section 34(3)(*b*), the transfer or sale of the asset will not be penalised in certain circumstances. However, while claiming protection under this proviso in respect of the development rebate already allowed on the ground that the second condition should not be enforced, the assessee cannot claim that the first condition, too, namely, that the amount of the development rebate reserve should not be utilised for the distribution of dividends or profits, should also not be enforced. Even if the asset is not sold or transferred at all but continues to remain with the original owner, he, too, would forfeit the development rebate allowance in the event of a violation of the first condition. Merely because the violation of the second condition is condoned in certain circumstances by virtue of the proviso to section 34(3)(*b*), it does not follow that, in those cases, the violation of the first condition also stands condoned. Thus, if this condition is violated, the development rebate already allowed to the assessee, will have to be withdrawn." [*Circular No. 26, dated 6th August, 1969*].

II. *Development rebate allowed in respect of assets sold to the Government—Clarification regarding.*—"In para. 1.45 of their 100th report (1969-70), the Public Accounts Committee have observed as follows:

'The Government are yet to clarify to the public, whether a party would forfeit the development rebate when the entire assets are sold to Government and the development rebate reserve cannot stand as such in his books. The Committee trust the Government will take suitable action at an early date.'.

2. Section 34(3)(*a*) of the Income-tax Act, 1961, provides, *inter alia*, that development rebate shall be allowed only if in addition to certain other requirements, an amount equal to 75% of the development rebate to be actually allowed is to be debited to the profit and loss account and credited to a reserve account. The reserve so created is not to be utilised for a period of 8 years either for distribution by way of dividends or profits or for remittance outside India as profits or for creation of any asset outside India. When an assessee sells his entire assets to the Government, the development rebate reserve created on such assets cannot stand as such in his books. The development rebate reserve account would then be closed by transfer to the capital account of the proprietor. If the sale takes place within 8 years of the previous year when the development rebate (*sic*) was created and the reserve is credited to the proprietor's capital account, it would amount to utilisation of the reserve for distribution by way of profit to the proprietor under section 34(3)(*a*)(*i*) of the Income-tax Act, 1961.

3. These instructions may please be brought to the notice of the Income-tax Officers working in your charge." [*Circular No. 40, dated 11th May, 1970*].

Provisions including those for withdrawal are not *ultra vires*.—The provisions of section 10(2)(*vi-b*) of the 1922 Act, which correspond to section 33/34 of the 1961 Act, do not violate Article 14 of the Constitution of India. The legislature has directed the giving of a rebate on conditions which are exactly the same for every

LexisNexis

assessee, one condition being that if the assessee sells, within a period of ten years under the 1922 Act or eight years under the 1961 Act from the end of the previous year in which the asset was acquired, the asset to a person other than the Government, he would forfeit the development rebate allowed to him in respect of the asset. This condition is applicable to every assessee and an assessee has a choice of either selling the asset to the Government and keep the allowance benefit already granted to him or to sell it to some other person and get the rebate forfeited [*Chittoor Motor Transport Co.* (*P.*) *Ltd. v. ITO,* (1966) 59 ITR 238 (SC)].

Remand to High Court.—As section 34(1) stood omitted (w. e. f. 1-4-1988), in *Joint CIT v. United Phosphorous Ltd.* [(2008) 299 ITR 9 (SC)], regarding whether the assessee had an option in law to claim partial depreciation in respect of any block of assets, the Supreme Court has remanded the matter to the High Court for fresh consideration.

LexisNexis

Omitted/Phased-out provisions of section 34A of the 1961 Act

[1][**S. 34A. Restriction on unabsorbed depreciation and unabsorbed investment allowance for limited period in case of certain domestic companies.—**](1) In computing the profits and gains of the business of a domestic company in relation to the previous year relevant to the assessment year commencing on the 1-4-1992, where effect is to be given to the unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before the 1-4-1991, the deduction shall be restricted to two-thirds of such allowance or allowances and the balance,—

(*a*) where it relates to depreciation allowance, be added to the depreciation allowance for the previous year relevant to the assessment year commencing on the 1-4-1993, and be 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;

(*b*) where it relates to investment allowance, be carried forward to the assessment year commencing on the 1-4-1993, and the balance of the investment allowance, if any, still outstanding shall be carried forward to the following assessment year and where the period of eight years has expired before the portion of such balance is adjusted, the said period shall be extended beyond eight years till such time the portion of the said balance is absorbed in the profits and gains of the business of the domestic company.

(2) For the assessment year commencing on the 1-4-1992, the provisions of sub-section (2) of section 32 and sub-section (3) of section 32A shall apply to the extent such provisions are not inconsistent with the provisions of sub-section (1) of this section.

(3) Nothing contained in sub-section (1) shall apply where the amount of unabsorbed depreciation allowance or of the unabsorbed investment allowance, as the case may be, or the aggregate amount of such allowances in the case of a domestic company is less than one lakh rupees.

(4) Nothing contained in sections 234B and 234C shall apply to any shortfall in the payment of any tax due on the assessed tax or, as the case may be, returned income where such shortfall is on account of restricting the amount of depreciation allowance or investment allowance under this section and the assessee has paid the amount of shortfall before furnishing the return of income under sub-section (1) of section 139.]

LexisNexis

Introduction under 1961 Act.—*The Finance Act, 1992.*—By **the Finance Act, 1992** (18 of 1992), **section 34A** has been **inserted** (**w. e. f. 1-4-1992**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 636, dated 31-8-1992*, as follows:—

'*Deferment of unabsorbed carried forward depreciation and investment allowance.*—**28.** Under the existing provisions of Income-tax Act, unabsorbed depreciation allowance and unabsorbed investment allowance are allowed as deductions in the computation of income from business or profession.

28.1 The Finance Act, 1992 (18 of 1992), has introduced a new section 34A in the Income-tax Act to provide that in the case of domestic companies, only sixty-six and two-third per cent. of unabsorbed depreciation allowance or unabsorbed investment allowance or the aggregate of such allowances carried forward from earlier years shall be allowed to be deducted from the business income and the balance shall be carried forward and allowed in the subsequent years until the same is absorbed. However, to ensure that marginal cases are not affected, the operation of this amendment has been restricted only to cases where such brought forward allowance is ₹ 1,00,000 or more.

28.2 The provisions relating to charging of interest under sections 234B and 234C of the Income-tax Act will not apply to any shortfall in the payment of any tax due on the assessed income or returned income where such shortfall is due to the restriction on the quantum of unabsorbed depreciation or investment allowance and the assessee has made good the shortfall by paying the amount before filing the return of income under section 139(1).

28.3 This amendment will take effect from 1-4-1992, and will, accordingly, apply in relation to the assessment year 1992-93 only. [*Section 13*]'.

In case of a domestic company, set-off to the extent of 2/3rds of the unabsorbed depreciation and/or unabsorbed investment allowance to be allowed in A.Y. 1992-93—section 34A.—The provisions of **section 34A(1)** contemplate a situation where,—

---

1. Section 34A has been inserted by the Finance Act, 1992 (18 of 1992), s. 13 (w. e. f. 1-4-1992).

—in computing the profits and gains of the business of a domestic company in relation to the previous year relevant to assessment year 1992-93,

—effect is to be given to the unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to assessment year 1991-92 or any earlier assessment year.

In such a situation, for the assessment year 1992-93, the deduction shall be restricted to 2/3rds of such allowance or allowances and the balance,—

—where it relates to depreciation allowance, be added to the depreciation allowance for the previous year relevant to the assessment year 1993-94 and be 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;

—where it relates to investment allowance, be carried forward to the assessment year 1993-94 and the balance of the investment allowance, if any, still outstanding shall be carried forward to the following assessment year and where the period of eight years has expired before the portion of such balance is adjusted, the said period shall be extended beyond eight years till such time the portion of the said balance is absorbed in the profits and gains of the business of the domestic company.

Extent of the applicability of the provisions of sections 32(2) and 32A(3).—According to **section 34A(2)**, for the assessment year 1992-93, the provisions of sections 32(2) and 32A(3) shall apply to the extent such provisions are not inconsistent with the provisions of section 34A(1).

Section 34A(1), when not to apply.—Section 34A(3) provides that nothing contained in section 34A(1) shall apply where the amount of unabsorbed depreciation allowance or of the unabsorbed investment allowance, as the case may be, or the aggregate amount of such allowances in the case of a domestic company is less than Rs. 1,00,000.

Section 34A restricts the unabsorbed depreciation and unabsorbed investment allowance for limited period, in the case of certain domestic companies. The said provision was introduced by the Legislature w. e. f. 1-4-1992 and, in the instant case, it has been held that the set off of unabsorbed income should be restricted to the extent of two-thirds [*CIT v. Kunal Engineering Co. Ltd*., (2010) 325 ITR 328 (Mad)].

Sections 234B and 234C not to apply in certain cases.—As provided in **section 34A(4)**, nothing contained in sections 234B and 234C shall apply to any shortfall in the payment of any tax due on the assessed tax or, as the case may be, returned income where such shortfall is on account of restricting the amount of depreciation allowance or investment allowance under this section and the assessee has paid the amount of shortfall before furnishing the return of income under section 139(1).

Remand to AO.—In *CIT v. Madras Forging & Allied Industries* (*CBE*) *Ltd.* [(2014) 369 ITR 552, 557 (Mad)], **following** *CIT v. Kisan Engineering Works Ltd.* [(2013) 358 ITR 510] it has been held that the matter is remitted back to the AO to recompute the unabsorbed depreciation.

LexisNexis

Omitted/Phased-out provisions of section 35 of the 1961 Act

Capital asset used for scientific research—cessation of such use—terminal allowance, how allowable?—Clauses (*ii*) and (*iii*) of section 35(2) of the 1961 Act have application when an asset used for scientific research was purchased, or a capital expenditure was incurred therefor, before 1-4-1967. Suppose, such an asset was purchased for ₹ 20,000 in November, 1965, and was, since then, used in relation to scientific research related to assessee's business. For assessment years 1966-67, 1967-68 and 1968-69, a total sum of ₹ 12,000 was allowed deduction under section 35(2)(*i*) of the 1961 Act. It ceased to be used for scientific research related to assessee's business on and from 1-6-1968, when its value was ₹ 5,000. Section 35(2)(*ii*) of the 1961 Act provides that the deficiency of ₹ 3,000 [₹ 20,000 *minus* (₹ 5,000 + ₹ 12,000)] shall be allowed deduction, for the assessment year 1969-70, as terminal allowance.

Clause (*iii*) has application, *inter alia*, where the asset is, after cessation of its use and deduction of terminal allowance in respect thereof having been allowed under section 35(2)(*ii*) of the 1961 Act, sold away without it having been used for any other purpose. In such a case, a further terminal allowance is deductible in the year in which the sale took place, the extent of which is the deficit between the value adopted for section 35(2)(*ii*) of the 1961 Act and the actual sale price. In the above example, if the asset was sold for ₹ 3,500 in September, 1970, the terminal allowance deductible under section 35(2)(*iii*) of the 1961 Act shall be ₹ 1,500 [₹ 5,000 *minus* ₹ 3,500], for the assessment year 1971-72.

In *CIT v. Indian Telephone Industries*, SLP (Civil) Nos. 834-837 of 1994: (1994) 206 ITR (St.) 275 (SC), their Lordships of the Supreme Court have, by an order dated 3-1-1994, granted special leave to the Department to appeal against the judgment dated 16-9-1992 of the Karnataka High Court in I.T.R.C. No. 36 of 1990 whereby the High Court on a reference held that the assessee was entitled to the allowance under section 35(2)(*iii*) of the 1961 Act on assets purchased out of grant-in-aid from the Government.

Allowability of depreciation on an asset used for business after it ceases to be used for scientific research.—Section 35(2)(*v*) of the 1961 Act provides that where the asset mentioned in section 35(2)(*ii*) of the 1961 Act is used in the business after it ceases to be used for scientific research, depreciation in respect thereof may be allowable.

Deduction of certain sum paid to scientific research associations, universities, colleges or other institutions or a public sector company for scientific research undertaken under an approved programme having regard to the social, economic and industrial needs of India [s. 35(2A) of 1961 Act].—Section 35(2A) of the 1961 Act, which had been **inserted** (**w. e. f. 1-4-1974**) by **the Direct Taxes (Amendment) Act, 1974** (26 of 1974), granted a weighted deduction equal to 1⅓ times the sum paid, between 1-4-1973 and 29-2-1984, by an assessee to a—

—scientific research association, etc., approved for the purposes of section 35(1)(*ii*) of the 1961 Act, or

—(**w. e. f. 1-9-1980**) *public sector company* [as defined in *Explanation (b)* below section 32A(2B) of the 1961 Act],

in computing the taxable profits of the assessee. Such weighted deduction was to be allowed only if the sum so paid was to be used for a scientific research programme approved by the prescribed authority [*i.e.*, Secretary to the Government of India, Department of Science & Technology or any other officer of that Department nominated by him in this behalf] in this behalf, having regard to the social, economic and industrial needs of India. As a result of the amendment of **section 35(2A)** of the 1961 Act by **the Finance Act, 1983** (11 of 1983), **with effect from 1-4-1984**, such weighted deduction was to be allowed only if the sum is paid by the assessee with a specific direction that the sum shall not be used for acquisition of any land or building or construction of any building. Further, where a weighted deduction had been allowed under section 35(2A) of the 1961 Act, no deduction in respect of the same sum is to be allowed under section 35(1)(*ii*) of the 1961 Act.

In the facts of *CIT v. Khosala Metal Powder Pvt. Ltd.*, (1994) 208 ITR 115 (Bom), the assessee was held entitled to weighted deduction under section 35(2A) of the 1961 Act in respect of the donations of ₹ 15 lakhs given in the calendar year 1974, relevant to the assessment year 1975-76, even though the programmes of the University of Poona had been approved by the Department of Science and Technology, New Delhi, only after the dates of donation and on 9-12-1975.

Assessee failed to produce the certificate which is one of the condition precedent to grant deduction under section 35(2A) of the 1961 Act and, therefore, denial of deduction to the assessee justified [*Ganapathy & Co. v. CIT*, (2016) 381 ITR 363, 387 (SC) = (2016) 283 CTR (SC) 121].

In a nutshell, the weighted deduction under section 35(2A) of the 1961 Act has been discontinued in relation to the sums paid after 29-2-1984.

Approval of scientific research programme under section 35(2A).—The following *Circular No. 294, dated 27-2-1981* clarifies the procedure, etc., for obtaining requisite approval under section 35(2A):—

LexisNexis

"Section 35(2A) provides that where the assessee pays any sum to a scientific research association or university or college or other institution referred to in section 35(1)(*ii*) or to a public sector company to be utilised for scientific research undertaken under a programme approved in this behalf by the prescribed authority having regard to the social, economic and industrial needs of India, then, there shall be allowed a deduction of a sum equal to one and one-third times the sum so paid.

2. Notifications under section 35(2A) are issued by the Ministry of Finance on the basis of the recommendation of the prescribed authority, containing, *inter alia*, the details of the research programme, the name of the sponsors, the name of the institution conducting the research and the total estimated cost of the project of the research programme. A question has been raised as to whether in a case where research programme has already been approved, notified payments made by persons other than the original sponsors mentioned in the notification to the research programme can also qualify for weighted deduction or not. The Board have been advised that the approval under section 35(2A) is of the "research programme" and not of the sponsors and, therefore, any person other than the original sponsors making payments to the approved research programme can also claim the benefit of weighted deduction provided the amount collected from all the sponsors does not exceed the cost of the particular programme approved by the prescribed authority. However, before allowing the weighted deduction, the ITO shall call for from the sponsors/contributors a certificate issued by the research association/institution certifying, *inter alia*, the amount actually paid by the sponsor/contributor to the research programme as approved and mentioned in the notification and also certifying that the total contribution received from all the sponsors/contributors do not exceed the cost of the programme as approved by the prescribed authority....."

Guidelines for approval of scientific research programmes under section 35(2A) in respect of sponsored research under the category of "other natural or applied sciences" and procedural matters related thereto.—The following guidelines have been issued by the Department of Science and Technology, Government of India, for the approval of scientific research programme:—

"*I. Preamble*

1. The scheme under section 35(2A), which has come into effect from 1st April, 1974, provides that 133⅓ per cent. of the amount paid by an assessee to a scientific research association, university, college or other institution referred to in section 35(1)(*ii*), for the execution of a programme of scientific research, which has been approved in this behalf by the "prescribed authority", having regard to the social, economic and industrial needs of the country, may be treated as expenditure for the calculation of the tax liabilities of the assessee. Under Notification No. 142(41)/74-TPL, dated 2-11-1974, of the Central Board of Direct Taxes, the Secretary to the Government of India, Department of Science and Technology or any other officer of that Department nominated by him in this behalf would be the "prescribed authority" under section 35 in relation to research in the field of "other natural or applied sciences". It has been considered necessary to lay down a set of procedural guidelines, etc., for ensuring smooth implementation of this provision and to define the areas of research which would qualify for approval of programmes under section 35(2A).

2. Secretary, Department of Science and Technology, has examined the matter as the prescribed authority in the field of "other natural or applied sciences" and after careful consideration lays down the following guidelines for purposes of approval of programmes of Scientific Research falling in the aforesaid fields under the provisions of section 35(2A). The guidelines would remain in force until further orders.

II. List of research programmes eligible for approval under section 35(2A) and conditions attendant to such approvals.

3. Any programme of scientific research which aims—

—to create or develop—

(*a*) any new source of energy, which is capable of being commercially exploited, or to improve the efficiency of any existing method of energy generation/distribution;

(*b*) any new source of proteinous/or other nutritional food for human consumption;

—to conserve energy, food or any of the scarce material resources by devising new methods or by improving any of the existing methods of processing/manufacture used in agriculture, industry, etc.;

—to devise new or better techniques for the utilisation or re-cycling of wastes;

—to develop new or better techniques for pollution control/reduction;

—to develop new/improved/cheaper basic drugs/medicines for the treatment of any of the more commonly prevalent human/animal diseases;

—to develop new/improved/cheaper techniques or methods of family planning, which are likely to find wider acceptance among the masses in general;

—to develop new/improved techniques of house-building or construction or discover new building materials with a view to achieve cost reduction, substitution of scarce materials and the like, with special reference to rural areas;

—to develop new/improved/cheaper kinds of fertilisers/other plant nutrients, plant protection chemicals, etc., with a view to achieve greater yield per hectare from agriculture;

—to devise new techniques of manufacture or production of goods which result in substantial conservation of foreign exchange by way of import substitution/ export promotion;

—to achieve such other objectives which the prescribed authority, in its discretion, considers important for the social, economic and industrial needs of India,

would be eligible for being considered for approval under section 35(2A) of the Income-tax Act, 1961.

4. Before a scientific research project/programme is considered for approval under the provisions of section 35(2A) by the prescribed authority, the institution concerned with the implementation of such project/programme would be required to establish that it has necessary facilities and competence for undertaking the proposed research programme.

A programme which relates purely to market research, sales promotion, quality control, testing, commercial production, style changes and routine data collections, etc., would not qualify for being considered for approval.

III. Procedural and other matters

5. All applications for approval of research programmes under the provisions of section 35(2A), which satisfy the above guidelines, may be made to the Secretary to the Government of India, Department of Science and Technology, with a copy to the Central Board of Direct Taxes, New Delhi.

The applications would normally be received from the sponsors of research, who are going to be the beneficiaries of income-tax concessions. However, when a number of assessees intend to sponsor the same programme in the same institution, which is approved by the prescribed authority under section 35(1)(*ii*) for the time being, applications may be entertained from the Research Institution concerned.

LexisNexis

All applications should, *inter alia*, be accompanied by the following particulars/documents:

(*a*) essential profiles of the Scientific Research Programmes proposed to be undertaken and their broad objectives;

(*b*) time phasing of each project or programme;

(*c*) financial outlays for each project or programme;

(*d*) justification in assessee's own terms as to how the Scientific Research Programme in question is considered to be of importance to the social, economic and industrial needs of India;

(*e*) particulars of institutions where the Scientific Research Programmes are proposed to be executed, including number and date of the Government Notification under which the institution is approved under section 35(1)(*ii*);

(*f*) brief details of buildings, equipments, staff and other facilities available in the institution where such programmes are to be carried out;

(*g*) a letter of willingness from the institution to undertake the research work within the specified time-limits and furnishing detailed break-up (in the enclosed format) with justification, of the estimated cost of each project;

(*h*) any other points considered relevant by the applicant.

Letters of approval/rejection would be addressed by the Department of Science and Technology to the applicant concerned, with a copy to the Central Board of Direct Taxes, who will arrange for the issue of a general notification under section 35(2A) and intimate the approval of the prescribed authority to the appropriate Income-tax Officers.

The sponsors/institutions concerned would be responsible for submitting to the Secretary, Department of Science & Technology, in respect of each accounting year, Annual Statements showing progress of implementation of each project, actuals of the expenditure incurred thereon, and other details in such pro forma as may be prescribed and intimated to them for this purpose. A copy of this Annual Return would also be sent by them to the Income-tax Officer having jurisdiction over the Institution.".

ANNEXURE

CONTAINING PARTICULARS OF SCIENTIFIC RESEARCH PROGRAMMES TO BE CONSIDERED FOR APPROVAL UNDER SECTION 35(2A)

Sl. No.	Title of the Research Project (with brief details)	Name(s) and address(es) of the sponsor(s)	Name and address of the implementing laboratory/institution	Estimated Outlay (in ₹)							Grand Total 5(*c*) + 5(*g*)	Proposed date of starting	Proposed date of completion	Relevance of the project for social, economic & industrial needs of India (use separate sheet, if necessary)	Remarks
				Capital			Revenue								
				Land and building	Equipment and machinery	Total	Salaries	Raw materials	Other Items	Total					
1	2	3	4	5(*a*)	5(*b*)	5(*c*)	5(*d*)	5(*e*)	5(*f*)	5(*g*)	6	7	8	9	10

Head of the Laboratory/Institute"

Deduction of certain expenditure incurred on scientific research undertaken under an approved programme having regard to the social, economic and industrial needs of India [s. 35(2B) of 1961 Act].—Section 35(2B) of the 1961 Act, which had been **inserted** (**w. e. f. 1-9-1980**) by **the Finance (No. 2) Act, 1980** (44 of 1980), granted a weighted deduction equal to 1¼ times the expenditure incurred, between 1-9-1980 and 29-2-1984, by an assessee on scientific research undertaken by him under a programme approved in this behalf by the *prescribed authority* [*i.e.*, Secretary to the Government of India, Department of Science & Technology] having regard to the social, economic and industrial needs of India.

Further, the expenditure qualifying for such weighted deduction is to be limited to the amount of the expenditure certified by the prescribed authority to have been so incurred during the relevant previous year. Only revenue expenditure and capital expenditure incurred on the purchase of machinery and equipment for carrying out the approved programme are to qualify for the weighted deduction. However, capital expenditure incurred on the acquisition of land or acquisition or construction of building is specifically excluded from forming part of the qualifying expenditure for the weighted deduction [**s. 35(2B)(*a*)** of the 1961 Act].

Where a weighted deduction has been allowed under section 35(2B)(*a*) of the 1961 Act for any previous year, no deduction in respect of the same expenditure is to be allowed under section 35(1)(*i*) or section 35(2)(*ia*) of the 1961 Act for the same or any other previous year [**s. 35(2B)(*b*)** of the 1961 Act].

It is also provided that no depreciation is to be allowed in respect of any asset represented by expenditure in respect of which a weighted deduction has already been allowed under section 35(2B) of the 1961 Act, whether in the year of such allowance or any other previous year [**s. 35(2B)(*c*)** of the 1961 Act].

Section 35(2B)(*d*) read with section 155(5B) of the 1961 Act makes provision for withdrawal of the weighted element of the deduction if the assessee fails to furnish, within 1 year of the period allowed by the prescribed authority for completion of the programme, a certificate of its completion obtained from the prescribed authority.

In *CIT v. Orissa Cement Ltd.*, (1995) 215 ITR 409, 411 (Del), the finding of the Tribunal to the effect that deduction under section 35(2B) of the 1961 Act was allowable for assessment year 1983-84 as the same was based on the certificate of the prescribed authority even though the claim for the same was not made before the Assessing Officer but the claim was entertained by the first appellate authority, did not give rise to a question of law.

Section 35(2B) *vis-à-vis* section 35(1)(*iv*) of 1961 Act.—Section 35(1)(*iv*) of the 1961 Act refers to expenditure of a capital nature on scientific research related to the business carried on by the assessee. Section 35(2B) of the 1961 Act refers to expenditure, other than capital expenditure incurred on the acquisition of any

land or building or construction of any building, on scientific research undertaken under a programme approved in that behalf by the prescribed authority, having regard to the social, economic and industrial need of India. It is only such expenditure as is incurred on a programme which has been approved by the authority prescribed under section 35(2B) of the 1961 Act, which can be claimed as deduction under that provision. The capital expenditure on the acquisition of land or building whether acquired or constructed cannot be claimed under section 35(2B) of the 1961 Act. The benefit of section 35(1)(*iv*) of the 1961 Act can be availed of by the assessee in respect of expenditure of a capital nature on scientific research if that research is related to the business carried on by the assessee. The approval of the authority prescribed under section 35(2B) of the 1961 Act is not an essential pre-requisite for claiming the allowance under section 35(1)(*iv*) of the 1961 Act if it is found that a part of the claim falls within the ambit of section 35(1)(*iv*) of the 1961 Act. The mere fact of a claim not having been found admissible under section 35(2B) of the 1961 Act will not constitute a bar to allowing an expenditure under section 35(1)(*iv*) of the 1961 Act if that expenditure is capital expenditure and falls squarely within the ambit of section 35(1)(*iv*) of the 1961 Act. Capital expenditure incurred on the acquisition of land or construction of building which is excluded by the very terms of section 35(2B) of the 1961 Act can be claimed under section 35(1)(*iv*) of the 1961 Act [*Tube Investments of India Ltd. v. CIT*, (2003) 260 ITR 94, 95-96 (Mad)].

Guidelines for approval of scientific research programmes under section 35(2B) in respect of sponsored research in the industrial in-house R&D units.— The following guidelines have been issued by the Secretary, Department of Science and Technology, Government of India, in connection with approval of scientific research programmes under section 35(2B):—

"*I. Preamble*

1. The weighted deduction scheme under section 35(2B) of the Income-tax Act has come into effect from 1-9-1980 and provides for 125 per cent. deduction of the amount spent on the execution of a programme of scientific research in the in-house R&D unit of the assessee which has been approved in this behalf by the 'Prescribed Authority' having regard to the social, economic and industrial needs of the country. The Secretary to the Government of India, Department of Science & Technology, is 'Prescribed Authority' under section 35(2B) of the Income-tax Act, 1961. It has been considered necessary to lay down a set of procedural guidelines for ensuring smooth implementation of this provision and to define the areas of research which would qualify for approval of programmes.

2. Secretary, Department of Science & Technology, has examined the matter as the Prescribed Authority and after careful consideration lays down the following guidelines for purposes of approval of programmes of scientific research under the provisions of section 35(2B). The guidelines would remain in force until further orders.

II. List of research programmes eligible for approval under section 35(2B) and conditions attendant to such approvals

3. Any programme of scientific research which aims at any of the following would be eligible for being considered for approval under section 35(2B):

3.1 Setting up of pilot plant/semi-commercial plant based on the know-how released from NRDC[1] of India, New Delhi.

3.2 Setting up full scale trial/proving plant based on technology developed through programmes founded by the Government.

3.3 Absorption of imported technology.

3.4 To create or develop any new source of energy, which is capable of being commercially exploited, or to improve the efficiency of any existing method of energy generation/distribution; to conserve energy, or any or the scarce material resources by devising new methods or by improving any of the existing methods of processing/manufacture used in agriculture, industry, etc.

3.5 To achieve such other objectives which the prescribed authority, in its discretion, considers important for the social, economic and industrial needs of India, such as:

(*i*) to create any new source of proteinous and/or other nutritional food for human consumption;

(*ii*) development of watershed hydrologic instruments/equipments, watershed management and flood control;

(*iii*) to devise new or better techniques for the utilisation or re-cycling of wastes;

(*iv*) to develop new or better techniques for pollution control/reduction;

(*v*) to develop new/improved/cheaper basic drugs/medicines for the treatment of any communicable disease or any of the more commonly prevalent human/ animal diseases;

1. NRDC stand for "National Research and Development Council".

(*vi*) to develop new/improved/cheaper techniques or methods of family planning which are likely to find wider acceptance among the masses in general;

(*vii*) to develop new/improved techniques of house-building or construction or discover new building materials with a view to achieve cost reduction; substitution of scarce materials and the like, with special reference to rural areas;

(*viii*) to develop new/improved/cheaper kinds of fertilisers/other plant nutrients, plant protection chemicals, etc., with a view to achieve greater yield per hectare from agriculture;

(*ix*) to devise new techniques of manufacture or production of goods which result in substantial conservation of foreign exchange by way of import substitution/export promotion.

4.1 Before a scientific research project/programme is considered for approval under the provisions of section 35(2B) by the prescribed authority, the in-house R&D unit concerned with the implementation of such project/ programme would be required to establish that it has necessary facilities and competence for undertaking the proposed research programme.

4.2 A programme which relates to market research, sales promotion, quality control, testing, commercial production, style changes and routine data collections, acquisition of land, purchase or construction of buildings, etc., would not qualify for being considered for approval.

4.3 Normally the research programme shall be so planned as to complete the proposed investigation within a period of three years.

III. Procedural and other matters

5.1 All applications for approval of research programmes under the provisions of section 35(2B) which satisfy the above guidelines may be made to the Secretary to the Government of India, Department of Science and Technology, Technology Bhavan, New Mehrauli Road, New Delhi-110 029.

5.2 The application should be submitted in 6 sets in A4 size paper.

5.3 The applications would normally be submitted by the management of the industry/undertaking who is to obtain weighted benefit in their assessment.

5.4 All applications should, *inter alia*, be accompanied by the following particulars/documents:

(*a*) essential profiles of the scientific research programme proposed to be undertaken and their broad objectives;

(*b*) information about the items of R&D work proposed and research work being done on them in the country (location to be indicated) and reasons for the investigation. If the answer to above is negative, basis of claim should be indicated;

(*c*) time phasing of each project or programme;

(*d*) financial outlays for each project or programme;

(*e*) justification in assessee's own terms as to how the scientific research programme in question is considered to be of importance to the social, economic and industrial needs of India;

(*f*) particulars of in-house R&D unit where the scientific programmes are proposed to be executed;

(*g*) details of equipments, staff and other facilities available in the in-house R&D unit where such programmes are to be carried out; and

(*h*) any other points considered relevant by the applicant.

5.5 Letters of approval/rejection would be addressed by the Department of Science & Technology to the applicant concerned with a copy to the Central Board of Direct Taxes and to the concerned Commissioner of Income-tax.

5.6 The assessee would be responsible for submitting to the Secretary, Department of Science & Technology, in respect of each accounting year, annual progress of implementation of each project, actuals of the expenditure incurred thereon, and other details in such pro forma as may be prescribed and intimated to them for this purpose. A copy of this annual return would also be sent by them to the ITO having jurisdiction over the assessee.

5.7 For claiming the weighted deduction the assessee has to obtain a certificate of completion of the programme from the prescribed authority. Therefore, as soon as the programme is completed, the completion report bringing out any variation in details furnished to the Department at the time of approval of the project along with the results of research will be submitted to the prescribed authority. The authority will then examine the issue of the completion certificate.

LexisNexis

5.8 The R&D premises of the assessee will be inspected by the representatives of the prescribed authority or a team constituted by it during the progress and/or after completion of the work and all facilities by way of clarification/information will be extended to the team to complete its task.

APPLICATION FOR APPROVAL OF SCIENTIFIC RESEARCH PROGRAMME UNDER SECTION 35(2B)

PART A

1. Name of the applicant/firm

2. (*a*) Head Office/Registered Office/Location

(*b*) Factory/Factories/Location

(*c*) R&D Laboratory/Centre/Location

(*d*) Address to which all communications to be sent

3. Company structure:

(*a*) Public/private/co-operative/joint sector/proprietary/partnership concern

(*b*) Whether foreign equity participation? Please give name of foreign equity participant and percentage thereof

4. Category of the firm:

Small-scale unit/registered with DGTD/covered under IDR Act/covered under MRTP Act/other (Please indicate sponsoring authority)

5. Technical collaboration, if any:

Sl. No.	*Product*	*Name and address of the technical collaborator*	*History of collaboration*
1	2	3	4

LexisNexis

Note.—Under column 4, please indicate year(s) of approval(s) including extension, and the date of expiry of existing collaboration arrangements.

6. Annual turnover for the last three years (year-wise) in rupees.

7. Main products manufactured

		Capacity		
Sl. No.	*Product*	*Licensed*	*Installed*	*Production*

8. Whether your R&D unit is recognised by the Department of Science & Technology? If yes, give No. and date of recognition letter

9. Particulars of equipments/pilot plant facilities available (Please enclose list, indicating value and sources) and year of purchase

10. Details of R&D achievements during the last three years (enclose a separate sheet, if necessary) including patent filed in India or abroad during the last three years

11. Whether any of the technologies developed have been commercialised, sold to other parties in India, or exported? If yes, give details

12. Expenditure of R&D work. Please furnish year-wise figures for the past three years (actuals), current year (budgeted):

Past three years (Actuals)		*Current year (Budgeted)*
1	2	3
(*a*) *Capital*		

(*b*) *Recurring*

(*c*) *Total*

13. Please indicate income-tax rebate allowed, if any, on R&D expenditure during the past three years

14. Manpower employed on R&D work (existing) and enclose a list of the staff employed on R&D in the units as under:

No	*Name*	*Educational quali-fications*	*Design-ation*	*Age*	*Date of joining*	*Present salary* ₹	*Total/ Annual* ₹
1	2	3	4	5	6	7	8

15. Have you obtained any assistance/purchased know-how from NRDC or any of the National Laboratory/Universities/ITI's/other institutions during the last three years? Please give details, along with year and source

16. Have you submitted any other programme for approval to DST unit under section 35(2B) earlier? If yes, give the reference number

PART B—PROGRAMME SUMMARY

17. Title of programme

18. Proposed date of commencement

19. Duration of the programme and the likely date of completion

20. Name of the programme leader

21. Total cost of the programme

22. Please give below a 100-word summary about the programme bringing out its relevance to social, economic and industrial needs of India. Details of present state of affairs, investigation envisaged, programme methodology proposed, time phasing of the activity may be given separately

23. Details about the cost of the programme:

Time period (give year-wise), e.g., 1980-81, 1981-82, etc.	*Equipment & Machinery*		*Total*	*Salary*
	Particulars	*Value (₹)*		
1	2	3	4	5

Raw materials		*Other items*	*Grand total*
Particulars	Value		
6	7	8	9

I certify that all the particulars furnished above are correct and complete and I agree to comply with the requirements laid down in the guidelines and/or specifically required.

…….

Signature of the Managing Director/General Manager

Note.—This application may please be submitted in 6 sets on A4 size paper."

LexisNexis

Omitted/Phased-out provisions of section 35A of the 1961 Act

[1][**S. 35A. Expenditure on acquisition of patent rights or copyrights.—**](1) In respect of any expenditure of a capital nature incurred after the 28th day of February, 1966, [2][but before the 1st day of April, 1998,] on the acquisition of patent rights or copyrights (hereafter, in this section, referred to as rights) used for the purposes of the business, there shall, subject to and in accordance with the provisions of this section, be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

Explanation.—For the purposes of this section,—

(*i*) "relevant previous years" means the fourteen previous years beginning with the previous year in which such expenditure is incurred or, where such expenditure is incurred before the commencement of the business, the fourteen previous years beginning with the previous year in which the business commenced:

Provided that where the rights commenced, that is to say, became effective, in any year prior to the previous year in which expenditure on the acquisition thereof was incurred by the assessee, this clause shall have effect with the substitution for the reference to fourteen years of a reference to fourteen years less the number of complete years which, when the rights are acquired by the assessee, have elapsed since the commencement thereof, and if fourteen years have elapsed as aforesaid, of a reference to one year;

(*ii*) "appropriate fraction" means the fraction the numerator of which is one and the denominator of which is the number of the relevant previous years.

(2) Where the rights come to an end without being subsequently revived or where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) are not less than the cost of acquisition thereof remaining unallowed, no deduction under sub-section (1) shall be allowed in respect of the previous year in which the rights come to an end or, as the case may be, the whole or any part of the rights is sold or in respect of any subsequent previous year.

(3) Where the rights either come to an end without being subsequently revived or are sold in their entirety and the proceeds of the sale (so far as they consist of capital sums) are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed or, as the case may be, such cost remaining unallowed as reduced by the proceeds of the sale, shall be allowed in respect of the previous year in which the rights come to an end, or, as the case may be, are sold.

(4) Where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) exceed the amount of the cost of acquisition thereof remaining unallowed, so much of the excess as does not exceed the difference between the cost of acquisition of the rights and the amount of such cost remaining unallowed shall be chargeable to income-tax as income of the business of the previous year in which the whole or any part of the rights is sold.

Explanation.—Where the whole or any part of the rights is sold in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(5) Where a part of the rights is sold and sub-section (4) does not apply, the amount of the deduction to be allowed under sub-section (1) shall be arrived at by—

(*a*) subtracting the proceeds of the sale (so far as they consist of capital sums) from the amount of the cost of acquisition of the rights remaining unallowed; and

(*b*) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the rights are sold.]

[3][(6) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the rights to the amalgamated company (being an Indian company),—

(*i*) the provisions of sub-sections (3) and (4) shall not apply in the case of the amalgamating company; and

LexisNexis

1. Section 35A has been inserted by the Finance Act, 1966 (13 of 1966), s. 10 (w. e. f. 1-4-1966).
2. Ins. by the Finance (No. 2) Act, 1998 (21 of 1998), s. 12 (w. e. f. 1-4-1999).
3. Sub-section (6) has been inserted by Act 20 of 1967, s. 14 (w. r. e. f. 1-4-1967).

(*ii*) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not so sold or otherwise transferred the rights.]

[4][(7) Where in a scheme of demerger, the demerged company sells or otherwise transfers the rights to the resulting company (being an Indian company),—

(*i*) the provisions of sub-sections (3) and (4) shall not apply in the case of the demerged company; and

(*ii*) the provisions of this section shall, as far as may be, apply to the resulting company as they would have applied to the demerged company, if the latter had not sold or otherwise transferred the rights.]

Introduction under 1961 Act.—*The Finance Act, 1966.*—By **the Finance Act, 1966** (13 of 1966), **section 35A** has been **inserted** (**w. e. f. 1-4-1966**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 4P, dated 21-7-1966*, as follows:—

'*New provision for deduction of capital expenditure on acquisition of patent rights and copyrights used for business, in instalments over a period of years, in the computation of the profits from the business.*—**62.** The Finance Act, 1966 (13 of 1966), has made certain provisions in the new section 35A of the Income-tax Act for the deduction, in the computation of the profits of a business, of capital expenditure incurred after 28-2-1966 on the acquisition of patent rights or copyrights used for the purposes of the business. The deduction for such expenditure will be allowable in equal instalments over a period of 14 years or over the period of the unexpired life of the patent rights or copyrights (as reckoned from the previous year in which such rights were acquired), whichever is less. In a case where the patent rights or copyrights (hereinafter referred to as rights) come to an end during the previous year without being subsequently revived, the allowance will be made in respect of that previous year for such part of the cost of acquisition of the rights as remains unallowed. Similarly, where the rights are sold in their entirety during a previous year and the capital sum received on the sale falls short of the cost of the acquisition of the rights remaining unallowed, the amount of the shortfall will be allowed as a deduction in computing the profits of the previous year in which the sale takes place. On the other hand, where the capital sum received on the sale of the whole or a part of the rights exceeds the cost of acquisition of the rights remaining unallowed, the excess (up to the total amount of the allowance made under section 35A in earlier years) will be chargeable to income-tax as the income of the business of the year in which sale took place. In a case where only a part of the rights is sold and the capital sum received on the sale falls short of the cost of acquisition of the rights remaining unallowed, the deduction to be allowed in respect of the year in which such sale takes place and each of the subsequent years for which the allowance is otherwise due will be taken to be the sum arrived at by dividing the amount of shortfall by the number of such years.

63. In view of the above-mentioned provisions, the instructions issued by the Board in their Circular No. 16 (XI-4) of 1961, dated 31-5-1961, and Circular No. 11 (XI-5) of 1962, dated 30-4-1962, for the allowance of capital expenditure on the acquisition of patent rights and copyrights as a deduction in computing the profits of a business over a period of 14 years in equal instalments will not be applicable to the allowance of such expenditure incurred after 28-2-1966.".

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1967.*—By **the Finance (No. 2) Act, 1967** (20 of 1967), **section 35A(6)** has been **inserted** (**w. e. f. 1-4-1967**).

For the scope and effect of the above insertion, reference may be made to paras. 55 to 58 of the *Departmental Circular No. 5P, dated 9-10-1967*.

II. *The Finance (No. 2) Act, 1998.*—By **the Finance (No. 2) Act, 1998** (21 of 1998), **section 35A(1)** has been **amended** (**w. e. f. 1-4-1999**).

For the scope and effect of the above amendment, reference may be made to paras. 15 to 15.3 of the *Departmental Circular No. 772, dated 23-12-1998*.

III. *The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 35A(7)** has been **inserted** (**w. e. f. 1-4-2000**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 779, dated 14-9-1999*, as follows:—

'**56.** *Business re-organization—extensive amendments in relation to amalgamation, demerger and slump sale.*—**56.1** The business and economic environment of the country has thrown up the need for simplification and rationalisation of laws relating to business re-organization for rationalisation of the production system and better utilization of resources which have become necessary with a view to enabling the Indian industry to restructure itself to become globally competitive. It was in this background that the tax concessions to

4. Sub-section (7) has been inserted by the Finance Act, 1999 (27 of 1999), s. 16 (w. e. f. 1-4-2000).

conversion of firms into companies or proprietary concerns into companies were provided in the Finance (No. 2) Act, 1998, and were widely welcomed. Following this up, the Finance Act, 1999, has carried out a number of amendments for the entire gamut of business reorganization. These include rationalisation of the existing provisions relating to amalgamation of companies, new provisions relating to demerger of companies and sale or transfer of business as a going concern through slump sale.

56.2 Amalgamation in relation to the companies has been defined under the existing provisions of the Income-tax Act to mean the merger of one or more companies with another company or the merger of two or more companies to form one company. There are a number of provisions in the Income-tax Act having bearing on amalgamation. Demerger is relatively a new phenomenon in the Indian corporate sector. A demerger is a reorganization of a company where all the existing assets and liabilities are divided into one or more additional entities leading to resulting companies. While there are no specific provisions under the Companies Act governing demergers, some transactions of this nature do take place through schemes of compromise or arrangement under sections 391 to 394 of the Companies Act and these are sanctioned by the High Courts. A slump sale is a form of reorganization where an undertaking or a division is transferred from one person to another for a lump sum consideration without values being assigned to the individual assets and liabilities transferred.

56.3 *Extensive amendments in the Income-tax Act have been carried out on the basis of the following broad principles*:

(*a*) The restructuring shall not attract additional liabilities to tax and also not result in the withdrawal of relief and concessions available to the existing unit.

(*b*) The tax benefits and concessions available to an undertaking of a company shall continue to be available to the undertaking on transfer of the same while concessions and benefits that are available to the transferor company as an entity and not to the undertaking of the company proposed to be transferred, should remain with the transferor-company.

(*c*) Tax benefits to such business reorganizations should be limited to the transfer of business as a going concern and not to the transfer of specific assets which would amount to sale of assets and not a business reorganization.

56.4 (*x*) A new sub-section (7) has been inserted in section 35A of the Income-tax Act which provides for the deduction of expenditure on acquisition of patent rights and copyrights. Sub-sections (3) and (4) prescribe the manner in which expenditure allowed or yet to be allowed is to be treated for the purpose of deduction or write-back in the year such rights came to an end or were sold with reference to the proceeds from such sale. The newly inserted sub-section (7) provides that provisions of sub-sections (3) and (4) shall not apply to demerged company in a case of demerger and the provisions of this section shall apply to the resulting company as they would have applied to the demerged company, if the latter had not sold or otherwise transferred the rights. [*Section 16*]

* * *

56.5 These amendments will take effect from 1st day of April, 2000 and will, accordingly, apply to the assessment year 2000-01 and subsequent years. [*Section 58*]'.

Expenditure on acquisition of patent rights or copyrights—Law before 1-4-1966.—The 1922 Act or the 1961 Act before its amendment by the Finance Act, 1966 (13 of 1966), did not contain any specific provision about allowance or disallowance of capital expenditure incurred by an assessee on acquisition of patent rights or copyrights. Later, two departmental circulars were issued thereabout, namely, (1) Circular No. 16(XI-4) of 1961, F.No. 27/67/60-IT (AI), dated 31-5-1961, and (2) Circular No. 11 (XI-5) of 1962, F.No. 10/68/61-IT (AI), dated 30-4-1962.

In the facts of *Anup Engineering Ltd. v. CIT* [(1991) 192 ITR 633, 638 (Guj)], the matter was remanded to the Tribunal for considering the claim of the assessee-company in the light of the said circular No. 16 (XI-4), dated 31-5-1961.

Special provisions in relation to assessment year 1989-90.—Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, 1/14th of the amount of capital expenditure is to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

No deduction available under section 35A for and from assessment year 1999-2000.—As a result of **amendment** (w. e. f. 1-4-1999) of **section 35A** by **the Finance (No. 2) Act, 1998** (21 of 1998), no deduction under section 35A shall be available for and from assessment year 1999-2000. However, patent rights or copyrights shall be eligible for depreciation for and from assessment year 1999-2000 as per the provisions of amended section 32.

LexisNexis

Section 35A, object and purport of.—Section 35A requires three conditions to be fulfilled : (*a*) the expenditure ought to have been incurred after 28-2-1966; (*b*) the expenditure should be related to acquisition of patent rights or copyrights used for the purposes of business; and (*c*) the expenditure should be in the nature of capital expenditure [*CIT v. V.R.V. Breweries & Bottling Industries Ltd.*, (2012) 347 ITR 249 (Del)].

Amortisation of expenditure on acquisition of patent rights or copyrights—section 35A(1).—Section 35A(1) provides that any capital expenditure incurred by an assessee after the 28-2-1966, but before the 1-4-1998, on the acquisition of patent rights or copyrights (hereafter referred to as "rights") used for the purposes of the business will be allowed as a deduction in equal instalments over a period of 14 years or 14 years as reduced by the number of complete years comprised in the period which has expired since the commencement of the said rights and before their acquisition by the assessee, whichever of the two periods is shorter. Where a full period of 14 years had expired before such acquisition, the entire cost of acquisition will be allowed in one instalment.

In other words, such capital expenditure is to be allowed in equal instalments over a period of 14 years beginning with the previous year in which such expenditure is incurred. If the expenditure is incurred before the commencement of the business, the period of 14 years would be reckoned from the previous year in which the business commenced. Where at the time of the acquisition, the rights had already commenced, the 14 years' period would be reduced by the number of completed years which had elapsed between the commencement of the rights and their acquisition by the assessee.

In order to apply section 35A, it is necessary that there should have been an expenditure of a capital nature, such expenditure should have been incurred after the 28-2-1966, but before the 1-4-1998, and such expenditure should have been incurred on the acquisition of patent rights or copyright used for the purposes of the business. Only when all these conditions are satisified, any question of deduction under sec-tion 35A would arise [*CIT v. Cochin Refineries Ltd.,* (1982) 135 ITR 278, 283 (Ker), special leave petition granted by the Supreme Court: (1985) 151 ITR (St.) 13 (SC)].

In that case, the payment towards patent rights was held to have been incurred prior to 28-2-1966, and, therefore, not eligible for amortisation under section 35A.

Where there was no material to show that the asset concerned was a patent right or copyright, the assessee was held not entitled to the benefit of section 35A [*Rockweld Electrodes* (*India*) *Ltd. v. CIT,* (1986) 158 ITR 819 (Mad)].

In *CIT v. Mangalore Ganesh Beedi Works* [(2003) 264 ITR 142, 152 (Karn)], it has been held that the expenses on trade mark are not covered under section 35A.

In *CIT v. Printers House Pvt. Ltd.* [(2000) 246 ITR 663, 669 (Del)], the question as to the allowability of deduction under section 35A in respect of expenditure on acquisition of patent rights in pursuance of an agreement entered into with a foreign company, has been returned unanswered by the High Court because neither the agreement in question was annexed with the statement of the case nor its terms were fully setout in the statement or in any one of the orders of the Tribunal.

Illustration on the working of section 35A(1).—"A" purchased, on 1-4-1966, the patent rights of a particular medicine for the sum of Rs. 1,26,000. He could not commence production of the medicine till 1-8-1968, although he was carrying on the business of manufacturing other medicines. Section 35A(1) provides that—

(*i*) the purchase consideration of Rs. 1,26,000 shall be divided into 14 equal parts, each of Rs. 9,000;

(*ii*) one such part of Rs. 9,000 shall be allowed deduction from A's income for the assessment year 1969-70 (taking financial year as A's previous year); and

(*iii*) the remaining 13 parts of Rs. 9,000 each shall be allowed deduction in each of the 13 assessment years following, *i.e.*, assessment years 1970-71 to 1982-83.

Suppose, that the right to manufacture the medicine was acquired by A, on 1-4-1962, under a licence from the inventor for a period of four years to test the efficacy of the invention, with an agreement to purchase it on the expiry of that period on being satisfied about the efficacy. The proviso to *Explanation* (*i*) of section 35A(1) says that the cost of acquisition, that is, the sum of Rs. 1,26,000, shall be divided into 14 *minus* 4, *i.e.*, 10 equal parts. One such part, Rs. 12,600, shall be deducted from the income of assessment year 1967-68 and the balance nine parts, from the income of the next nine assessment years up to 1976-77. If, however, the licence was for a period 16 years and the acquisition was made on 1-4-1978, then, the entire cost of acquisition, Rs. 1,26,000, would be deductible from the income of assessment year 1979-80.

LexisNexis

Allowance, if any, when rights come to an end—section 35A(2).—Sub-section (2) provides that where before the end of any of the relevant previous years for which the allowance is to be made, the rights come to an end without being subsequently revived or where the assessee sells the whole or any part of the rights for an amount which is not less than the capital cost remaining unallowed, allowance in the manner provided in sub-section (1) will not be granted in respect of the previous year in which the rights come to an end or, as the case may be, are sold. In fact, there can be no question of further allowance in a case where the right is extinguished either by sale, and the price realised *plus* allowance already made under section 35A(1) equals the cost of acquisition, or otherwise.

Terminal allowance for deficit portion—section 35A(3).—Sub-section (3) provides that where the rights come to an end without being subsequently revived or are sold in their entirety and the proceeds of the sale are less than the cost of acquisition thereof remaining unallowed, then the cost so remaining unallowed or, as the case may be, such cost reduced by the sale proceeds, will be allowed as a deduction in full in the previous year in which the rights come to an end or, as the case may be, are sold. In other words, where the patent rights or copyrights come to an end during a previous year, without being subsequently revived, such part of the cost of their acquisition as remains unallowed shall be allowed deduction in its entirety in such previous year. Similarly, where the rights are sold away during a previous year and the price received on the sale falls short of the cost of acquisition of the rights remaining unallowed, the amount of the shortfall will be allowed deduction in computing the profits of the previous year in which the sale took place.

Balancing charge to be taxed—section 35A(4).—Sub-section (4), on the other hand, provides that where the rights or any part thereof are sold and the capital sum received on such sale exceeds the unallowed capital expenditure incurred in the acquisition thereof, the excess to the extent of the amount already allowed, shall be charged to tax as the assessee's profits of the previous year in which such sale takes place. In other words, the excess, up to the total amount of the allowance made under section 35A(1) in the earlier years, will be chargeable to tax.

Illustration.—For instance,—

Copyright purchased on 1st September, 1966	..	Rs. 14,000
Allowance made under section 35A(1) for assessment years 1967-68 and 1968-69	..	Rs. 2,000
Cost to the assessee after allowance under section 35A(1)	..	Rs. 12,000
Copyright sold on 13-4-1968	..	Rs. 24,000
Profit on sale (Rs. 24,000 minus Rs. 12,000)	..	Rs. 12,000
Balancing charge to be added in the income of the assessment year 1969-70, which can be added under section 35A(4) up to the amount actually allowed	..	Rs. 2,000

LexisNexis

The further surplus of Rs. 10,000 may be added to the income for the assessment year 1969-70 as short-term capital gains.

But if the copyright was sold for Rs. 13,500 instead of Rs. 24,000, the entire excess of Rs. 1,500 [which was less than the total allowance of Rs. 2,000] would have been added in the income of the assessment year 1969-70 as balancing charge under section 35A(4).

Suppose, the copyright was sold for Rs. 8,500 instead of Rs. 24,000. The shortfall on the actual cost to the assessee after adjusting allowance given to him under sec-tion 35A(1), *i.e.*, Rs. 12,000 *minus* Rs. 8,500, *i.e.*, Rs. 3,500 would have been deducted as terminal allowance under section 35A(3), from the income for assessment year 1969-70

When only a part of the rights is sold—section 35A(5).—In a case where only a part of the patent right or copyright is sold and the capital sum received on the sale falls short of the cost of acquisition of the right remaining unallowed, the deduction to be allowed in respect of the year in which such sale takes place, and each of the subsequent years for which the allowance is otherwise due, will be taken to be the sum arrived at by dividing the amount of shortfall by the number of such years.

It may be noted that in cases where only a part of the patent right or copyright is sold and a part is retained by the assessee—

(*i*) if the amount realised by such sale is more than the capital cost remaining unallowed, the excess, to the extent of the amount already allowed under section 35A(1), shall be added as assessee's income for the previous year in which the sale takes place, as provided in section 35A(4); but

(*ii*) if the amount realised by such sale is less than the capital cost remaining unallowed, the allowance to be made under sub-section (1) in respect of the previous year in which such sale takes place and subsequent previous years will be recomputed. The recomputation will be made by reducing the capital cost remaining unallowed by the sale proceeds, and the balance will be allowed in equal instalments for the relevant previous year and subsequent previous years.

Amalgamation—section 35A(6).—Sub-section (6) was **inserted** by **the Finance (No. 2) Act, 1967** (20 of 1967), with effect from 1-4-1967. It provides that where, in a scheme of amalgamation, patent rights or copyrights are sold or otherwise transferred by the amalgamating company to the amalgamated company which is an Indian company, the provisions of section 35A(3) relating to the grant of terminal allowance and the provisions of section 35A(4) relating to the balancing charge will not have application to the amalgamating company. On the other hand, the provisions of section 35A shall continue to apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not sold or otherwise transferred the rights.

Demerger—section 35A(7).—A new **section 35A(7)** has been **inserted** (w. e. f. 1-4-2000) by **the Finance Act, 1999** (27 of 1999).

LexisNexis

Omitted/Phased-out provisions of section 35AB of the 1961 Act

[1][**S. 35AB. Expenditure on know-how.—**(1) Subject to the provisions of sub-section (2), where the assessee has paid [2][in any previous year relevant to the assessment year commencing on or before the 1st day of April, 1998,] any lump sum consideration for acquiring any know-how for use for the purposes of his business, one-sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years.

(2) Where the know-how referred to in sub-section (1) is developed in a laboratory, university or institution referred to in sub-section (2B) of section 32A, one-third of the said lump sum consideration paid in the previous year by the assessee shall be deducted in computing the profits and gains of the business for that year, and the balance amount shall be deducted in equal instalments for each of the two immediately succeeding previous years.

[3][(3) Where there is a transfer of an undertaking under a scheme of amalgamation or demerger and the amalgamating or the demerged company is entitled to a deduction under this section, then, the amalgamated company or the resulting company, as the case may be, shall be entitled to claim deduction under this section in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the amalgamating company or the demerged company, as the case may be, had such amalgamation or demerger not taken place.]

Explanation.—For the purposes of this section, "know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).]

Introduction under 1961 Act.—*The Finance Act, 1985.*—By **the Finance Act, 1985** (32 of 1985), **section 35AB** has been **inserted** (**w. e. f. 1-4-1986**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 421, dated 12-6-1985*, as follows:—

'**15.** *Deduction in respect of expenditure on "know-how".*—**15.1** With a view to providing further encouragement for indigenous scientific research, the Finance Act, 1985 (32 of 1985), has inserted a new section 35AB in the Income-tax Act. The section provides that any lump sum consideration paid by the taxpayer for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it over 6 years, namely, the year in which the lump sum consideration is paid and the five immediately succeeding years. Where the "know-how" is developed in a laboratory, university or institution, referred to in sub-section (2B) of section 32A, the consideration shall be spread equally over 3 years.

15.2 For the purposes of this section, "know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other source of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).

15.3 The new section will apply in relation to the assessment year 1986-87 and subsequent years.'.

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1998.*—By **the Finance (No. 2) Act, 1998** (21 of 1998), **section 35AB(1)** has been **amended** (**w. e. f. 1-4-1999**).

For the scope and effect of the above amendment, reference may be made to paras. 15 to 15.3 of the *Departmental Circular No. 772, dated 23-12-1998*.

II. *The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 35AB(3)** has been **inserted** (**w. e. f. 1-4-2000**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 779, dated 14-9-1999*, as follows:—

'**56.** *Business re-organization—extensive amendments in relation to amalgamation, demerger and slump sale.*—**56.1** The business and economic environment of the country has thrown up the need for simplification and rationalisation of laws relating to business re-organization for rationalisation of the production system and better utilization of resources which have become necessary with a view to enabling the Indian industry to restructure itself to become globally competitive. It was in this background that the tax concessions to

LexisNexis

1. Section 35AB has been inserted by the Finance Act, 1985 (32 of 1985), s. 8 (w. e. f. 1-4-1986).
2. Subs., for "in any previous year", by the Finance (No. 2) Act, 1998 (21 of 1998), s. 13 (w. e. f. 1-4-1999).
3. Sub-section (3) has been inserted by the Finance Act, 1999 (27 of 1999), s. 17 (w. e. f. 1-4-2000).

conversion of firms into companies or proprietary concerns into companies were provided in the Finance (No. 2) Act, 1998, and were widely welcomed. Following this up, the Finance Act, 1999, has carried out a number of amendments for the entire gamut of business reorganization. These include rationalisation of the existing provisions relating to amalgamation of companies, new provisions relating to demerger of companies and sale or transfer of business as a going concern through slump sale.

56.2 Amalgamation in relation to the companies has been defined under the existing provisions of the Income-tax Act to mean the merger of one or more companies with another company or the merger of two or more companies to form one company. There are a number of provisions in the Income-tax Act having bearing on amalgamation. Demerger is relatively a new phenomenon in the Indian corporate sector. A demerger is a reorganization of a company where all the existing assets and liabilities are divided into one or more additional entities leading to resulting companies. While there are no specific provisions under the Companies Act governing demergers, some transactions of this nature do take place through schemes of compromise or arrangement under sections 391 to 394 of the Companies Act and these are sanctioned by the High Courts. A slump sale is a form of reorganization where an undertaking or a division is transferred from one person to another for a lump sum consideration without values being assigned to the individual assets and liabilities transferred.

56.3 *Extensive amendments in the Income-tax Act have been carried out on the basis of the following broad principles*:

(*a*) The restructuring shall not attract additional liabilities to tax and also not result in the withdrawal of relief and concessions available to the existing unit.

(*b*) The tax benefits and concessions available to an undertaking of a company shall continue to be available to the undertaking on transfer of the same while concessions and benefits that are available to the transferor company as an entity and not to the undertaking of the company proposed to be transferred, should remain with the transferor-company.

(*c*) Tax benefits to such business reorganizations should be limited to the transfer of business as a going concern and not to the transfer of specific assets which would amount to sale of assets and not a business reorganization.

56.4 (*xi*) Section 35AB of the Income-tax Act relating to deduction of expenditure on know-how has been amended to allow the continuation of deduction under the section to the amalgamated company or the resulting company in the case of transfer of business under the scheme of amalgamation or demerger. [*Section 17*]

* * *

56.5 These amendments will take effect from 1st day of April, 2000 and will, accordingly, apply to the assessment year 2000-01 and subsequent years. [*Section 58*]'.

Special provisions in relation to assessment year 1989-90.—Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, 1/6th or 1/3rd of the amount paid as lump sum consideration is to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to the said rule 3.

No amortisation possible under section 35AB for and from assessment year 1999-2000.—As a result of **amendment** (w. e. f. 1-4-1999) of **section 35AB** by **the Finance (No. 2) Act, 1998** (21 of 1998), no amortisation under section 35AB in respect of expenditure on know-how shall be possible for and from assessment year 1999-2000. However, know-how shall be eligible for depreciation for and from assessment year 1999-2000 as per the amended provisions of section 32.

Continuance of deduction in case of transfer under a scheme of amalgamation or demerger—new section 35AB(3).—The **newly inserted** (w. e. f. 1-4-2000) **section 35AB(3)** by **the Finance Act, 1999** (27 of 1999), enacts provisions for continuance of deduction in case of transfer under a scheme of amalgamation or demerger. For the scope and effect of such insertion, reference may be made to paragraph 56.4(*xi*) of the departmental circular No. 779, dated 14-9-1999, which has been reproduced, *ante*, under section 35AB.

Expenses on trade mark are not covered under section 35AB [*CIT v. Mangalore Ganesh Beedi Works*, (2003) 264 ITR 142, 152 (Karn)].

During the period section 35AB remained effective, the know-how, irrespective of whether it is a capital or a revenue expenditure was to be treated only in accordance with section 35AB and the deduction allowable in respect of such know-how was 1/6th of the amount paid as lump sum consideration for acquiring the know-how. Once it is shown that such expenditure was incurred for acquiring of know-how for use for the purpose of the

LexisNexis

assessee's business in the previous year, deduction was required to be given. If in a subsequent year by reason of return of the know-how the assessee derived a benefit, inclusion of the value of the benefit in the income of the assessee, if it was permissible, was a matter for consideration in the subsequent year that would not affect the right of the assessee to receive the benefit of the deduction in the year in which lump sum consideration was made [*CIT v. Tamil Nadu Chemical Products Ltd.*, (2003) 259 ITR 582, 585-86 (Mad)]. In the facts of that case, the Tribunal was held right in law in holding that the assessee was entitled to deduction under section 35AB for the assessment year 1991-92. This Madras view [259 ITR 582 (Mad)] has been **followed in** *CIT v. Drilcos* (*India*) *Pvt. Ltd.* [(2004) 266 ITR 12, 14 (Mad)].

In order to attract the provisions of section 35AB what is necessary is that the assessee must have paid in any previous year prior to 1-4-1998, a lump sum consideration for acquiring any know-how for use for the purposes of his business. Once, this condition is found to have been proved the provisions of section 35AB(1) get attracted, thereby entitling the assessee to deduct one-sixth of the amount in computing the profits and gains of business for that previous year and the remaining to be deducted in equal instalments for each of the five immediately succeeding previous years [*CIT v. Bright Automotives & Plastics Ltd.*, (2005) 273 ITR 59 (MP)].

The royalty payments made by the assessee under the agreement did not fall within the domain of section 35AB [*CIT v. Swaraj Engines Ltd.*, (2008) 301 ITR 284 (Punj)].

There being no ambiguity in the *Explanation* to section 35AB, which defines the phrase 'technical know-how'. The definition of the said phrase is very specific. It means industrial information or technique which is likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits [*CIT v. Frontline Software & Services P. Ltd.*, (2008) 301 ITR 396 (MP)].

The three conditions which must exist, in an order to attract the provisions of section 35AB are: (*i*) a lump sum consideration; (*ii*) it is for acquiring the know-how; and (*iii*) the acquisition is to be used for his business. Imparting know-how to the personnel of assessee would arise only after acquiring the know-how and, thus, the imparting is distinct from acquisition of know-how though both are for the use of the business of the assessee [*CIT v. Molex* (*India*) *Ltd.*, (2012) 344 ITR 156 (Karn)].

The provisions of section 35AB states that where the assessee has paid in any previous year any lump sum consideration for acquiring any know-how for use for the purposes of his business, one-sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years. The *Explanation* to the section 35AB defines the term 'know-how' so as to mean any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine. Once section 35AB of the Act came into play, section 37 of the Act had no application [*Drilcos* (*India*) *Pvt. Ltd. v. CIT*, (2012) 348 ITR 382 (SC)].

LexisNexis

The royalty payments made under the technical collaboration agreements are purely in the nature of revenue expenditure & not capital expenditure [*CIT v. Hitech Arai Ltd.*, (2014) 368 ITR 577, 587 (Mad)].

Since the depreciation under section 32(1) is available in respect of an amount paid as know-how fees by the assessee could not become the reason to deny the benefit he had sought under section 35AB in earlier years [*CIT v. Denso India Ltd.*, (2015) 374 ITR 62, 67 (Del)].

In the present case, there is no acquisition of technical know-how as contemplated under section 35AB. Secondly, section 35AB would not apply to a revenue expenditure [*Diffusion Engineers Ltd. v. Deputy CIT*, (2015) 376 ITR 487, 497 (Karn), **dissented from in** *Standard Batteries Ltd. v. CIT*, (2018) 12 ITR-OL 423 (Bom)]. In *Standard Batteries* case, it has been held that expenditure on account of technical know-how under the agreement dated 19-6-1984 held classifiable under section 35AB.

The assessee would be entitled to claim deduction in respect of sum of Rs. 5 crores for transfer of technical know-how even though the amount was payable and will be paid in instalments on subsequent dates [*CIT v. Amco Power Systems Ltd.*, (2015) 379 ITR 375, 392 (Karn) = 281 CTR (Karn) 332].

Consideration, meaning of.—The term 'consideration' in section 35AB is to be understood in the sense in which it has been used in the Indian Contract Act, 1872 (9 of 1872). The said term 'consideration' would include the entire obligation of the assessee, without which the assessee would not be able to acquire the know-how. The words 'lump sum' as used before the term 'consideration' in section 35AB only exclude periodical or turnover based payments like royalty etc., and any one-time payment for the know-how would fall within the expression 'lump sum' if it is fixed and specified in the agreement, although it may be payable in instalments [*Tata Yodogawa Ltd. v. CIT,* (2011) 335 ITR 53 (Jhar)].

Illustrative case-laws where weighted deduction held entitled under section 35AB.—In the instant case, the AO allowed deduction of Rs. 1 lakh in terms of section 35AB [*Aaa Fun-N-Food Pvt. Ltd. v. Joint CIT*, (2005) 279 ITR 219 (MP)].

The deduction under section 35AB was permissible in respect of the income-tax paid by the assessee on the remittances in terms of the collaboration agreement [*Tata Yodogawa Ltd. v. CIT,* (2011) 335 ITR 53 (Jhar)].

Reference may also be made to *CIT v. Claris Lifesciences Ltd.* [(2010) 326 ITR 251 (Guj)].

Illustrative case-laws where weighted deduction held not entitled under section 35AB.—Once a definite finding had been recorded by the Tribunal that the claim of the assessee was not covered under section 35AB, there was no valid reason for the Tribunal to have accepted the claim for any other reason hence, the assessee held not entitled to claim deduction under section 35AB on account of payments made to T [*CIT v. JCT Electronics Ltd.*, (2008) 301 ITR 290 (Punj)].

The collaboration agreement did not relate to the manufacture or processing of goods by the assessee and he was entitled to depreciation under section 32 on the engineering service fees paid to the foreign company for the technical know-how for setting up the float glass plant and not for deduction under section 35AB for the expenditure incurred which was not relatable to the manufacture or processing of goods [*CIT v. Gujarat Guardian Ltd.*, (2008) 306 ITR 320 (Del)].

Question of law.—(1) Whether the Tribunal was correct in law in the facts and circumstances of the case in holding that deduction under section 35AB could not be allowed in respect of payments made prior to 1-4-1986, and thereby denying deduction of Rs. 1,26,944 being 1/6th of Rs. 7,61,666 [*Escorts Employees Ancillaries v. CIT*, (1999) 236 ITR 468, 469 (Punj)].

Remand to the Tribunal.—In view of the absence of details, whether the expenditure incurred towards technical know-how was revenue or capital expenditure could not be determined thus, the matter was remanded back to the Tribunal for deciding the same afresh [*CIT v. Elgi Ultra Industries Ltd.*, (2010) 321 ITR 390 (Mad)].

Reference may also be made to *CIT v. Swaraj Engines Ltd.* [(2009) 309 ITR 443 (SC)].

LexisNexis

Omitted/Phased-out provisions of section 35AC of the 1961 Act

[1][**S. 35AC. Expenditure on eligible projects or schemes.—**](1) Where an assessee incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme, the assessee shall, subject to the provisions of this section, be allowed a deduction of the amount of such expenditure incurred during the previous year:

Provided that a company may, for claiming the deduction under this sub-section, incur expenditure either by way of payment of any sum as aforesaid or directly on the eligible project or scheme.

(2) The deduction under sub-section (1) shall not be allowed unless the assessee furnishes along with his return of income a certificate—

(*a*) where the payment is to a public sector company or a local authority or an association or institution referred to in sub-section (1), from such public sector company or local authority, or, as the case may be, association or institution;

(*b*) in any other case, from an accountant, as defined in the *Explanation* below sub-section (2) of section 288,

in such form, manner and containing such particulars (including particulars relating to the progress in the work relating to the eligible project or scheme during the previous year) as may be prescribed.

[2][*Explanation*.—The deduction, to which the assessee is entitled in respect of any sum paid to a public sector company or a local authority or to an association or institution for carrying out the eligible project or scheme referred to in this section applies, shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee,—

(*a*) the approval granted to such association or institution has been withdrawn; or

(*b*) the notification notifying the eligible project or scheme carried out by the public sector company or local authority or association or institution has been withdrawn.]

(3) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provision of this Act for the same or any other assessment year.

[3][(4) Where an association or institution is approved by the National Committee under sub-section (1), and subsequently—

(*i*) that [4][the Principal Chief Commissioner of Income-tax (Exemption) or Chief Commissioner of Income-tax (Exemption)] Committee is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted; or

(*ii*) such association or institution, to which approval has been granted, has not furnished to the [5][the Principal Chief Commissioner of Income-tax (Exemption) or Chief Commissioner of Income-tax (Exemption)], after the end of each financial year, a report in such form and setting forth such particulars and within such time as may be prescribed,

LexisNexis

---

1. Section 35AC has been inserted by the Finance (No. 2) Act, 1991 (49 of 1991), s. 13 (w. e. f. 1-4-1992).

2. Ins by the Taxation Laws (Amendment) Act, 2006 (29 of 2006), s. 6 (w. r. e. f. 1-4-2006).

3. Sub-sections (4) and (5) have been substituted by the Finance (No. 2) Act, 2004 (23 of 2004), s. 10 (w. e. f. 1-10-2004), for the following sub-sections (4) and (5):—

'(4) Where an association or institution is approved by the National Committee under sub-section (1), and subsequently that Committee is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted, it may, at any time, after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution, withdraw the approval.

(5) Where any project or scheme has been notified as an eligible project or scheme under clause (*b*) of the *Explanation* and subsequently the National Committee is satisfied that the project or the scheme is not being carried out in accordance with all or any of the conditions subject to which such project or scheme was notified, such notification may be withdrawn in the same manner in which it was issued:

Provided that a reasonable opportunity of showing cause against the proposed withdrawal shall be given by the National Committee to the concerned association, institution, public sector company or the local authority, as the case may be.'.

The above sub-sections (4) and (*5*) were inserted by the Finance (No. 2) Act, 1996 (33 of 1996), s. 13 (w. e. f. 1-10-1996).

4. Subs., for "Committee", by the Taxation & Other Laws (Relaxation & Amendment of Certain Provisions) Act, 2020 (38 of 2020), s. 4(*X*)(*i*)(*a*) (w. e. f. 1-11-2020).

5. Subs., for "National Committee", by Act 38 of 2020, s. 4(*X*)(*i*)(*b*) (w. e. f. 1-11-2020).

[6][the Principal Chief Commissioner of Income-tax (Exemption) or the Chief Commissioner of Income-tax (Exemption)] may, at any time, after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution, withdraw the approval:

Provided that a copy of the order withdrawing the approval shall be forwarded by [7][the Principal Chief Commissioner of Income-tax (Exemption) or the Chief Commissioner of Income-tax (Exemption)] to the Assessing Officer having jurisdiction over the concerned association or institution.

(5) Where any project or scheme has been notified as an eligible project or scheme under clause (*b*) of the *Explanation*, and subsequently,—

(*i*) [8][the Principal Chief Commissioner of Income-tax (Exemption) or the Chief Commissioner of Income-tax (Exemption)] is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which such project or scheme was notified; or

(*ii*) a report in respect of such eligible project or scheme has not been furnished after the end of each financial year, in such form and setting forth such particulars and within such time as may be prescribed,

such notification may be withdrawn in the same manner in which it was issued:

Provided that a reasonable opportunity of showing cause against the proposed withdrawal shall be given by [9][the Principal Chief Commissioner of Income-tax (Exemption) or the Chief Commissioner of Income-tax (Exemption)] to the concerned association, institution, public sector company or local authority, as the case may be:

Provided further that a copy of the notification by which the notification of the eligible project or scheme is withdrawn shall be forwarded to the Assessing Officer having jurisdiction over the concerned association, institution, public sector company or local authority, as the case may be, carrying on such eligible project or scheme.]

[10][(6) Notwithstanding anything contained in any other provision of this Act, where—

(*i*) the approval of the National Committee, granted to an association or institution, is withdrawn under sub-section (4) or the notification in respect of eligible project or scheme is withdrawn in the case of a public sector company, or local authority or an association or institution under sub-section (5); or

(*ii*) a company has claimed deduction under the proviso to sub-section (1) in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the National Committee [11][or the Principal Chief Commissioner of Income-tax (Exemption) or the Chief Commissioner of Income-tax (Exemption), as the care may be,] under sub-section (5),

the total amount of the payment received by the public sector company or the local authority or the association or the institution, as the case may be, in respect of which such company or authority or association or institution has furnished a certificate referred to in clause (*a*) of sub-section (2) or the deduction claimed by a company under the proviso to sub-section (1) shall be deemed to be the income of such company or authority or association or institution, as the case may be, for the previous year in which such approval or notification is withdrawn and tax shall be charged on such income at the maximum marginal rate in force for that year.]

[12][(7) No deduction under this section shall be allowed in respect of any assessment year commencing on or after the 1st day of April, 2018.]

Explanation.—For the purposes of this section,—

(*a*) "National Committee" means the Committee constituted by the Central Government, from amongst persons of eminence in public life, in accordance with the rules made under this Act;

(*b*) "eligible project or scheme" means such project or scheme for promoting the social and economic welfare of, or the uplift of, the public as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendations of the National Committee.]

---

6. Subs., for "National Committee", by Act 38 of 2020, s. 4(*X*)(*i*)(*c*) (w. e. f. 1-11-2020).
7. Subs., for "National Committee", by Act 38 of 2020, s. 4(*X*)(*i*)(*d*) (w. e. f. 1-11-2020).
8. Subs., for "National Committee", by Act 38 of 2020, s. 4(*X*)(*ii*)(*a*) (w. e. f. 1-11-2020).
9. Subs., for "National Committee", by Act 38 of 2020, s. 4(*X*)(*ii*)(*b*) (w. e. f. 1-11-2020).
10. Sub-section (6) has been inserted by the Finance Act, 2002 (20 of 2002), s. 16 (w. e. f. 1-4-2003).
11. Ins. by Act 38 of 2020, s. 4(*X*)(*iii*) (w. e. f. 1-11-2020).
12. Sub-section (7) has been inserted by the Finance Act, 2016 (28 of 2016), s. 17 (w. e. f. 1-4-2017).

Introduction under 1961 Act.—*The Finance (No. 2) Act, 1991.*—By **the Finance (No. 2) Act, 1991** (49 of 1991), **section 35AC** has been **inserted** (**w. e. f. 1-4-1992**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 621, dated 19-12-1991*, as follows:—

'*Tax concession for financing schemes for promoting social and economic welfare of the people.*—**19.** A new section 35AC for promoting social and economic welfare or uplift of the public has been inserted in the Income-tax Act.

19.1 Under the new section 35AC, taxpayers carrying on a business or profession will be entitled to deduct, while computing their taxable profits from any business or profession, the expenditure incurred in financing any eligible project or scheme for promoting social and economic welfare or uplift of the public. The qualifying expenditure would consist of payment made to a public sector company, a local authority or an approved association or an institution for being used for any such eligible project or scheme. Companies may, however, also incur expenditure directly on any such project or scheme.

19.2 A National Committee of eminent persons has been constituted, in accordance with the rules prescribed in the Income-tax Rules, for approving associations and institutions for executing projects or schemes for promoting social and economic welfare or uplift of the public and for recommending such projects and schemes for being notified by the Central Government for this tax concession.

19.3 Any claim for deduction under this provision will have to be supported by a certificate obtained from the public sector company, the local authority or the association or institution executing the eligible project or scheme. Where, in the case of a company, the claim for deduction is in respect of expenditure incurred directly on an eligible project or scheme, the company will have to obtain this certificate from a chartered accountant. The form of these certificates is to be prescribed in the Income-tax Rules.

19.4 Section 80GGA of the Income-tax Act has, likewise, been amended to provide for a similar deduction in the case of taxpayers not carrying on any business or profession. The deduction under this provision will be available only in relation to amounts paid to a public sector company, a local authority or an approved association or institution for carrying out any eligible project or scheme.

19.5 These amendments will take effect from 1-4-1992, and will, accordingly, apply in relation to the assessment year 1992-93 and the subsequent years. [*Sections 13 and 27*]'.

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1996.*—By **the Finance (No. 2) Act, 1996** (33 of 1996), **sections 35AC(4) & (5)** have been **inserted** (**w. e. f. 1-10-1996**) before the *Explanation*.

The scope and effect of the above insertions have been elaborated in the following portion of the *Departmental Circular No. 762, dated 18-2-1998*, as follows:—

'**25.** *Modification of provisions relating to expenditure on eligible projects or schemes.*—**25.1** Section 35AC provides that where an assessee incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme, he shall be allowed a deduction of the amount of such expenditure incurred during the previous year. The *Explanation* under this section defines "eligible project or scheme" to mean a project or a scheme for promoting the social and economic welfare of, or uplift of, the public, as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendations of the National Committee. The section, however, does not confer any power on the National Committee in explicit terms to withdraw the approval granted to an association or an institution, or to recommend to the Central Government the denotification of an eligible project or a scheme.

25.2 It is generally understood that, the power of approval normally includes the power to withdraw the approval. By an amendment statutory recognition to the aforesaid principle has been given by vesting the requisite powers in the National Committee to withdraw approval, earlier granted to an association or to an institution, and to recommend the withdrawal of notification regarding an eligible project or a scheme to the Central Government.

25.3 The [proposed?] amendment will take effect from the 1-10-1996. [*Section 13*]'.

II. *The Finance Act, 2002.*—By **the Finance Act, 2002** (20 of 2002), **section 35AC(6)** has been **inserted** (**w. e. f. 1-4-2003**) before the *Explanation*.

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 8 of 2002, dated 27-8-2002*, as follows:—

'**29.** *Amounts/donations received to be taxed as income in cases of withdrawal of approval to associations/institutions or withdrawal of notification in respect of eligible projects or schemes*.—**29.1** Under the existing provisions of section 35AC, a deduction of the amount of expenditure incurred during the previous year by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme

is allowed. Eligible project or scheme means a project or a scheme for promoting the social and economic welfare of, or upliftment of, the public as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendations of the National Committee. Sub-section (4) of the said section provides that where National Committee is satisfied that the project or scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted, it may withdraw the approval earlier granted to the association or institution. Sub-section (5) also provides for withdrawal of the notification where the project or scheme is not being carried out in accordance with all or any of the conditions on the basis of which such project or scheme was notified.

29.2 The Finance Act, 2002 (20 of 2002), has amended section 35AC, by inserting a new sub-section (6), to provide that in cases where the National Committee withdraws the approval granted by it to an association or institution on the ground that the project or scheme is not being carried out in accordance with all or any of the conditions subject to which the approval was granted or the notification through which a project or scheme was notified is withdrawn, the entire amount of contribution or donation received by the company or authority or association or institution, as the case may be, or the deduction claimed by a company in respect of any expenditure incurred directly on the eligible project or scheme, the notification for which is withdrawn by the National Committee, shall be deemed to be the income of the company or authority or association or institution, as the case may be, of the year in which such approval or notification is withdrawn. Such income will be taxed at the maximum marginal rate as if such income was not exempt under any provision of the Income-tax Act. This will be notwithstanding the exemption, if any, otherwise available to such company or authority or association or institution under any provision of the Income-tax Act.

29.3 The amendment will take effect from 1-4-2003, and will, accordingly, apply in relation to the assessment year 2003-2004 and subsequent years. [*Section 16*]'.

III. *The Finance (No. 2) Act, 2004.*—By **the Finance (No. 2) Act, 2004** (23 of 2004), **sections 35AC(4) & (5)** have been **substituted** (**w. e. f. 1-10-2004**).

The scope and effect of the above substitutions have been elaborated in the following portion of the *Departmental Circular No. 5 of 2005, dated 15-7-2005*, as follows:—

'*Withdrawal of approval granted to associations/institutions or withdrawal of notification of eligible project or scheme by the National Committee.*—**17.** Under the existing provisions of section 35AC of the Income-tax Act, a deduction of the amount of expenditure incurred during the previous year by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme is allowed. Sub-section (4) of the said section provides that where the National Committee is satisfied that the project or scheme is not being carried on in accordance with all or any of the conditions, it may withdraw the approval earlier granted to the association or institution. Sub-section (5) similarly provides for withdrawal of the notification of the eligible project or scheme if it is not being carried out in accordance with all or any of the conditions on the basis of which such project or scheme was notified.

17.1 Certain cases have come to notice where the projects or schemes are not implemented or have been abandoned midway. In some cases donations raised have not been used on the eligible projects and the projects and schemes were not implemented in proper manner.

17.2 With a view to ensure effective monitoring in cases where associations/ institutions are approved or eligible projects or schemes have been notified, the Finance (No. 2) Act, 2004 (23 of 2004), has substituted sub-sections (4) and (5) to provide for an additional mechanism for withdrawal of approval granted to associations/institutions or withdrawal of notification of eligible project or scheme by the National Committee. It has been provided that where an association or institution, to which approval has been granted, fails to furnish a progress report in the prescribed form within the prescribed time after the end of each financial year to the National Committee, the Committee may, at any time, after giving a reasonable opportunity of showing cause, withdraw the approval. It has also been provided that the notification of an eligible project or scheme may be withdrawn by the National Committee, after giving a reasonable opportunity of being heard in case a report in the prescribed form in respect of such project or scheme is not furnished within the prescribed time after the end of each financial year. It has also been provided that a copy of the order withdrawing the approval or notification through which the notification of eligible project or scheme is withdrawn shall be forwarded to the Assessing Officer having jurisdiction over the concerned association or institution or local authority or public sector company. This power of withdrawal will be in addition to the existing power of withdrawal of approvals or notifications in case the project or scheme is not being carried out in accordance with all or any of the conditions subject to which the approval was granted or project/scheme notified.

17.3 This amendment takes effect from 1-10-2004. [*Section 10*]'.

IV. *The Taxation Laws (Amendment) Act, 2006.*—By **the Taxation Laws (Amendment) Act, 2006** (29 of 2006), ***Explanation*** **to section 35AC(2)** has been **inserted** (**w. e. f. 1-4-2006**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 1/2007, dated 27-4-2007*, as follows:—

'**11.** *Deduction in the case of an assessee* (*i.e., the donor*) *not to be denied if approval is withdrawn in the case of the donee.*—**11.1** The Act has amended section 35AC of the Income-tax, 1961 by insertion of an *Explanation* so inserted clarifies that the deduction to which an assessee (*i.e.*, the donor) is entitled on account of payment of any sum by him to a public sector company or a local authority or to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such association or institution has been withdrawn or the notification notifying the eligible project or scheme referred to in section 35AC has been withdrawn.

11.2 *Applicability*: Assessment year 2006-07 onwards. [*Section 6*]'.

V. *The Finance Act, 2016.*—By **the Finance Act, 2016** (28 of 2016), **section 35AC(7)** has been **inserted** (**w. e. f. 1-4-2017**) before the *Explanation*.

For the scope and effect of the above insertion, reference may be made to paras. 34 to 34.3 of the *Departmental Circular No. 3 of 2017, dated 20-1-2017*.

VI. *The Taxation & Other Laws (Relaxation & Amendment of Certain Provisions) Act, 2020.*—By **the Taxation & Other Laws (Relaxation & Amendment of Certain Provisions) Act, 2020** (38 of 2020), the following **amendments** (**w. e. f. 1-11-2020**) have been made—

—**sections 35AC(4)(*i*) & (*ii*)** have been **amended**;

—**long line to section 35AC(4)** has been **amended**;

—**proviso to section 35AC(4)** has been **amended**;

—**section 35AC(5)(*i*)** has been **amended**;

—**1st proviso to section 35AC(5)** has been **amended**; and

—**section 35AC(6)(*ii*)** has been **amended**.

Deduction of expenditure incurred on eligible projects or schemes.—According to **section 35AC(1)** read with **section 35AC(7)** of the 1961 Act, **for assessment years 1992-93 to 2017-18**, if an assessee (including a company) incurs any expenditure by way of payment of any sum to certain persons for carrying out any *eligible project or scheme* [as defined], he shall be allowed a deduction under section 35AC(1) of the 1961 Act of the amount of such expenditure incurred during the previous year, subject to the provisions of section 35AC of the 1961 Act. Payment of any such sum may be made to any of the following:—

(*i*) a public sector company; or

(*ii*) a local authority; or

(*iii*) an association or institution approved by the *National Committee* [as defined] according to the guidelines set out in **Rule 11J of the 1962 Rules**.

LexisNexis

In case of a company, as per **proviso to section 35AC(1)** of the 1961 Act, it may also incur expenditure directly on the eligible project or scheme instead of paying to any of the aforesaid entities.

In order to encourage donations for or direct expenditure in certain approved projects or schemes meant for promoting social and economic welfare or the uplift of the public, the said provision was introduced by the Legislature. If, at a later point of time, the Union legislature in its wisdom was of the opinion that such benefit should no longer be granted, it is always open for Parliament to withdraw the deduction by framing necessary legislation. In plain terms, this provision discontinued the deduction available under section 35AC of the 1961 Act from the assessment year commencing on or after 1-4-2018. In other words, any expenditure incurred after 1-4-2017 would no longer be eligible for deduction under the said section. This provision in the strict sense of the term is to have prospective effect. It may have effect on projects and schemes which are in pipeline and in that sense may affect the pending or existing projects. Nevertheless, the withdrawal of the deduction is from a prospective date. In that view of the matter, it is possible that some of the institutions, projects or schemes may be adversely affected and the legislation may act somewhat harshly. However, this cannot be a ground for annulling the statutory provision [*Prashanti Medical Services & Research Foundation v. Union of India*, (2017) 399 ITR 450 (Guj), **affirmed in** *Prashanti Medical Services & Research Foundation v. Union of India*, (2019) 416 ITR 485 (SC)]. Reference may also be made to *Prashanti Medical Services & Research Foundation v. Union of India*, (2018) 92 taxmann.com 71 (SC).

"National Committee", defined.—As per ***Explanation (a)* to section 35AC** of the 1961 Act read with **Rule 11F of the 1962 Rules**, "National Committee" **means** the Committee constituted by the Central Government, from amongst persons of eminence in public life, in accordance with **Rule 11G of the 1962 Rules**, which shall consist of 14 members. In this regard, the following Notifications have been issued constituting the National Committee for Promotion of Social and Economic Welfare:—

(1) *Notification No. SO 5(E), dated 2-1-1992*, **as amended by** *Notification No. 9578, dated 2-8-1994* [For a period of 3 years between 2-1-1992 to 1-1-1995].

(2) *Notification No. SO 926(E), dated 22-12-1994*: (1995) 78 Taxman (St.) 55-56, **as amended by** *Notification No. 10369, dated 29-5-1997*: (1997) 92 Taxman (St.) 137 [For a period of 3 years between 2-1-1995 to 1-1-1998].

(3) *Notification No. SO 892(E), dated 23-12-1997*: (1998) 144 CTR (St.) 23-24, **as amended by** *Notification No. 10601, dated 19-5-1998*: (1998) 98 Taxman (St.) 258 [For a period of 3 years between 2-1-1998 to 1-1-2001].

(4) *Notification No. SO 444(E), dated 21-5-2001*: (2001) 116 Taxman (St.) 106-07 [For a period of 3 years between 21-5-2001 to 21-5-2004].

(5) *Notification No. SO 1258(E), dated 9-11-2004*: (2004) 141 Taxman (St.) 5-7 [For a period of 3 years between 9-11-2004 to 8-11-2007].

(6) *Notification No. SO 227(E), dated 1-2-2008* [For a period of 3 years between 1-2-2008 to 31-1-2011].

(7) *Notification No. SO 218(E), dated 1-2-2011* [For a period of 3 years between 1-2-2011 to 31-1-2014].

(8) *Notification No. SO 654(E), dated 4-3-2014* [For a period of 3 years between 4-3-2014 to 3-3-2017].

(9) *Notification No. SO 1021(E), dated 31-3-2017* [For a period of 1 year between 31-3-2017 to 30-3-2018]. This Notification has been extended up to 30-9-2018 *vide Notification No. SO 1658(E), dated 17-4-2018*; further extended up to 31-3-2019 *vide Notification No. SO 5160(E), dated 5-10-2019*; further extended up to 30-9-2019 *vide Notification No. SO 1706(E), dated 8-5-2019*; and ultimately extended up to 31-3-2020 *vide Notification No. SO 3122(E), dated 28-8-2019*.

The functions of such Committee have been described in **Rule 11-I of the 1962 Rules** and the headquarters of the Committee and the Secretariat to that Committee have been discussed under **Rule 11H of the 1962 Rules**. Emoluments to the members of the National Committee has been discussed under **Rules 11N(1) and 11N(2) of the 1962 Rules**.

"Eligible project or scheme", defined.—As per ***Explanation (b)* to section 35AC** of the 1961 Act, "eligible project or scheme" **means** such project or scheme for promoting the social and economic welfare of, or the uplift of, the public as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendations of the National Committee.

The deduction was therefore not confined to the healthcare service which the assessee is dispensing and would cover range of projects and schemes for promoting social and economic welfare or the uplift of the public as may be notified [*Prashanti Medical Services & Research Foundation v. Union of India*, (2017) 399 ITR 450 (Guj), **affirmed in** *Prashanti Medical Services & Research Foundation v. Union of India*, (2019) 416 ITR 485 (SC)]. Reference may also be made to *Prashanti Medical Services & Research Foundation v. Union of India*, (2018) 92 taxmann.com 71 (SC).

The guidelines for recommending projects or schemes by the National Committee to the Central Government have been prescribed under **Rule 11K of the 1962 Rules**.

Other conditions for claiming deduction [s. 35AC(2) of 1961 Act].—Deduction under section 35AC(1) of the 1961 Act shall not be allowed, where the payment is made to a public sector company or a local authority or an approved association or an approved institution, unless the assessee furnishes a certificate, along with his return of income, from such company or authority or association or institution, as the case may be, in **Form No. 58A of the 1962 Rules**, which has been specified in **Rule 11-O(1) of the 1962 Rules**.

Similarly, deduction shall not be allowed, where the payment is made directly on the eligible project or scheme, unless the company-assessee furnishes a certificate, along with his return of income, from an *accountant* [as defined in *Explanation* below section 288(2) of the 1961 Act] in **Form No. 58B of the 1962 Rules**, which has been specified in **Rule 11-O(2) of the 1962 Rules**.

Effect of subsequent withdrawal of approval granted to persons referred to in section 35AC(1) of 1961 Act.—With retrospective effect from 1-4-2006, ***Explanation* below section 35AC(2)** of the 1961 Act has been **inserted** to clarify that the deduction to which the assessee is entitled in respect of any sum paid to the persons referred to in section 35AC(1) of the 1961 Act for carrying out the eligible project or scheme shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee, the approval granted to such approved association or approved institution has been withdrawn; or the notification notifying the eligible project or scheme carried out by such persons has been withdrawn.

No double deduction allowable [s. 35AC(3) of 1961 Act].—Where a deduction under section 35AC(1) of the 1961 Act is claimed and allowed for any assessment year in respect of any expenditure referred to in section

35AC(1) of the 1961 Act, deduction shall not be allowed in respect of such expenditure under any other provision of the 1961 Act for the same or any other assessment year.

Application for approval of an association or institution or for recommendation of a project or scheme by the National Committee, etc.—An application for approval of an association or institution or for recommendation of a project or scheme by the National Committee for the purposes of section 35AC of the 1961 Act shall be made in view of **Rule 11L of the 1962 Rules**. Further, the procedure before the National Committee for applications made under Rule 11L of the 1962 Rules has been prescribed under **Rule 11M of the 1962 Rules**.

Donation made to hospital, prior to its being declared as eligible under a notification as per section 35AC of the 1961 Act, would also be eligible for deduction as notification would not only act prospectively but also retrospectively [*CIT v. Asea Brown Boveri Ltd.*, (2009) 316 ITR 450 (Karn)].

Rules 11N(3) and 11N(4) of the 1962 Rules discusses the provisions relating to granting of approval to any project or scheme undertaken by a company.

Withdrawal of approval granted to an association or institution [s. 35AC(4) of 1961 Act].—Where an association or institution is approved by the National Committee, and subsequently [(**w. e. f. 1-11-2020**) the Principal Chief CIT (Exemption) or the Chief CIT (Exemption)] [(**up to 31-10-2020**) that Committee] is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted, then such authority may, at any time, after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution, withdraw the approval.

With effect from 1-10-2004, the above authority may, at any time, after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution, withdraw the approval if the approved association or approved institution has not furnished to that authority, after the end of each financial year, a report in **Form No. 58C of the 1962 Rules** before the expiry of 3 months from the end of that financial year as prescribed in **Rule 11MA of the 1962 Rules**. Thereafter, that authority may, at any time, undertake to inspect or verify the information furnished by the association or institution.

As per **proviso to section 35AC(4)** of the 1961 Act, a copy of the order withdrawing the approval shall be forwarded by that authority to the Assessing Officer having jurisdiction over the concerned association or institution.

LexisNexis

Withdrawal of approved eligible project or scheme [s. 35AC(5) of 1961 Act].—Where any project or scheme has been notified as an eligible project or scheme, and subsequently the [(**w. e. f. 1-11-2020**) Principal Chief CIT (Exemption) or Chief CIT (Exemption)] [(**up to 31-10-2020**) National Committee] is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which such project or scheme was notified, then such notification may be withdrawn in the same manner in which it was issued.

With effect from 1-10-2004, where any project or scheme has been notified as an eligible project or scheme, and subsequently a report in respect of such eligible project or scheme has not been furnished after the end of each financial year in **Form No. 58D of the 1962 Rules** before the expiry of 3 months from the end of that financial year as prescribed in **Rule 11MAA of the 1962 Rules**, then such notification may be withdrawn in the same manner in which it was issued. Thereafter, that authority may, at any time, undertake to inspect or verify the information furnished by the public sector company or local authority or association or institution.

As per **1st proviso to section 35AC(5)** of the 1961 Act, a reasonable opportunity of showing cause against the proposed withdrawal shall be given by the authority to the concerned association, institution, public sector company or local authority, as the case may be.

As per **2nd proviso to section 35AC(5)** of the 1961 Act, a copy of the order withdrawing the approval shall be forwarded by that authority to the Assessing Officer having jurisdiction over the concerned association or institution.

Deeming provisions enacted for taxing amounts/donations received as income in cases of withdrawal of approval to associations/institutions or withdrawal of notification in respect of eligible projects or schemes, etc. [s. 35AC(6) of 1961 Act].—Section 35AC(6) of the 1961 Act, which has been **inserted** (**w. e. f. 1-4-2003**) by **the Finance Act, 2002** (20 of 2002) and which overrides anything contained in any other provision of the 1961 Act, takes care of the following situations:—

(*i*) where the approval of the National Committee granted to an association or institution is withdrawn under section 35AC(4) of the 1961 Act; or

(*ii*) where the notification in respect of eligible project or scheme is withdrawn in the case of a public sector company or local authority or an association or institution under section 35AC(5) of the 1961 Act; or

(*iii*) where a company has claimed deduction under the proviso to section 35AC(1) of the 1961 Act in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the [(**w. e. f. 1-11-2020**) Principal Chief CIT (Exemption) or Chief CIT (Exemption)] [(**up to 31-10-2020**) National Committee] under section 35AC(5) of the 1961 Act.

In any of the above situations, the total amount of the payment received by such company or authority or association or institution, as the case may be, in respect of which such company or authority or association or institution has furnished a certificate in **Form No. 58A of the 1962 Rules** or the deduction claimed by a company under the proviso to section 35AC(1) of the 1961 Act shall be deemed to be the income of such company or authority or association or institution, as the case may be, for the previous year in which such approval or notification is withdrawn and, hence, tax shall be charged on such income at the maximum marginal rate in force for that

LexisNexis

Omitted/Phased-out provisions of section 35B of the 1961 Act

[1]**[S. 35B. * * * *]**

---

1. Section 35B has been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989).

Omitted section 35B.—Section 35B, prior to its omission by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988) (w. e. f. 1-4-1989), granted allowance in respect of eligible expenditures incurred, between 1-3-1968 and 28-2-1983, by the eligible assessees on fulfilment of conditions in that regard. That section 35B stood as follows:—

'[a][**S. 35B. Export markets development allowance.—**](1)(*a*) Where an assessee, being a domestic company or a person (other than a company) who is resident in India, has incurred after the 29th day of February, 1968, [b][but before the 1st day of March, 1983,] whether directly or in association with any other person, any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) referred to in clause (*b*), he shall, subject to the provisions of this section, be allowed a deduction of a sum equal to one and one-third times the amount of such expenditure incurred during the previous year:

[c][*Provided* that in respect of the expenditure incurred after the 28th day of February, 1973, [d][but before the 1st day of April, 1978,] by a domestic company, being a company in which the public are substantially interested, the provisions of this clause shall have effect as if for the words "one and one-third times", the words "one and one-half times" had been substituted.]

(*b*) The expenditure referred to in clause (*a*) is that incurred wholly and exclusively on—

(*i*) advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business [e][* * * *];

[f][* * * *]

(*iv*) maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities;

[f][* * * *]

(*vii*) travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from, and return to, India;

[f][* * * *]

(*ix*) such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed.

[g][*Explanation 1*].—In this section, "domestic company" shall have the meaning assigned to it in clause (2) of section 80B.

[h][*Explanation 2*.—For the removal of doubts, it is hereby declared that nothing in clause (*b*) shall be construed to include any expenditure which is in the nature of purchasing and manufacturing expenses ordinarily debitable to the trading or manufacturing account and not to the profit and loss account.]

[i][(1A) * * * *]

(2) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]'.

---

a. Ins. by the Finance Act, 1968 (19 of 1968), s. 5 (w. e. f. 1-4-1968).

b. Ins. by Finance Act, 1983 (11 of 1983), s. 13 (w. e. f. 1-4-1983).

c. Ins. by the Direct Taxes (Amendment) Act, 1974 (26 of 1974), s. 6 (w. r. e. f. 1-4-1973).

d. Ins. by the Finance Act, 1978 (19 of 1978), s. 6 (w. e. f. 1-4-1978).

e. The words, etc. ", where such expenditure is incurred before the 1st day of April, 1978" were inserted by Act 19 of 1978, s. 6 (w. e. f. 1-4-1978) and the same were omitted by the Finance Act, 1979 (21 of 1979), s. 4 (w. e. f. 1-4-1980).

f. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980 (44 of 1980), s. 8(*a*) (w. e. f. 1-4-1981). Prior to their omission, these stood as follows:—

"(*ii*) obtaining information regarding markets outside India for such goods, services or facilities;

(*iii*) distribution, supply or provision outside India of such goods, services or facilities, not being expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit, *where such expenditure is incurred before the 1st day of April, 1978*;

(*v*) preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto;

(*vi*) furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities;

(*viii*) performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities;".

The above sub-clause (*iii*) (other than words, etc., printed in italics) was earlier substituted by Act 19 of 1970, s. 8 (w. r. e. f. 1-4-1968), for the following:—

"(*ii*) distribution, supply or provision outside India of such goods, services or facilities;".

The italics words, etc. ",where such expenditure is incurred before the 1st day of April, 1978" were inserted by Act 19 of 1978, s. 6 (w. e. f. 1-4-1978).

g. The *Explanation* was numbered as *Explanation* 1 by the Finance Act, 1973 (21 of 1973), s. 5(*a*) (w. r. e. f. 1-4-1968).

h. Subs. by Act 44 of 1980, s. 8(*b*) (w. e. f. 1-4-1981), for the following:—

"*Explanation 2*.—For the purposes of sub-clause (*iii*) and sub-clause (*viii*) of clause (*b*), expenditure incurred by an assessee engaged in the business of—

(*i*) operation of any ship or other vessel, aircraft or vehicle, or

(*ii*) carriage of, or making arrangements for carriage of, passengers, livestock, mail or goods,

on or in relation to such operation or carriage or arrangements for carriage (including in each case expenditure incurred on the provision of any benefit, amenity or facility to the crew, passengers or livestock) shall not be regarded as expenditure incurred by the assessee on the supply outside India of services or facilities.".

[Footnote No. 1 Contd.]

LexisNexis

EXPORT MARKETS DEVELOPMENT ALLOWANCE [IN RELATION TO EXPENDITURE INCURRED BETWEEN 1-3-1968 AND 28-2-1983]

Introduction.—Section 35B was inserted by the Finance Act, 1968 (19 of 1968), with effect from 1-4-1968. The provisions of section 35B, as originally enacted, have been elaborated in the following portion of the departmental **circular**:—

F. No. 1(*234*) *68-TPL—Circular No. 6-P*(*LXXVI-66*) *of 1968, dated 6-7-1968.*—"**42.** The Finance Act, 1968 (19 of 1968), has introduced a new section 35B in the Income-tax Act with effect from 1-4-1968. Under new section 35B domestic companies and also non-corporate taxpayers[2] resident in India, who incur any expenditure under specified heads to promote the sale outside India of any goods, services or facilities dealt in or provided by them in the course of their business, will be allowed an export markets development allowance. The allowance consists of a weighted deduction in an amount equal to 1⅓ times[3] the amount of the qualifying expenditure. The expenditure qualifying for this weighted deduction is that incurred by the taxpayer during the previous year wholly and exclusively on the following activities:—

(*i*) Advertisement or publicity outside India in respect of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business.[4]

[5](*ii*) Obtaining information regarding markets outside India for such goods, services or facilities.

[6](*iii*) Distribution, supply or provision outside India of such goods, services or facilities.

(*iv*) Maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

[7](*v*) Preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto.

[8](*vi*) Furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities.

[Footnote No. 1 Contd.]

The above *Explanation 2* was originally inserted by Act 21 of 1973, s. 5(*b*) (w. r. e. f. 1-4-1968).

i. Sub-section (1A), which was inserted by Act 19 of 1978, s. 6 (w. e. f. 1-4-1978), was omitted by Act 21 of 1979, s. 4 (w. e. f. 1-4-1980). Prior to its omission, section 35B(1A) stood as follows:—

'(1A) Notwithstanding anything contained in sub-section (1), no deduction under this section shall be allowed in relation to any expenditure incurred after the 31st day of March, 1978, unless the following conditions are fulfilled, namely:—

(*a*) the assessee referred to in that sub-section is engaged in—

(*i*) the business of export of goods and is either a small-scale exporter or a holder of an Export House Certificate; or

(*ii*) the business of provision of technical know-how, or the rendering of services in connection with the provision of technical know-how, to persons outside India; and

(*b*) the expenditure referred to in that sub-section is incurred by the assessee wholly and exclusively for the purposes of the business referred to in sub-clause (*i*) or, as the case may be, sub-clause (*ii*) of clause (*a*).

Explanation.—For the purposes of this sub-section,—

(*a*) "small-scale exporter" means a person who exports goods manufactured or produced in any small-scale industrial undertaking or undertakings owned by him:

Provided that such person does not own any industrial undertaking which is not a small-scale industrial undertaking;

(*b*) "Export House Certificate" means a valid Export House Certificate issued by the Chief Controller of Imports and Exports, Government of India;

(*c*) "provision of technical know-how" has the meaning assigned to it in sub-section (2) of section 80MM;

(*d*) "small-scale industrial undertaking" has the meaning assigned to it in clause (2) of the *Explanation* below sub-section (2) of section 32A.'.

2. Change in this regard was effected by section 35B(1A), which was inserted by the Finance Act, 1978, w. e. f. 1-4-1978, and later omitted by the Finance Act, 1979, w. e. f. 1-4-1980.

3. Changes in this regard were effected by the Direct Taxes (Amendment) Act, 1974, and the Finance Act, 1978.

4. Changes in this regard were effected by the Finance Act, 1978, and the Finance Act, 1979.

5. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980, w. e. f. 1-4-1981. Prior to such omission, sub-clause (*iii*) was substituted by the Finance Act, 1970 (with retrospective effect) and was amended by the Finance Act, 1978 (w. e. f. 1-4- 1978).

6. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980, w. e. f. 1-4-1981. Prior to such omission, sub-clause (*iii*) was substituted by the Finance Act, 1970 (with retrospective effect) and was amended by the Finance Act, 1978 (w. e. f. 1-4- 1978).

7. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980, w. e. f. 1-4-1981. Prior to such omission, sub-clause (*iii*) was substituted by the Finance Act, 1970 (with retrospective effect) and was amended by the Finance Act, 1978 (w. e. f. 1-4- 1978).

8. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980, w. e. f. 1-4-1981. Prior to such omission, sub-clause (*iii*) was substituted by the Finance Act, 1970 (with retrospective effect) and was amended by the Finance Act, 1978 (w. e. f. 1-4- 1978).

LexisNexis

(*vii*) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from, and return to, India.

[9](*viii*) Performance of services outside India in connection with or incidental to the execution of any contract for the supply outside India of such goods, services or facilities.

(*ix*) Such other activities for the promotion of the sale outside India of such goods, services or facilities, as may be prescribed.

43. It may be noted that the expenditure which qualifies for the weighted deduction is that incurred on activities exercised outside India for the development of export markets for Indian goods on a long-term basis. This provision is not intended to cover expenditure which the taxpayer incurs on activities inside India for his export business except where these are incidental to the activities outside India, such as that on preparation and submission of tenders referred to in item (*v*) above or furnishing samples or technical information referred to in item (*vi*) above. Under item (*ix*) above, it is open to the Board to notify in the Income-tax Rules any other activities for the promotion of the sale outside India of such goods, services or facilities for the purpose of this provision and on such notification, expenditure on such activities will also qualify for the weighted deduction. The need for notifying any other activities in this behalf, and what these activities should be, are under consideration.

44. The weighted deduction is admissible with reference to qualifying expenditure incurred by the taxpayer *after 29-2-1968*.[10] Expenditure of a capital nature and personal expenses of the taxpayer do not qualify for the weighted deduction. Besides expenditure incurred by the taxpayer directly, expenditure incurred by him through participation in joint export promotion arrangements with others will also qualify for the weighted deduction.

45. Expenditure on some of the activities specified for the purpose of section 35B may already be admissible as a deduction in computing the profits of the business while expenditure on other activities may not so qualify under the tests laid down in section 37(3). However, this consideration is not relevant for the purpose of computing the expenditure which qualifies for the weighted deduction under section 35B. Thus, the limits over the deductible amount of expenditure on advertisement, maintenance of guest houses and travelling, in section 37(3) and Rules 6A,[11] 6B, 6C[12] and 6D, will not apply for the purpose of computing the expenditure which qualifies for the weighted deduction under section 35B. This is because the deduction under this section is not of the expenditure as such, but is an *ad hoc* amount computed with reference to the qualifying expenditure. To avoid a double benefit, it has been provided that once an item of expenditure has been included as qualifying expenditure for the purpose of section 35B, no deduction will be admissible in respect of such expenditure under any other provision of the Act for the same or any other assessment year [*vide* section 35B(2)].

LexisNexis

46. There may be cases in which a foreign branch of an Indian business looks after the export business as also purchase of raw materials, etc., abroad or inspection of goods or equipment before they are shipped to India. Similarly, travel abroad may be undertaken by the director or executives of a company partly for export promotion and partly for other purposes. In such cases, the amount of expenditure qualifying for the weighted deduction will have to be determined by apportioning the total expenditure among the various activities of the branch or the various purposes for which the travel is undertaken, according to circumstances .....".

Legislative amendments.—I. *The Finance Act, 1970 (19 of 1970).*—The substitution of sub-clause (*iii*) of section 35B(1)(*b*) by the Finance Act, 1970 (19 of 1970), with effect from 1-4-1968, *i.e.*, the date from which section 35B was introduced, makes it clear that expenditure on the distribution, supply or provision outside India of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business [which is one of the heads of expenditure specified in section 35B(1) as qualifying for the grant of export markets development allowance] shall not include any expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of the goods to their destination outside India or on the insurance of the goods while in transit.

II. *The Finance Act, 1973 (21 of 1973).*—The insertion, by the Finance Act, 1973 (21 of 1973), of *Explanation 2* with retrospective effect from 1-4-1968, clarifies that for the purposes of sub-clause (*iii*) and sub-

---

9. Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) were omitted by the Finance (No. 2) Act, 1980, w. e. f. 1-4-1981. Prior to such omission, sub-clause (*iii*) was substituted by the Finance Act, 1970 (with retrospective effect) and was amended by the Finance Act, 1978 (w. e. f. 1-4- 1978).

10. As a result of the amendment made by the Finance Act, 1983, the weighted deduction was restricted to qualifying expenditure incurred before the 1st day of March, 1983.

11. Rule 6A was renumbered as Rule 6AA by the Income-tax (Third Amendment) Rules, 1970, and again renumbered as Rule 6AC by the Income-tax (Amendment) Rules, 1972.

12. Rule 6C was omitted by the Income-tax (Amendment) Rules, 1973, w. r. e. f. 1-4-1972.

clause (*viii*) of section 35B(1)(*b*), expenditure incurred by any person engaged in the business of (*a*) operation of any ship or other vessel, aircraft or vehicle, or (*b*) carriage of, or making arrangements for carriage of, passengers, livestock, mail or goods, on or in relation to such operation, carriage or arrangements for carriage (including expenditure incurred on the provision of any benefit, amenity or facility to the crew, passengers or livestock) will not be taken into account for the purposes of the weighted deduction allowed under that section. Thus, the said *Explanation 2* has no bearing on an expenditure which falls under sub-clauses other than sub-clauses (*iii*) and (*viii*) [*CIT v. Orient Charterers,* (1990) 185 ITR 354, 357 (Bom)].

Below is quoted the relevant portion of the Departmental **Circular** No. 126 [F. No. 131(21)/73-TPL], dated 28-11-1973, explaining the provisions of the Finance Act, 1973 (21 of 1973):—

"(*iv*) *Amendment of provision for grant of export markets development allowance so as to bring out the intention underlying the said provision.*—**44.** The Finance Act, 1968 (19 of 1968), introduced a new section 35B in the Income-tax Act under which domestic companies and resident non-corporate taxpayers, incurring expenditure under specified heads for development of export markets for Indian goods on a long-term basis, are entitled to an export markets development allowance in the computation of their taxable profits. This allowance consists of a weighted deduction in an amount equal to one & one-third times the amount of the qualifying expenditure. One of the heads of expenditure specified in the relevant provision as qualifying for the weighted deduction relates to expenditure incurred on 'distribution, supply or provision outside India' of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business. Another head of expenditure qualifying for the weighted deduction relates to expenditure incurred on 'performance of services outside India' in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities.

45. These provisions are susceptible of the interpretation that in the case of taxpayers engaged in the business of operating ships or aircraft, expenditure incurred on the transportation outside India of passenger, cargo, etc., (*e.g.*, expenditure on purchase of fuel and lubricants) will qualify for the weighted deduction. Similarly, it is also possible for a travel agent to claim that expenditure incurred by him on the carriage of, or making arrangement for the carriage of, passengers outside India, is also eligible for the weighted deduction. As such an interpretation of the relevant provisions would not be in conformity with the intention underlying these provisions, section 35B has been amended so as to make it clear that expenditure incurred by a taxpayer engaged in the business of operating any ship or other vessel, aircraft or vehicle, or the carriage of, or making arrangements for the carriage of, passengers, livestock, mail or goods, on or in relation to such operations, carriage or arrangements for carriage will not be regarded as expenditure incurred on the supply outside India of goods, services or facilities.

46. This amendment has come into force retrospectively from 1-4-1968, *i.e.*, the date from which section 35B was introduced in the Income-tax Act.".

III. *The Direct Taxes* (*Amendment*) *Act, 1974 (26 of 1974).*—This Act inserts, with effect from 1-4-1973, a proviso to clause (*a*) of section 35B(1). The effect of the insertion is that the weighted deduction in respect of export markets development allowance in the case of domestic companies in which the public are substantially interested has been raised from one and one-third times the amount of the qualifying expenditure to one and one-half times the amount of such expenditure incurred after 28-2-1973[13].

IV. *The Finance Act, 1978 (19 of 1978).*—The scope and effect of the amendments made by this Act [indicated in the footnotes] have been elaborated in the following portion of the departmental **circular** No. 240, dated 17-5-1978:—

'Modification of the scheme of export markets development allowance—section 35B.—**10.1** Domestic companies and non-corporate taxpayers resident in India are entitled to a weighted deduction in respect of the expenditure incurred by them on development of export markets, in accordance with the provisions of section 35B of the Income-tax Act. The Finance Act, 1978 (19 of 1978), has made three modifications in the scheme of export markets development allowance which are explained hereunder.

10.2 The first modification is that no deduction will be allowed under section 35B in relation to any expenditure incurred after 31-3-1978, unless the following conditions are fulfilled:—

(*i*) The domestic company or, as the case may be, the non-corporate taxpayer resident in India is engaged in (*a*) the business of export of goods and is either a "small-scale exporter" or a holder of an "Export House Certificate"; or (*b*) the business of "provision of technical know-how", or the rendering of services in connection with the provision of technical know-how, to persons outside India.

13. By an amendment made by the Finance Act, 1978, the weighted deduction at the enhanced rate has been restricted to such expenditure incurred before the 1st day of April, 1978.

LexisNexis

(*ii*) The expenditure on export markets development allowance in relation to which the weighted deduction has been claimed is incurred by the taxpayer wholly and exclusively for the purposes of the business referred to in (*i*) above.

10.3 For the purposes of this provision, the term "small-scale exporter" means a person who exports goods manufactured or produced in any "small-scale industrial undertaking" or undertakings owned by him provided that he does not own any industrial undertaking which is not a small-scale industrial undertaking. The expression "small-scale industrial undertaking", for this purpose, has the meaning assigned to it in clause (2) of the *Explanation* below section 32A(2) of the Income-tax Act. The expression "Export House Certificate" means a valid Export House Certificate issued by the Chief Controller of Imports and Exports, Government of India. The expression "provision of technical know-how" will have the meaning assigned to it in section 80MM(2) of the Income-tax Act.

10.4 At present, the weighted deduction under section 35B is allowed at the rate of one and one-half times the amount of the qualifying expenditure in the case of widely-held domestic companies and at the rate of one and one-third times the amount of such expenditure in the case of other taxpayers. The second modification made by the Finance Act, 1978 (19 of 1978), is that, in relation to expenditure incurred after 31-3-1978, the weighted deduction in the case of widely-held domestic companies will also be allowed at the lower rate of one and one-third times the amount of qualifying expenditure, as in the case of other categories of taxpayers.

10.5 The third modification made by the Finance Act, 1978 (19 of 1978), is that expenditure incurred after 31-3-1978, under two of the eight heads of expenditure qualifying for weighted deduction, namely, those specified in sub-clause (*i*) and sub-clause (*iii*) of clause (*b*) of section 35B(1) of the Income-tax Act, will not qualify for weighted deduction. These heads of expenditure are the following:—

(*a*) advertisement or publicity outside India in respect of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business; and

(*b*) distribution, supply or provision outside India of such goods, services or facilities, not being expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit.

10.6 These amendments take effect from 1-4-1978. However, as stated in paragraph 10.2 above, the aforesaid modifications will apply only in relation to expenditure incurred after 31-3-1978.'.

V. *The Finance Act, 1979 (21 of 1979).*—The amendments made by this Act have also been indicated in the footnotes to section 35B. The following portion of the departmental **Circular** No. 258, dated 14-6-1979, elaborates the scope and effect of these amendments:—

'Extension of the scope of the export markets development allowance—section 35B.—**10.1** Under section 35B of the Income-tax Act, an export markets development allowance in the form of a weighted deduction at the rate of 133⅓ per cent. of the qualifying expenditure is allowed in the computation of the taxable profits of a small-scale exporter, a holder of an Export House Certificate and a person engaged in the business of provision of technical know-how to persons outside India or in the performance of services in connection therewith. The weighted deduction is allowed with reference to the expenditure incurred wholly and exclusively on the following activities, namely:—

(*i*) Obtaining information regarding markets outside India for such goods, services or facilities.

(*ii*) Maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

(*iii*) Preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto.

(*iv*) Furnishing to a person outside India samples or technical information for the promotion of the sale outside India of such goods, services or facilities.

(*v*) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from and return to India.

(*vi*) Performance of services outside India in connection with or incidental to the execution of any contract for the supply outside India of such goods, services or facilities.

(*vii*) Such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed.

10.2 The Finance Act, 1979 (21 of 1979), has made the following modifications in the scheme of export markets development allowance:—

LexisNexis

(*i*) The benefit of export markets development allowance will be extended to all domestic companies and non-corporate taxpayers resident in India at the uniform rate of 133⅓ per cent. of the qualifying expenditure.

(*ii*) Expenditure incurred on advertisement or publicity outside India in respect of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business would also qualify for the weighted deduction.

10.3 These provisions will take effect from 1-4-1980, and will accordingly apply in relation to any previous year relevant to the assessment year 1980-81 and subsequent years.'.

VI. *The Finance* (*No. 2*) *Act, 1980 (44 of 1980).*—The entire scheme of the export markets development allowance was completely overhauled by this Act. The amendments have been indicated in the footnotes to the text of the section. The scope and effect of these amendments have been explained and elaborated in the following portion of the departmental **circular** No. 281, dated 22-9-1980:—

'Modification of the provisions relating to the export markets development allowance—section 35B.—**11.1** Under section 35B of the Income-tax Act, domestic companies and non-corporate assessees resident in India are entitled to a weighted deduction, in the computation of their taxable profits, at the rate of one and one-third times the amount of the qualifying expenditure incurred by them on the development of export markets. The weighted deduction under this provision is allowed with reference to expenditure on the following activities:—

(*i*) Advertisement or publicity outside India in respect of the goods, services or facilities dealt in or provided by the assessee in the course of his business.

(*ii*) Obtaining information regarding markets outside India for such goods, services or facilities.

(*iii*) Distribution, supply or provision outside India of such goods, services or facilities, where such expenditure is incurred before 1-4-1978. [Expenditure incurred in India in connection with these activities or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit is not taken into account for determining the qualifying amount of expenditure under this category. Expenditure incurred by an assessee engaged in the business of operating any ship, aircraft, etc., or the carriage of, or making arrangements for the carriage of passengers, live-stock, mail or goods, or in relation to such operations, carriage or arrangements is not regarded as expenditure incurred by the assessee on the supply outside India of services or facilities for the purposes of this provision.]

(*iv*) Maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

(*v*) Preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto.

(*vi*) Furnishing to a person outside India samples or technical information for the promotion of the sale outside India of such goods, services or facilities.

(*vii*) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from and return to India.

(*viii*) Performance of services outside India in connection with or incidental to the execution of any contract for the supply outside India of such goods, services or facilities.

(*ix*) Such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed.

11.2 The actual operation of this provision revealed considerable misuse of this important tax concession by claiming a weighted deduction in respect of expenditure incurred in India on activities which have no direct relation with the basic objective of development of export markets. The claim for weighted deduction in respect of several items had led to considerable protracted litigation and resulted in loss of revenue.

11.3 Having regard to the fact that the basic objective for the grant of a weighted deduction in respect of expenditure on development of export markets was primarily to provide an incentive for promoting exports on a continuing basis, the Finance (No. 2) Act, 1980 (44 of 1980), has amended section 35B so as to limit the benefit of the weighted deduction only in respect of the following categories of expenditure, namely:—

(*i*) Advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business.

(*ii*) Maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

LexisNexis

(*iii*) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities including travelling outward from and return to India.

(*iv*) Such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed in the Income-tax Rules. (No[14] rules have so far been framed in this regard.)

Sub-clauses (*ii*), (*iii*), (*v*), (*vi*) and (*viii*) of clause (*b*) of section 35B(1) have accordingly been omitted.

11.4 Further, the Finance (No. 2) Act, 1980 (44 of 1980), has substituted another *Explanation* for *Explanation 2* below clause (*b*) of section 35B(1) with a view to clarifying that any expenditure which, by its very nature, is debitable to the trading account or a manufacturing account of a business, such as, wages to labourers, purchase of raw materials, carriage inward, etc., will not qualify for the weighted deduction.

11.5 These amendments will take effect from 1-4-1981, and will accordingly apply in relation to the assessment year 1981-82 and subsequent years.'.

VII. *The Finance Act, 1983 (11 of 1983).*—By this Act, no deduction shall be allowed under section 35B in relation to expenditure incurred on or after 1-3-1983. The scope and effect of such amendment have been elaborated in the following portion of the departmental **circular** No. 372, dated 8-12-1983:—

'(*xviii*) *Withdrawal of export markets development allowance—Section 35B.*—**26.1** Under the existing provisions of section 35B of the Income-tax Act, 1961 (43 of 1961), relating to export markets development allowance, a domestic company or a resident non-corporate assessee is entitled to a weighted deduction in the computation of the profits or gains from business in respect of expenditure (other than capital expenditure or personal expenses of the assessee) on certain specified activities related to export of goods, services or facilities which the assessee deals in or provides in the course of his business. The deduction is allowed in an amount equal to one and one-third times the aggregate of such expenditure incurred by the assessee during the previous year.

26.2 The Finance Act, 1983 (11 of 1983), has amended the section to provide that no deduction will be allowed under this provision in relation to expenditure incurred after 28-2-1983.

26.3 The amendment comes into force from 1-4-1983, and will, accordingly, apply in relation to the assessment year 1983-84 and subsequent years. [Section 13 of the Finance Act, 1983 (11 of 1983)]'.

VIII. *The Direct Tax Laws* (*Amendment*) *Act, 1987 (4 of 1988).*—By this Act, section 35B has been omitted with effect from 1-4-1989.

LexisNexis

Export Markets Development Allowance.—Section 35B was **inserted** by **the Finance Act, 1968** (19 of 1968), with a view to help export promotion. It was operative for assessment years 1968-69 to 1983-84.

Section 35B relates to export markets development allowance and by virtue of the provisions of this section, *inter alia*, any expenditure referred to in section 35B(1)(*b*) is to be allowed as a deduction to the extent of the sum equal to one and one-third times the amount of such expenditure incurred during the previous year. Section 35B(1)(*b*) details the expenditure for which a deduction can be claimed [*CIT v. Junach* (*P.*) *Ltd.*, (2005) 274 ITR 168 (Del)].

Weighted deduction under section 35B can only be granted if the assessee is able to establish that the expenditure had been incurred during the previous year wholly and exclusively for the purposes set out under various sub-clauses of section 35B(1)(*b*) [*CIT v. Material Dress Engineering Foundry*, (2005) 275 ITR 308 (Punj)].

The income that accrued or arose in Iran was prior to the adjustments contemplated under section 35B. It was on that income, that the assessee held entitled to the benefit of double taxation relief. The curtailment of the benefit in this regard by imputing the deduction under section 35B to the income from Iran was erroneous [*CIT v. Best & Crompton Engineering Ltd.*, (2006) 284 ITR 225 (Mad)].

Export Markets Development Allowance withdrawn.—As a result of the **amendment of section 35B(1)(*a*)** by **the Finance Act, 1983** (11 of 1983), no deduction under section 35B is available in relation to expenditure incurred after 28-2-1983.

Thus, an assessee is not entitled to claim any weighted deduction under section 35B in relation to the expenditure incurred on or after 1-3-1983. Therefore, there is no question of allowance of weighted deduction under section 35B for the assessment year 1984-85 [*CIT v. Bharat Overseas Bank Ltd.,* (2002) 258 ITR 573, 574 (Mad)].

Who was entitled to claim?—It is only domestic companies or a person (other than a company) resident in India who were entitled to claim deduction for Export Markets Development Allowance. A non-Indian company or a company which has not made the prescribed arrangements for the declaration and payment, within India, of

14. Rule 6AA made such prescriptions.

the dividends payable out of income liable to tax under the Act or a non-resident person (other than a company) was not entitled to claim the benefit of these provisions.

Section 35B(1) provides that where an assessee has incurred any expenditure referred to in clause (*b*) thereof, he shall be allowed deduction of a certain fraction of the amount of such expenditure incurred during the previous year. The expenditure referred to in clause (*a*) is that incurred wholly and exclusively 'in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business'. In so far as goods are concerned, the expenditure must be incurred on goods in which the assessee deals in the course of his business. In so far as services or facilities are concerned, the services or facilities must be those which the assessee provides in the course of his business. There is no requirement that the assessee should be the owner of the goods in which he deals in the course of his business for the purposes of receiving the weighted deduction contemplated by that section [*H.M.T.* (*International*) *Ltd. v. CIT,* (1992) 196 ITR 118, 121 (Karn)]. In the facts of that case, the assessee was held entitled to weighted deduction under section 35B in respect of expenditure incurred on the export of goods manufactured by assessee's holding company.

The weighted deduction under section 35B can be claimed only by an exporter and not by an importer [*S. Muthiah v. CIT: M. Subbaraya Mudaliar v. CIT,* (1983) 140 ITR 1030 (Mad)]. Thus, the assessee, a partner of a non-resident firm, has been held not entitled to weighted deduction where neither the firm nor the partners of the firm have made export of any goods from India [*T. Anandavalli v. CIT,* (1992) 197 ITR 138, 139 (Mad)].

Where the objects of the assessee's business do not enable it to undertake export or marketing of goods outside India as one of its businesses, the assessee cannot claim weighted deduction under section 35B [*Karnataka Small Industries Development Corporation Ltd. v. CIT,* (1987) 164 ITR 140 (Karn)].

An insurance company, whose profits from insurance business are to be computed under section 44 read with the First Schedule, is not entitled to the weighted deduction under section 35B [*United India Fire & General Insurance Co. Ltd. v. CIT,* (1983) 144 ITR 638 (Mad), **affirmed in** *CIT v. Hero Cycle Pvt. Ltd.,* (1997) 228 ITR 463, 471-72 (SC); *National Insurance Co. Ltd. v. CIT,* (1994) 73 Taxman 527 (Cal); *CIT v. Oriental Fire & General Insurance Co. Ltd.,* (1999) 237 ITR 542, 543 (Del); *United India Insurance Co. Ltd. v. CIT,* SLP (Civil) No. 14478 of 1990 : (1991) 187 ITR (St.) 44-45 (SC)].

There is nothing in section 35B(1)(*a*) which debars a broker or agent who supplies services or facilities as distinct from goods from getting weighted deduction under section 35B if other conditions in that behalf are fulfilled [*CIT v. Orient Charterers,* (1990) 185 ITR 354, 356-57 (Bom)]. In *CIT v. Indian Hotels Co. Ltd.* [IT Reference No. 375 of 1977, decided on 13-6-1978 (Bom)], the Bombay High Court has held that an asssessee whose business was merely to extend facilities and render services is entitled to weighted deduction under section 35B.

LexisNexis

A person may export goods in association with others. He may do it directly or indirectly. There is nothing in section 35B to indicate that a person to be entitled to weighted deduction must export the goods himself or he must be an exporter. Section 35B was inserted with a view to help export promotion. The expenditure must be incurred under the specified heads by the assessee to promote sales outside India of any goods, services or facilities dealt in or provided by it in the course of its business. Thus, a manufacturer, who exports its products through a third party, is eligible for weighted deduction [*CIT v. G.E.C. of India Ltd.,* (1991) 192 ITR 559, 562 (Cal)].

Section 35B does not require that for availing the benefit thereunder the export should be from India [*Bombay Burmah Trading Corporation Ltd. v. CIT,* (1991) 188 ITR 122 (Bom), special leave petition granted by the Supreme Court : (1994) 207 ITR (St.) 29 (SC)]. In that case, the assessee derived income from the sale of tea and coffee from its estates in South India as also from business in a number of foreign countries. It exported tea from its East African branches to the United Kingdom. Expenditure incurred in relation to such export was held eligible for weighted deduction under section 35B. The Bombay decision [188 ITR 122 (Bom)] has been **affirmed in** *CIT v. Bombay Burmah Trading Corporation* [(2000) 242 ITR 298, 302 (SC)]. This Supreme Court ruling [242 ITR 298 (SC)] has been **followed in** *CIT v. Gimpex* (*P.*) *Ltd.* [(2004) 268 ITR 377, 378-79 (Mad)]. The Bombay decision [188 ITR 122 (Bom)] has been **followed in** *Bombay Burmah Trading Corporation v. CIT* [(1998) 147 Taxation 296, 297 (Bom)].

Requisite conditions must be satisfied.—A perusal of section 35B shows that weighted deduction is permissible only in respect of certain specified types of expenditure. The several sub-clauses show that all such expenditure must have been incurred outside India. The further requirement is that such expenditure must have been incurred wholly and exclusively on the specified activities. In order to claim this special benefit, the conditions specified have to be satisfied. Each of the sub-clauses of clause (*b*) of section 35B(1) sets out the conditions which must be satisfied before the deduction can be allowed [*CIT v. Baldeo Ram Salig Ram Pvt. Ltd.,* (1991) 188 ITR 470, 475, 476 (All)].

For claiming weighted deduction under section 35B(1) there should be some nexus either directly or indirectly between the expenditure incurred by the assessee and the business carried on by it. In the absence of

such nexus, no weighted deduction can be claimed in respect of the expenditure concerned [*Dr. Beck & Co.* (*India*) *Ltd. v. CIT,* (1993) 202 ITR 922, 928-29 (Bom)]. Also see, *Chief CIT v. H.M.T.* (*International*) *Ltd.,* (1993) 203 ITR 573, 578 (Karn); *Dr. Beck & Co.* (*India*) *Ltd. v. CIT,* (1994) 206 ITR 311, 312 (Bom); *Apeego Corporation v. CIT,* (1995) 215 ITR 697, 700 (Bom).

In order to claim weighted deduction under section 35B, the assessee must be able to establish that the expenditure has been incurred wholly and exclusively on the specific activities enumerated in sub-clauses (*i*) to (*ix*) of section 35B(1)(*b*) [*Bhansali & Co. v. CIT,* (1995) 78 Taxman 501, 509 (Cal)].

It is necessary for the assessee to own the industrial undertaking or undertakings to qualify as a small scale exporter within the meaning of *Explanation* (*a*) to section 35B(1A) [*CIT v. Faizan & Co.*, (2008) 296 ITR 161 (All)].

An expenditure may be covered under more than one clause.—The subjects covered by the provisions of section 35B are quite wide. Under several sub-clauses, provisions are made for giving weighted deduction obviously to encourage exports from India. In the case of a business transaction, an item of transaction cannot be always identified by a particular nomenclature. It is quite possible that a particular transaction may admit of more than one description. For example, a manufacturer in India may invite representatives of the traders from abroad and in that regard, expenditure may have to be incurred. These foreign invitees not only would convey information regarding markets in their country, but also would gain their own impressions about the articles manufactured by the particular manufacturer, which, in turn, would cause publicity for the said articles outside India. This is a situation which will be covered both by sub-clause (*i*) and the pre-1980 sub-clause (*ii*) of section 35B(1)(*b*). Similarly, under the pre-1980 sub-clause (*v*), activities incidental to the main activity of preparation and submission of tenders, etc., are covered. For the purpose of preparation and submission of tenders, etc., necessarily the requisite information shall have to be obtained. This is a situation which can be brought within the pre-1980 sub-clause (*ii*) and sub-clause (*v*) [*Gokuldas Exports v. CIT,* (1993) 200 ITR 401, 403 (Karn)]. In the facts of that case, expenditure incurred for samples sent abroad was held eligible for weighted deduction, for assessment years 1981-82 and 1982-83, under section 35B(1)(*b*)(*i*) although section 35B(1)(*b*)(*vi*), covering specifically 'samples', was omitted by the Finance (No. 2) Act, 1980 (44 of 1980) (w. e. f.1-4-1981), *i.e.*, for and from assessment year 1981-82. Further, such expenditure was held not to be in the nature of purchasing and manufacturing expenses as contemplated by the newly substituted *Explanation 2* to section 35B(1) by the Finance (No. 2) Act, 1980 (44 of 1980) (w. e. f. 1-4-1981).

Liberal interpretation needed.—Having regard to the object of section 35B, it is necessary to give a liberal interpretation so that the purpose behind it could be properly effectuated [*Gokuldas Exports v. CIT,* (1993) 200 ITR 401, 403-04 (Karn)].

Weighted deduction available, even though no profit results from the export business.—An assessee can claim weighted deduction under section 35B even though there is no corresponding receipt from the export business [*CIT v. C.R. Narayana Rao,* (1984) 146 ITR 310 (Mad)].

Expenditure—meaning of in section 35B.—The primary meaning of the expression 'expenditure' is spending or payment of money. In so far as **section 35B** is concerned, keeping in view the object of the provision, the word 'expenditure' has to be construed in the ordinary sense of the word. If a particular expenditure cannot be allowed as business expenditure under section 37(1), there is no question of weighted deduction being allowed on the same expenditure. That section 35B not only postulates actual spending by the assessee, it also requires the assessee to establish that the expenditure for which deduction under section 35B is being claimed had been incurred outside India for the specified purpose. Merely selling of goods to foreign buyers is not sufficient for claiming the benefit of weighted deduction. 'Incentive' or 'discount' to foreign buyer to achieve a particular target of sales, is nothing but a rebate allowed on the price of goods sold to the purchaser, which cannot be said to be an 'expenditure' as contemplated in section 35B. In that view of the matter, the Tribunal was held not correct in law in holding that incentive granted to the foreign buyer for increase in turn over qualified for weighted deduction under section 35B.

Further, where the expenditure incurred is personal in nature, the same cannot be eligible for weighted deduction [*Exportos India v. CIT,* (2000) 246 ITR 1, 10 (Del)].

Weighted deduction available with reference to gross amount of expenditure.—Section 35B refers to 'any expenditure'. Expenditure refers to outgoing. If the monies had been expended, all such monies would qualify for weighted deduction, provided the expenditure was incurred for any one or more of the purposes referred to in section 35B. It is significant that that section refers to 'any expenditure'. The use of the word 'any' preceding the word 'expenditure' would also indicate that the focus is on the expenditure actually incurred by way of outgoing, and once it is established that such expenditure had been incurred, there is no occasion for making any deduction therefrom [*CIT v. Bharat Overseas Bank Ltd.,* (2000) 242 ITR 314, 316 (Mad)]. In that

LexisNexis

case, it has been held that the weighted deduction under section 35B should be allowed, for the assessment year 1980-81, to the assessee-bank in respect of the gross interest paid by the assessee's foreign branches to its depositors without setting off the interest received by the foreign branches from its customers. Same view has been taken in *CIT v. Indian Bank* [(2000) 243 ITR 187, 189 (Mad) (assessment year 1978-79)]; *CIT v. Indian Overseas Bank* [(2001) 247 ITR 572, 573 (Mad) (assessment year 1976-77)]; *CIT v. Indian Bank* [(2001) 249 ITR 676, 677 (Mad) (assessment years 1976-77 and 1979-80)]. Also see, *Indian Overseas Bank v. CIT,* SLP (C) No. 23072 of 2002 : (2003) 261 ITR (St.) 23-24 (SC).

It seems that such weighted deduction has been allowed under the provisions of section 35B(1)(*b*)(*iii*) [operative upto assessment year 1980-81].

In *CIT v. Bharat Overseas Bank Ltd.* [(2000) 243 ITR 320, 322, 325-26 (Mad)], the assessee-bank has claimed deduction, for the assessment year 1981-82, in respect of interest paid by its foreign branch to its customers by placing reliance on section 35B(1)(*b*)(*iv*), as section 35B(1)(*b*)(*iii*) stood omitted (w. e. f. 1-4-1981) by the Finance (No. 2) Act, 1980 (44 of 1980). The claim has been negatived because the expenditure so incurred was not expenditure on the maintenance of the branch which had been maintained for the purpose of promoting its goods, services and facilities outside India. Also see, *CIT v. Bharat Overseas Bank Ltd.,* (2001) 247 ITR 685, 686 (Mad) (assessment year 1982-83).

Reference may also be made to *Indian Overseas Bank Ltd. v. CIT* [SLP (C) Nos. 9696-9697 of 2000 : (2000) 245 ITR (St.) 1-2 (SC)].

Weighted deduction not dependent on non-eligibility to section 80-O relief.—The weighted deduction under section 35B can be availed of by an assessee on fulfilment of the conditions thereabout. That deduction is not dependent on the assessee not being eligible to relief under section 80-O. These two reliefs are not alternative but are independent of each other [*CIT v. C.R. Narayana Rao,* (1984) 146 ITR 310 (Mad)].

Weighted deduction, in respect of what?—Weighted deduction under section 35B can be allowed in respect of expenses only if they are wholly and exclusively incurred for any of the purposes mentioned in the various sub-clauses of clause (*b*) of section 35B(1). The section is quite clear and categorical. There is no way that any other expenditure can be given weighted deduction. Under section 35B, it is the assessee's duty to prove facts which will bring the case within any of these sub-clauses. Unless that is done, the assessee will not be entitled to get this deduction. So far as the Tribunal is concerned, it has also to give a finding as to the entitlement of the assessee with reference to the particular sub-clause of section 35B(1)(*b*). The facts have to be found out and the law has to be applied to those facts. In other words, the Tribunal cannot allow any weighted deduction without linking the expenditure to one or more of the activities referred to in various sub-clauses of section 35B(1)(*b*) [*CIT v. Hero Cycles Pvt. Ltd.,* (1997) 228 ITR 463, 469, 468, 473 (SC)].

LexisNexis

Expenditure eligible for weighted deduction.—The expenditures which were, even after amendments by the Finance (No. 2) Act, 1980 (44 of 1980), eligible for weighted deduction under section 35B, for assessment years 1968-69 to 1983-84, were expenditures (not being in the nature of capital expenditure or personal expenses of the assessee) incurred on or after 1-3-1968, but before 1-3-1983, by an eligible assessee, whether directly or in association with any other person, wholly and exclusively on—

(1) advertisement or publicity outside India in respect of the goods, services or facilities which the assessee dealt in or provided in the course of his business. However, for assessment years 1978-79 and 1979-80, such expenditures incurred on or after 1-4-1978, were not eligible for weighted deduction. For and from assessment year 1980-81 such condition was removed [**s. 35B(1)(*b*)(*i*)**];

(2) maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities. For weighted deduction of such expenditure, it was sufficient that the branch, etc., dealt in goods exported from India by the assessee, whether or not the assessee dealt in those goods in India. Thus, a dealer dealing in textiles in India might well export hardware to his foreign branch and be entitled to weighted deduction in respect of expenditure on maintenance of foreign branch [*CIT v. Kasturi Palayacat Co.,* (1979) 120 ITR 827 (Mad), special leave petition granted by the Supreme Court: (1983) 143 ITR (St.) 39 (SC) [**s. 35B(1)(*b*)(*iv*)**];

(3) travelling in foreign countries for the promotion of the sale in those countries of such goods, services or facilities, including travelling charges from and to India [**s. 35B(1)(*b*)(*vii*)**]; and

(4) such other activities for the promotion of the sale in foreign countries of such goods, services or facilities as may be prescribed. The new rule 6AA prescribes such additional activities [**s. 35B(1)(*b*)(*ix*)**]. For details, see, *"Prescribed activities for export markets development allowance"*, under section 35B, *post*.

India Hotels Ltd., which runs the Taj Mahal at Bombay, had incurred, in the year relevant to assessment year 1972-73, an expenditure of Rs. 2,11,135 on foreign tours by its directors and employees for meeting travel agents, airlines, etc. The company claimed weighted deduction on this amount under section 35B(1)(*b*)(*i*) which allows

such weighted deduction in respect of expenditure incurred wholly and exclusively on "advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business". The ITO had allowed the claim. The CIT withdrew the allowance in exercise of his power under section 263 on the ground that for such weighted deduction the sale of goods or services should have taken place outside India. The Tribunal, accepting the claim of the company, held that the expenditure incurred fell within sub-clauses (*i*) and (*vii*) of section 35B(1)(*b*). The advertisement or publicity may take any form including representatives travelling from place to place to announce or inform the public with regard to the goods or services sold or provided by a particular organisation or business.

Reference application made by the CIT was rejected both at the Tribunal and High Court stages. The CIT filed a petition under article 136 for special leave to appeal against the High Court decision. Accepting the arguments on behalf of the company, contending that actual export of goods was not a condition precedent for the allowance and that advertisement and publicity made outside India of goods and services in which the company deals is enough, the Supreme Court rejected the petition for special leave to appeal [*CIT v. India Hotels Ltd.,* Special Leave Petition (Civil) No. 4177 of 1979 decided on 14-9-1979 (SC)].

Before any allowance was made under section 35B(1)(*b*)(*iv*), it was necessary to find out as to whether or not the maintenance of the agency outside India was for the promotion of sale outside India of the goods which the assessee dealt in. The mere securing of information about the market conditions prevailing abroad could not amount to sales promotion [*CIT v. Tribeni Tissues Ltd.,* (1996) 217 ITR 846, 848 (Cal)].

For attracting section 35B(1)(*b*)(*iv*), it is enough if it is found that on behalf of the assessee, the other person had entered into transaction in the foreign country. It is not necessary that the assessee should have executed a formal agreement of agency, or to have an office for that purpose [*CIT v. Cadila Laboratories* (*P.*) *Ltd.,* (1996) 221 ITR 35, 37 (Guj)].

For attracting section 35B(1)(*b*)(*iv*), what is requisite is that the assessee should have maintained the branch, office or agency outside India. It is also requisite that such branch, office or agency should be for the promotion of sales outside India of the assessee's goods, services or facilities [*Aravinda Paramila Works v. CIT,* (1999) 237 ITR 284, 287 (SC)].

The fact that the assessee had an agent outside India, and had paid commission on the sales effected through that agent does not render the payment of that commission into expenditure incurred by the assessee on the maintenance of an agency within the meaning of section 35B(1)(*b*)(*iv*) [*CIT v. Southern Sulphates & Chemicals Pr. Ltd.,* (1999) 240 ITR 710, 712 (Mad)].

Interest paid by the assessee-bank's foreign branch on its deposits would not qualify for weighted deduction under section 35B(1)(*b*)(*iv*) as expenditure incurred on the maintenance of the foreign branch [*CIT v. Bharat Overseas Bank Ltd.,* (2000) 243 ITR 320, 322, 325-26 (Mad); *CIT v. Bharat Overseas Bank Ltd.,* (2001) 247 ITR 685, 686 (Mad)]. Both these cases have been discussed, *ante*, under section 35B.

Where the evidence clearly showed that the branch office was established for the execution of the contract as per the agreement entered into with the main contractor by the assessee (sub-contractor), it cannot be said that the branch office was intended for promotion of sale of the services with which the assessee was dealing and, therefore, it cannot be said that the branch office in a foreign country was established for the purpose of promotion of the sale of services outside India so as to attract section 35B(1)(*b*)(*iv*) [*CIT v. K. Pattabhirama Reddy,* (2001) 250 ITR 423, 431 (AP)].

Where there was nothing to show that the office of the agent was being maintained by the assessee, commission paid to the agent cannot be allowed as a weighted deduction under section 35B(1)(*b*)(*iv*) [*CIT v. Chillies Export House Ltd.,* (2002) 253 ITR 327, 327-28 (Mad)].

Where the assessee has reimbursed the expenditure of the agent in running the warehouse for the storage of the assessee's tea for the purpose of the sale abroad, it has been held that it was the assessee which was maintaining the warehouse for the promotion of the sales of its tea outside India, and, therefore, the requirements of section 35B(1)(*b*)(*iv*) were met and the assessee was entitled to weighted deduction in respect of expenditure so reimbursed [*CIT v. Assam Frontier Tea Ltd.,* (2002) 253 ITR 549, 551 (SC), **affirming** *CIT v. Assam Frontier Tea Ltd.,* (1997) 224 ITR 398 (Gauh)]. In taking this view, the Supreme Court decision in *Aravinda Paramila Works v. CIT* [(1999) 237 ITR 284 (SC)] has been **relied on.**

In *Bank of Baroda v. H.C. Shrivatsava* [(2002) 256 ITR 385, 390 (Bom)], it has been held that the assessee-bank is entitled to deduction under section 35B(1)(*b*)(*iv*) in respect of expenditure on maintenance of branches outside India.

Similar view has been taken in *CIT v. State Bank of India* [(2003) 261 ITR 82, 86 (Bom)] to the effect that the State Bank of India, which has branches all over the world outside India and which certainly facilitates and promotes export markets, both in India and outside India, is eligible for weighted deduction under section

35B(1)(*b*)(*iv*) in respect of expenditure on maintenance of branches outside India for promotion of sale outside India of goods, services or facilities.

Prescribed activities for export markets development allowance.—The Central Board of Direct Taxes framed **rule 6AA** (the then existing rule 6AA was renumbered as rule 6AAA) for the purposes of section 35B(1)(*b*)(*ix*). The **said rule 6AA** was **inserted** by **the Income-tax (Eighth Amendment) Rules, 1981** [*Notification No. SO 618(E), dated 1-8-1981*] in the Income-tax Rules, 1962, with effect from 1-8-1981, and was **amended** (w. e. f. 27-5-1982) by **the Income-tax (Third Amendment) Rules, 1982** and **ultimately omitted** by **the Income-tax (32nd Amendment) Rules, 1999** (w. e. f. 19-11-1999). The **so-omitted rule 6AA** reads as follows:—

"**R. 6AA.** *Prescribed activities for export markets development allowance.*—For the purposes of sub-clause (*ix*) of clause (*b*) of sub-section (1) of section 35B, other activities for the promotion of the sale outside India of the goods, services or facilities which the assessee deals in or provides in the course of his business shall be as follows, namely:—

(*a*) conducting of pre-investment surveys or the preparation of feasibility studies or project reports:

Provided that the pre-investment surveys are conducted or the feasibility studies are made or the project reports are prepared on the request in writing made by the Central Government or a foreign party to whom such goods, services or facilities are likely to be sold or provided by the assessee;

(*b*) maintenance outside India of a warehouse for the promotion of the sale outside India of such goods;

(*c*) maintenance of a laboratory or other facilities for quality control or inspection of such goods:

Provided that in a case where only a part of the sales is made outside India, the amount of expenditure incurred on the maintenance of such laboratory or other facilities which shall qualify for deduction under clause (*a*) of sub-section (1) of section 35B shall not exceed the amount which bears the same proportion as the value of the turnover in respect of such exports bears to the turnover of the business in respect of which the laboratory or other facilities are maintained;

(*d*) purchase of foreign trade periodicals or journals related to the business of the assessee;

(*e*) litigation outside India for the purposes of the protection of the business interests of the assessee or of trading activities relating to the goods, services or facilities which the assessee deals in or provides in the course of his business.".

LexisNexis

The originally inserted (w. e. f. 1-8-1981) rule 6AA has been held to be operative for the entire previous year relevant to assessment year 1982-83 and not only for the period falling on or after 1-8-1981 comprised in that previous year [*CIT v. Moran Tea Co.* (*India*) *Ltd.,* (1992) 194 ITR 429, 431 (Cal)]. In the facts of that case, the entire expenditure of Rs 12,54,382 on maintenance of a warehouse outside India was held entitled to deduction under section 35(B)(1)(*b*)(*ix*) read with rule 6AA for assessment year 1982-83 (previous year being calendar year 1981) and not Rs. 5,75,392 on *pro rata basis* for the period from 1-8-1981 to 31-12-1981.

That rule 6AA has been held not to have any retrospective operation in respect of the assessment year 1980-81, although the assessment for that assessment year was completed on or after 1-8-1981 [*CIT v. Bishnauth Tea Co. Ltd.,* (1992) 197 ITR 150, 155 (Cal), **followed in** *CIT v. Assam Frontier Tea Ltd.,* (1997) 224 ITR 398, 402 (Gauh)].

In *Lucas TVS Ltd. v. CIT* [(1996) 217 ITR 382, 399, 403 (Mad)], it has been held that a closer look, however, at the provision under rule 6AA reveals that it is in the nature of restriction to what, in certain circumstances, would have been found includible under section 35B(1)(*b*)(*vi*) and thus a clarificatory rule so that claims in respect of pre-investment surveys, preparation of feasibility studies or project reports are kept within the limitations of strict requirements of the law as engrafted under section 35B(1)(*b*)(*vi*) and in cases where there are doubts whether any pre-investment survey or feasibility study or project was at all necessary and if it was done, it was for furnishing to a person outside India technical information for the promotion of sale, it is disallowed unless conducted, made or prepared on the request in writing made by the Central Government or a foreign party to whom such goods, services or facilities were/are likely to be sold or provided by the assessee. The presumption against retrospective operation of a fiscal statute is not applicable to declaratory statutes. Reference in this connection may be made to *Keshavlal Jethalal Shah v. Mohanlal Bhagwandas* [AIR 1968 SC 1336], *Channan Singh v. Jai Kaur* [AIR 1970 SC 349] and *Punjab Traders v. State of Punjab* [AIR 1990 SC 2300]. It is pertinent to note that the Madras case [217 ITR 382 (Mad)] related to assessment year 1976-77.

In *CIT v. National Agricultural Co-operative Marketing Federation of India Ltd.* [(1999) 236 ITR 766, 767, 772, 773 (Del)], rule 6AA, which was inserted with effect from 1-8-1981 could not have retrospective operation in relation to assessment year 1979-80 and the inspection fee paid to a third party was not covered by clause (*c*) of rule 6AA and the same was not entitled to weighted deduction.

Similarly, rule 6AA has been held not to have retrospective effect so as to be applicable to assessment year 1981-82 [*Agro Cargo Transport Ltd. v. CIT,* (1999) 236 ITR 1000, 1001 (Mad), **following** *CIT v. Bishnauth Tea Co. Ltd.,* (1992) 197 ITR 150 (Cal); *Yuvaraj International v. CIT,* (2000) 244 ITR 641, 645 (Mad)] or assessment years 1977-78 and 1978-79 [*CIT v. Dr. Beck & Co.* (*India*) *Ltd.,* (1999) 239 ITR 561, 565-66 (Bom)].

It is pertinent to note that rule 6AA has been framed under section 35B(1)(*b*)(*ix*). That rule cannot be regarded to be in the nature of a declaratory or clarificatory rule so far as section 35B(1)(*b*)(*vi*), which clause was omitted (w. e. f. 1-4-1981) whereas the said rule 6AA was inserted (w. e. f. 1-8-1981) much after the omission of section 35B(1)(*b*)(*vi*). In taking this view, the Punjab High Court has **dissented from** Madras decision [217 ITR 382 (Mad)], [*Kansal Woollen & Hosiery Mills* (*P.*) *Ltd. v. CIT,* (1999) 237 ITR 93, 99, 100 (Punj)].

The provisions of the aforesaid **rule 6AA**, as originally framed, have been explained in the following **Press Note** issued by the Ministry of Finance (Department of Revenue) on 1-8-1981:—

'Export markets development allowance—Additional activities prescribed in new rule 6AA inserted by the Income-tax (Eighth Amendment) Rules, 1981.—The Central Board of Direct Taxes have today issued a notification prescribing additional activities for the purpose of export markets development allowance.

Under the existing provisions, domestic companies and non-corporate taxpayers resident in India are entitled to a weighted deduction, in the computation of their taxable profits, at the rate of one and one-third times the amount of qualifying expenditure in respect of certain activities for the development of export markets. At present, the activities specified in this behalf are: advertisement or publicity outside India; maintenance outside India of a branch, office or agency and travelling outside India for the promotion of sale outside India of the goods, services or facilities dealt in by the taxpayer. The Board are empowered to prescribe by rules any other activities for the purpose of this provision.

The notification issued today prescribes the following activities for the purpose of export markets development allowance, namely:—

(*i*) conducting of pre-investment surveys, preparation of feasibility reports or project reports at the written request of the Central Government or the foreign party;

(*ii*) maintenance outside India of a warehouse for promotion of sale of goods outside India;

(*iii*) maintenance of a laboratory or other facilities for quality control or inspection of such goods. However, the expenditure on this activity which qualifies for weighted deduction will be restricted to the amount which bears the same proportion as the export sales to the total turnover of the business in respect of which such laboratory or other facilities are maintained;

(*iv*) purchase of foreign trade periodicals or journals related to the business of the taxpayer.'.

LexisNexis

Purchasing and manufacturing expenses not entitled.—For and from assessment year 1981-82, a **newly-substituted *Explanation 2* to section 35B(1)** clarified that any expenditure which was in the nature of purchasing and/or manufacturing expenses ordinarily debitable to the trading or manufacturing account and not to the profit and loss account shall not be entitled to earn weighted deduction.

Expenditures no more eligible for deduction.—For and from assessment year 1981-82, the following expenditures were no more eligible for weighted deduction:—

(1) expenditure on obtaining information regarding markets outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business [**s. 35B(1)(*b*)(*ii*)**];

(2) expenditure on distribution, supply or provision outside India of such goods, services or facilities [For details, see, *"Sub-clause* (*iii*) *of section 35B*(*1*)(*b*)*—now omitted"*, under section 35B, *post*];

(3) expenditure on preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto [**s. 35B(1)(*b*)(*v*)**];

(4) expenditure on furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities [**s. 35B(1)(*b*)(*vi*)**]; and

(5) expenditure on performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities [**s. 35B(1)(*b*)(*viii*)**]. It may be noted that the expenditures covered by the then *Explanation 2* were not eligible for weighted deduction right from assessment year 1968-69.

Where a middleman approached the assessee for purchase of its goods for and on behalf of a foreign buyer and the assessee agreed to sale his goods and middleman obtained the commission, this did not amount to obtaining information regarding 'markets outside India of such goods, services or facilities' so as to fall within section 35B(1)(*b*)(*ii*). This was nothing but payment of sales commission to a middleman for the purpose of

effecting sales, the foreign buyer located the assessee through the middleman. In such circumstances, the assessee was not entitled to weighted deduction under that sub-clause (*ii*) [*CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 176 (SC)].

In case it is found that the assessee was required to employ some one for the activities stipulated under section 35B(1)(*b*)(*v*) and pay any wages or emoluments or engage some one who also worked for matters falling under section 35B(1)(*b*)(*v*), the assessee can claim apportionment and seek allowances. The expenditure referable under section 35B(1)(*b*)(*v*) is that incurred wholly and exclusively on the preparation and submission of tenders for the supply or provision outside India of goods, services or facilities and activities incidental thereto [*V.D. Swami & Co. Ltd. v. CIT,* (1995) 216 ITR 129, 136 (Mad)].

In so far as the payment to the export inspection agency is concerned, if it was incurred wholly and exclusively for the purpose of furnishing to a person outside India technical information for the promotion of sale, it may qualify for deduction under section 35B(1)(*b*)(*vi*) [*Lucas TVS Ltd. v. CIT,* (1996) 217 ITR 382, 403 (Mad)].

A plain reading of **sub-clause (*viii*)** would make out that three conditions must be fulfilled to claim weighted deduction thereunder. These conditions are as follows:—

(*i*) the service must be performed outside India;

(*ii*) the service should be rendered in connection with or incidental to the execution of any contract; and

(*iii*) the activity should be for the supply of goods, services or facilities to a foreign country.

If any of the three conditions is not available in connection with any activity on which expenditure is incurred by the assessee, it would not attract sub-clause (*viii*) [*CIT v. O.K. Hosiery Mills,* (1997) Tax LR 1049, 1052 (Punj)].

Even upto assessment year 1980-81, section 35B(1)(*b*)(*viii*) did not allow all expenditure incurred wholly and exclusively in connection with, or incidental to, the execution of any contract for supply of goods, services and facilities outside India. The allowance was restricted to expenditure which had been incurred wholly and exclusively on 'performance of services outside India' when it was found that such services were 'in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities' [*Brooke Bond India Ltd. v. CIT,* (1992) 193 ITR 390, 396 (Cal)]. Unless the assessee performs some services outside India for the supply of the goods exported, it would not be entitled to weighted deduction in respect of the expenditure incurred for such services. The mere fact that, under the terms of the contract, the assessee permitted the foreign buyer to make payment for the goods supplied on the arrival of the steamer would not show that the assessee had performed some services for the buyer outside India [*Walker Anjaria & Sons Pvt. Ltd. v. CIT,* (1992) 197 ITR 568, 572 (Guj)].

LexisNexis

In order to fall under sub-clause (*viii*), it must be : (*i*) an expenditure incurred wholly and exclusively on the performance of services outside India; (*ii*) the services should be in connection with or incidental 'to the execution of any contract for the supply outside India of such goods, services or facilities' which the assessee deals in or provides in the course of his business [*Walchandnagar Industries Ltd. v. CIT,* (1994) 206 ITR 328, 330 (Bom)]. In the facts of that case, weighted deduction under section 35B(1)(*b*)(*viii*) was held not eligible in respect of interest paid on postshipment loans as also in respect of professional charges paid for designing for undertaking the export contract as the assessee has failed to produce requisite material in that regard. Similarly, weighted deduction in respect of director's salary was held not eligible under section 35B(1)(*b*)(*viii*) as the conditions in that regard were not satisfied [*J.M.A. Industries Ltd. v. CIT,* (1993) 200 ITR 210, 214-15 (Del)].

However, sea freight and marine insurance have been held clearly to be services rendered outside India, in connection with the execution of the contract entered into with the foreign buyer so as to attract the provisions of section 35B(1)(*b*)(*viii*) [*CIT v. Roadmaster Industries of India Pvt. Ltd.,* (1993) 202 ITR 968, 974 (Punj), **followed in** *CIT v. Indo Asian Switch-Gears* (*P.*) *Ltd.,* (1996) 222 ITR 772, 787-88 (Punj). Also see, *Vijay Kumar Aggarwal v. CIT,* (1998) 232 ITR 179, 186-87 (Punj); *CIT v. Road-master Industries of India* (*P.*) *Ltd.,* (1998) 229 ITR 68, 70 (Punj), **set aside** and the Supreme Court has directed the Tribunal to refer the question of law to the High Court in *CIT v. Roadmaster Industries of India P. Ltd.,* (2001) 248 ITR 451, 452 (SC)]. This has been so held on the basis of the interpretation that each sub-clause must be read independently and that the terms of one sub-clause cannot be read into those of another sub-clause. According to the Bombay High Court, in *Forbes Forbes Campbell & Co. Ltd. v. CIT* [(1994) 206 ITR 495, 500 (Bom)], this view is not in consonance with the well settled principle of interpretation of statutes. In their Lordships' opinion, the specific exclusion made in sub-clause (*iii*) will prevail over the general provisions contained in the other sub-clauses of clause (*b*) of section 35B(1). Such an interpretation is also in accord with the principle of harmonious construction. Also see, *Bhansali & Co. v. CIT,* (1995) 78 Taxman 501, 507-08 (Cal).

In the context of allowability of weighted deduction in respect of interest on packing credit and shipping lien under section 35B(1)(*b*)(*viii*), the basic document is the certificate in regard thereto from the financing bank. It, therefore, becomes absolutely necessary for the bank authorities to bear in mind in the process of calculation the above statutory requirements. The certificate is expected to contain specific calculation with regard to the services and financial liabilities arising therefrom confining it to those outside India in connection with the execution of the contract. The bank certificate has to be specific in character in regard to the statutory requirements relating thereto which would not only enable the assessee to claim benefit of deduction under sub-clause (*viii*) but it would also be a facility to the tax authorities to pinpoint the amount calculated in accordance with the provisions of sub-clause (*viii*). Naturally, then the certificate is expected to be precise with regard to the figures relating to pre-shipment position as against the post-shipment credit. This is in view of the statutory requirements that the assessee would get benefit with regard to the claim under consideration in accordance with the requirements of sub-clause (*viii*) only with regard to post-shipment credit and the interest in regard thereto. The bank certificate has to be in accordance with the above statutory requirements [*CIT v. N.C. John & Sons Ltd.,* (1997) 226 ITR 934, 938, 953 (Ker)]. In that case, it has been observed (p. 955) that the bank should issue the certificates specifying the exact calculation of the amount separating the amount of interest in regard thereto specifically in accordance with the provisions of the statutory requirements. Further, the Tribunal was directed to remand the proceedings to the tax authorities, which in their turn were also directed to examine the bank certificate in the light of the observations made in the judgment to find out as to whether on the strength of the bank certificate it is possible to apply the statutory provisions for the purpose of weighted deduction in regard thereto.

In *CIT v. Twinklers* [(1998) 234 ITR 691, 693 (Del)], it has been held that the assessee was not entitled to weighted deduction under section 35B(1)(*b*)(*viii*) for assessment years 1972-73, 1973-74 and 1974-75 in respect of expenses on packing and forwarding and import licence fee because none of the expenses were relatable to the performance of services outside India.

Holding that the phraseology used by the Legislature in drafting section 35B(1)(*b*)(*viii*) is very wide and, in that view of the matter, expenditure reimbursed by the assessee-exporter to the importer, who has incurred expenditure on refining, melting and handling charges for and on behalf of the exporter, has been held eligible for weighted deduction under section 35B(1)(*b*)(*viii*) [*CIT v. Bansal Exports Pvt. Ltd.,* (1999) 238 ITR 455, 457-58 (Del)].

Where the Tribunal has found that certain expenses fell within the ambit of section 35B(1)(*b*)(*viii*), the assessee was held entitled to weighted deduction on such expenses [*CIT v. Bharat Heavy Electricals Ltd.,* (1999) 239 ITR 756, 763 (Del)].

In *Golden Hind Shipping* (*India*) *Pvt. Ltd. v. CIT* [(1999) 240 ITR 324, 329 (Del)], expenses incurred on payment of hire charges, which are in the nature of trading expenses incurred in India, held not eligible for weighted deduction under section 35B(1)(*b*)(*viii*)].

The weighted deduction under section 35B(1)(*b*)(*viii*) with regard to exchange and bank charges cannot be denied solely on the ground that the payment was made by way of reimbursement in India. However, the question whether the assessee is entitled to weighted deduction also cannot be decided solely on that basis. It must entail an inquiry whether the amount which was spent by the assessee by way of reimbursement was incurred wholly and exclusively for the purpose of such service outside India in connection with or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities which the assessee was to perform or execute outside India [*CIT v. Official Liquidator, Ahmedabad Manufacturing & Calico Printing Co. Ltd.,* (2000) 244 ITR 156, 164-65 (Guj)].

In *CIT v. Shapoorji Pallonji & Co. Pvt. Ltd.* [(2004) 266 ITR 209, 212-13 (Bom)], the assessee was held entitled to weighted deduction under section 35B(1)(*b*)(*viii*) in connection with expenditure incurred on payment of commission to the bank and insurance company for providing guarantees for the performance of service outside India by the assessee.

Sub-clause (*iii*) of section 35B(1)(*b*)—omitted w. e. f. 1-4-1981.—Sub-clause (*iii*) of section 35B(1)(*b*) had created many problems before the Income-tax authorities and ultimately the provisions—rather good and beneficial to country's economy—have been omitted with effect from 1-4-1981, *i.e.*, for and from assessment year 1981-82. It may also be noted that the legislature had already circumscribed, for and from assessment year 1978-79, the benefit of the sub-clause by adding the words "where such expenditure is incurred before the 1-4-1978". Thus, the effect of the sub-clause was maimed in regard to expenditure incurred on or after 1-4-1978. It still needs examination as to precisely what were the provisions of that sub-clause.

It allowed weighted deduction in respect of expenditure incurred wholly and exclusively on distribution, supply or provision outside India (to foreign countries) of goods, services or facilities which the assessee dealt in or provided in the course of his business. On the face of the provisions, their gamut was much too wide. But those were the provisions originally enacted. On better thought, **the Finance Act, 1970** (19 of 1970),

LexisNexis

substituted a new sub-clause (*iii*) with retrospective effect from 1-4-1968, the date of the birth of the provisions.

The **so-substituted sub-clause**, in making such expenditure eligible for weighted deduction, truncated the provisions by placing three bans. These were by making the following expenditures not eligible for the weighted deduction:

(1) Expenditure **incurred in India** in connection with distribution, supply or provision outside India of such goods, services or facilities.

(2) Expenditure, **whether incurred in India or outside India,** on the carriage of such goods to their destination outside India [*e.g.*, freight, etc.].

(3) Expenditure, **whether incurred in India or outside India,** on the insurance of such goods while in transit. It may be noted that this ban covered only the expenditure on insurance of such goods while in transit and not insurance after the goods have been taken delivery of in their foreign destination.

The correct interpretation of section 35B(1)(*b*)(*iii*) was that it allowed all expenditure on distribution, supply, etc., of goods outside India, except (*i*) expenditure incurred in India, in connection with supply, distribution or provision; and (*ii*) expenditure on carriage or transit insurance of such goods, wherever incurred [*Handicrafts & Handloom Export Corporation of India v. CIT,* (1983) 140 ITR 532, 545 (Del); *Nath Bros. Exim International Ltd. v. CIT,* (1997) 227 ITR 635, 638 (Del). Also see, *Vijay Kumar Aggarwal v. CIT,* (1998) 232 ITR 179, 185 (Punj)]. Thus, no deduction under section 35B(1)(*b*)(*iii*) could be allowed to the assessee for expenditure incurred in India in connection with sale of goods [*CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 176 (SC)].

An assessee would be entitled to weighted deduction under section 35B on the expenses on the exports markets development though the expenditure was incurred in India, unless specifically excluded [*CIT v. Prakash Cotton Mills Pvt. Ltd.,* (1991) 188 ITR 713, 715 (Bom), **following,** *CIT v. Eldee Wire Ropes Ltd.,* (1978) 114 ITR 485 (Bom)].

Any expenditure incurred wholly and exclusively for distribution and supply outside India of goods would qualify for weighted deduction under section 35B(1)(*b*)(*iii*) so long as such expenditure did not form part of the expenses on the carriage of goods to destinations outside India. If the goods were stored in a warehouse for sale, although the assessee admittedly was not the owner of such warehouse, such expenditure would be eligible for weighted deduction. Where the expenditure was incurred for storing goods in the warehouse before the sale of goods exported, such expenditure by way of warehousing expenses would relate to distribution and supply of the goods outside India qualifying for weighted deduction under section 35B(1)(*b*)(*iii*) [*CIT v. Bishnauth Tea Co. Ltd.,* (1992) 197 ITR 150, 154-55 (Cal)]. In the facts of that case, the assessee was held entitled to weighted deduction under section 35B. Also see, *Prakash Cotton Mills Pvt. Ltd. v. CIT,* (1993) 203 ITR 75, 77 (Bom).

However, the Madras High Court has, in *V. Guruviah Naidu & Sons v. CIT* [(1995) 216 ITR 156, 165-66 (Mad)], taken the view that the expenditure on transport of goods for export incurred in India or expenditure on insurance in transit incurred in India is eligible for deduction under section 35B(1)(*b*)(*iii*).

In view of the two conflicting views, the matter has been referred to a larger Bench for deciding the correctness of the above Madras decision : 216 ITR 156 (Mad) [*V. Guruvaiah Naidu & Sons v. CIT,* (1997) 142 CTR (Mad) 546, 552-53].

On such reference, the Full Bench has, in *V. Guruvaiah Naidu & Sons v. CIT* [(2002) 174 CTR (Mad) 100, 101 (FB)], **overruled** the above Madras decision [216 ITR 156 (Mad)] and has held that expenditure on carriage of goods and insurance did not qualify for weighted deduction under section 35B(1)(*b*)(*iii*).

In the facts of *Kamal Silk Emporium v. CIT* [(2003) 264 ITR 520, 521 (Del)], the assessee was held not entitled to weighted deduction, for assessment year 1977-78, under section 35B on the expenditure incurred by it in India on the sales effected in India, even against foreign exchange.

The expenditure referred to in section 35B(1)(*b*)(*iii*) referred to sales outside India and not within India. In that view of the matter, section 35B(1) was not attracted in respect of counter sales within India, even against foreign currency, as such sales could not be treated as export sales for availing weighted deduction under section 35B [*CIT v. Ganeshi Lal & Sons*, (2004) 266 ITR 203, 204 (All)].

Further, the **then *Explanation 2* to section 35B(1)** (which was operative up to assessment year 1980-81) clarified that expenditure incurred by an eligible assessee engaged in the business of (*a*) operation of any ship or other vessel, aircraft or vehicle, or (*b*) carriage of, or making arrangements for carriage of, passengers, livestock, mail or goods, on or in relation to such operations, etc. (as indicated by the said *Explanation*) shall not earn weighted deduction.

In view of the provisions of section 35B(1)(*b*)(*iii*) read with *Explanation 2*, the Tribunal was held right in holding that the assessee was not entitled to claim weighted deduction of Rs. 8,29,518 being export expenses

and Rs. 7,68,512 being export freight under section 35B [*Premier Vegetable Products Ltd. v. CIT,* (1997) 227 ITR 698, 701 (Raj)].

Barring these types of expenditure, the other expenditures falling within the umbrella of the sub-clause earned weighted deduction, if such expenditure was incurred before 1-4-1978.

In this view of the matter it may be seen that customs duty paid and packing charges incurred by the assessee's foreign branches for import of goods from India were held eligible for weighted deduction [*CIT v. Kasturi Palayacat Co.,* (1979) 120 ITR 827 (Mad). Also see, *CIT v. Kasturi Palayacot & Co.,* SLP (Civil) No. 16520 of 1994 : (1994) 210 ITR (St.) 7 (SC)]. But export duty paid in India would fall in the first ban above and would not earn weighted deduction [see, *CIT v. Eldee Wire Ropes Ltd.,* (1978) 114 ITR 485 (Bom)]. Similar is the case with the agency commission paid in India [*CIT v. Girdharlal Vithaldas,* (1992) 196 ITR 316, 318 (Guj). Also see, *Canara Wire & Wire Products Ltd. v. CIT,* (1992) 196 ITR 426, 428 (Karn); *I.C. Gandhi Silk Mills Pvt. Ltd. v. CIT,* (1992) 196 ITR 495 (Guj); *Sonal Gum Industries v. CIT,* (1992) 197 ITR 613, 615-16 (Guj)].

In the following cases, the **first ban** above was also **held attracted**:—

(1) *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 234, 235, 242 (Guj) [advertisement and bank guarantee charges incurred in India; expenditure on packing and tower testing charges incurred in India].

(2) *Dr. Beck & Co.* (*India*) *Ltd. v. CIT,* (1994) 206 ITR 311, 314-15 (Bom) [export inspection charges and loading and unloading expenses].

(3) *Mafatlal Fine Spg. and Mfg. Co. Ltd. v. CIT,* (1994) 206 ITR 578, 579 (Bom) [export licence fees].

(4) *Sam Fashion Wear Pvt. Ltd. v. CIT,* (1994) 209 ITR 214, 220 (Bom) [packing expenses incurred in India].

(5) *Rajan Trading Co. v. CIT,* (1995) 214 ITR 335, 337, 341 (Mad) [commission on exports paid in India].

In the following cases, the **second ban** above was **held attracted**:—

(1) *CIT v. Ram Narain Pratap Narain,* (1991) 191 ITR 361, 362 (All) [air freight charges].

(2) *Canara Wire & Wire Products Ltd. v. CIT,* (1992) 196 ITR 426, 428 (Karn) [freight].

(3) *Shri Ambica Mills Ltd. v. CIT,* [(1992) 198 ITR 99, 103-04 (Guj) [export freight paid in India]. Also see, *K.V. Patel & Co. v. CIT*, (1994) 122 CTR (Guj) 297, 299.

(4) *J.M.A. Industries Ltd. v. CIT,* (1993) 200 ITR 210 (Del) [freight, dock charges, etc., paid in India].

(5) *Isabgul Export Corporation v. CIT,* (1993) 200 ITR 797 (Guj) [transport charges, shipping and forwarding charges]. Also see, *Parshuram Pottery Works Co. Ltd. v. CIT,* [(1993) 204 ITR 458, 461 (Guj); *Wintex Mills Ltd. v. CIT,* (1994) 205 ITR 476, 478 (Guj); *I.C. Gandhi Silk Mills v. CIT,* (1993) 115 Taxation 148 (Guj); *Parshuram Pottery Works Co. Ltd. v. CIT,* (1993) 117 Taxation 403 (Guj).

(6) *M.H. Daryani v. CIT,* (1993) 202 ITR 731 (Bom) [freight and forwarding charges]. Also see, *Southern Asbestos Cements Ltd. v. CIT,* (1998) Tax LR 229, 230 (Mad).

(7) *CIT v. Roadmaster Industries of India Pvt. Ltd.,* (1993) 202 ITR 968, 974 (Punj) [railway freight].

(8) *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 242 (Guj) [freight]. Also see, *Nath Bros. Exim International Ltd. v. CIT,* (1997) 227 ITR 635, 638 (Del); *Hamosons v. CIT,* (1998) Tax LR 571, 573 (Mad) = (1999) 239 ITR 752, 756 (Mad).

(9) *Bralco Metal Industries Pvt. Ltd. v. CIT,* (1994) 206 ITR 477, 481 (Bom) [expenditure incurred on carriage of goods].

(10) *Mafatlal Fine Spg. and Mfg. Co. Ltd. v. CIT,* (1994) 206 ITR 578, 579 (Bom) [export freight charges]. Also see, *Sam Fashion Wear Pvt. Ltd. v. CIT,* (1994) 209 ITR 214, 216 (Bom); *HMM Ltd. v. CIT,* (1998) 231 ITR 726, 729-30 (Punj).

(11) *Associated Stone Industries Ltd. v. CIT,* (1994) 210 ITR 821, 826 (Raj) [Packing charges and freight].

(12) *Bhansali & Co. v. CIT,* (1995) 78 Taxman 501, 508-09 (Cal) [expenditure incurred in India on the carriage of goods to their destination outside India; expenses incurred on the transportation of goods from the assessee's warehouses to ports for the purpose of export].

(13) *Avon Cycles Pr. Ltd. v. CIT,* (1999) 238 ITR 85, 88 (Punj) [carriage outward expenses].

(14) *Hamosons Export* (*P.*) *Ltd. v. CIT,* (1999) 238 ITR 773, 774 (Mad) [export air freight charges; shipping and harbouring charges and export handling charges as the same related to the carriage of such goods to a destination outside India or the insurance of such goods while in transit].

In the following cases, the **third ban** above was **held attracted**:—

LexisNexis

(1) *I.C. Gandhi Silk Mills Pvt. Ltd. v. CIT,* (1992) 196 ITR 495 (Guj) [insurance]. Also see, *I.C. Gandhi Silk Mills v. CIT,* (1993) 115 Taxation 148 (Guj); *Nath Bros. Exim International Ltd. v. CIT,* (1997) 227 ITR 635, 638 (Del).

(2) *Isabgul Export Corporation v. CIT,* (1993) 200 ITR 797 (Guj) [insurance].

(3) *M.H. Daryani v. CIT,* (1993) 202 ITR 731 (Bom) [insurance]. Also see, *Apeego Corporation v. CIT,* (1995) 215 ITR 697, 699 (Bom).

(4) *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 242 (Guj) [insurance].

(5) *Wintex Mills Ltd. v. CIT,* (1994) 205 ITR 476, 478 (Guj) [insurance]. Also see, *Parsuram Pottery Works Co. Ltd. v. CIT,* (1993) 117 Taxation 403 (Guj).

(6) *Mafatlal Fine Spg. and Mfg. Co. Ltd. v. CIT,* (1994) 206 ITR 578, 579 (Bom) [export insurance charges]. Also see, *CIT v. V.H. Jewellers,* (1994) 121 Taxation 142 (Raj).

(7) *Avon Cycles Pr. Ltd. v. CIT,* (1999) 238 ITR 85, 88 (Punj) [transit insurance charges].

(8) *Hamosons Export* (*P.*) *Ltd. v. CIT,* (1999) 238 ITR 773, 774 (Mad) [insurance charges].

Also see, *ITO v. Universal Ferro & Allied Chemicals Ltd.,* (1988) 172 ITR 30 (Bom), **setting aside,** *Universal Ferro & Allied Chemicals Ltd. v. P.G.K. Warrier,* (1983) 143 ITR 959 (Bom); *CIT v. Sahney Steel & Press Works* (*P.*) *Ltd.,* (1989) 177 ITR 354, 357 (Bom).

Relief on estimate basis.—In the absence of proper particulars and details, the exact relief to the export of goods can only be arrived at on the basis of the estimate [*Rajan Trading Co. v. CIT,* (1995) 214 ITR 335, 341 (Mad)]. In that case, it was found by the Tribunal that the assessee has not given the full details with regard to the expenditure incurred for foreign trade. Therefore, the relief granted under section 35B, on the estimated basis, has been held to be quite correct and reasonable.

Special provisions for A.Y. 1978-79 and 1979-80—section 35B(1A).—For assessment years 1978-79 and 1979-80, **section 35B(1A)** was **introduced** providing certain variations in the scheme of weighted deduction. No weighted deduction could be available in respect of expenditure incurred on or after 1-4-1978, unless the following conditions were fulfilled, namely:—

(*a*) the eligible assessee was engaged in—

(*i*) the business of export of goods, and was either a small-scale exporter (exporting goods manufactured in his own "small-scale industrial undertaking") or a holder of an Export House Certificate issued by the Chief Controller of Imports and Exports; or

(*ii*) the business of "provision of technical know-how" or the rendering of services in connection with the provision of technical know-how, to persons outside India; and

(*b*) the expenditure in relation to which weighted deduction has been claimed is incurred by the assessee wholly and exclusively for the purposes of the business referred to in (*a*) above.

LexisNexis

These special provisions have been **omitted for and from assessment year 1980-81**.

In the facts of *CIT v. R.N. Oswal Hosiery Factory* [(1987) 165 ITR 662 (Punj)], it was held that the special provisions of section 35B(1A) were satisfied and, therefore, the assessee was entitled to claim weighted deduction in respect of payment of commission.

Where there was no evidence to show that the assessee was owning a 'small-scale industrial undertaking', no weighted deduction under section 35B(1A) was eligible [*CIT v. Dhandia Gems Corporation,* (1994) 208 ITR 923 (Raj); *CIT v. Raja Jewellers,* (1994) 208 ITR 928 (Raj); *CIT v. Pink Jewellers,* (1995) 216 ITR 289, 291 (Raj); *CIT v. Rawat Jewellers,* (1995) 127 CTR (Raj) 416, 417.

In the facts of *CIT v. Travancore Mats & Mattings Co.* [(1998) 229 ITR 93, 94, 98, 100 (Ker)], the assessee was held to be a small-scale industrial undertaking eligible for weighted deduction under section 35B(1A) for assessment year 1979-80 as the aggregate value of plant and machinery installed did not exceed Rs. 10 lakhs, excluding the value of two lorries which were not plant and machinery installed.

In *CIT v. Tara Agencies* [(2000) 243 ITR 336, 338, 343-44 (Ker), special leave petition granted by the Supreme Court: (2001) 250 ITR (St.) 3 (SC)], the assessee engaged in purchasing different qualities of tea and blending the same for the purpose of export, has been held entitled to weighted deduction, for the assessment year 1979-80, in the light of section 35B(1A) in respect of the expenditure incurred in connection with its exports. This is so because the blending of tea would come within the term 'processing' used in the definition of industrial undertaking.

According to **clause (*d*) of the *Explanation* to section 35B(1A)**, the expression 'small-scale industrial undertaking' has the meaning assigned to it in clause (2) of the *Explanation* to section 32A(2).

In *Ganapathy Engineering Manufacturing P. Ltd. v. CIT* [(2000) 245 ITR 203, 208-10 (Mad)], it has been held that even for the purposes of section 35B(1A) the said clause (2) of the *Explanation* to section 32A(2) has

to be read in the setting in which it appears in section 32A and in the context of that *Explanation* those items on which investment allowance is not allowed should be altogether excluded to determine the aggregate value of the plant and machinery for the purpose of deciding the controversy whether an undertaking can be regarded as a small-scale industrial undertaking or not. Further, it is not possible to pick out only clause (2) of that *Explanation* to section 32A(2) and engraft the same as part of section 35B(1A). The Legislature has referred to the small-scale industrial undertaking in the context of section 32A and the reading of that *Explanation* in isolation of the other provisions of section 32A would distort the meaning and would defeat the object of encouraging export by small-scale exporters. Consequently, the view of the Tribunal that only the value of the tools, jigs, dies and moulds should alone be excluded from the computation of the total value of machinery or plant is not sustainable. Therefore, the matter has been remanded to the Tribunal for hearing it afresh in the light of the directions stated in the judgment.

Measure of benefit.—The allowance to be given deduction under **section 35B** was an amount equal to **one and one-third times** the amount of the qualifying expenditure so incurred. The amount of **deduction was increased** to one and one-half times the amount of actual expenditure incurred after the 28-2-1973, but before the 1-4-1978, by **domestic companies in which the public are substantially interested.** This enhanced weighted deduction was applicable only in case of widely-held domestic companies and was not available in case of other categories of taxpayers.

The assessee-company has been held for assessment years 1975-76 and 1979-80 not entitled to weighted deduction at the increased rate of 1½ times the expenditure but only at 1⅓rd times the expenditure, because the company could not be treated as a company in which the public were substantially interested within the meaning of section 2(18)(*b*) [*CIT v. Sundaram Clayton Ltd.,* (1997) 226 ITR 81, 85 (Mad)]. Similar view has been taken in relation to assessment year 1977-78 [*CIT v. Lucas TVS Ltd.,* (1997) 226 ITR 281, 285 (Mad)].

Thus, where the assessee-company was held to be a company in which public were not substantially interested for the assessment year 1977-78, the assessee-company was held entitled to claim weighted deduction only at 1⅓ times of the expenditure and not at 1½ times as contemplated in the proviso to section 35B(1)(*a*) [*Lucas TVS Ltd. v. CIT,* (1999) 236 ITR 752, 756 (Mad)]. It is pertinent to note that the case reported in (1997) 226 ITR 281 (Mad) is the same case but having *vice versa* name.

Section 35B supplemented section 37(1).—The basic criteria for attraction of **section 35B and section 37(1)** are, more or less, similar. The expenditure must not be a capital expenditure or personal expenses of the assessee. The expenditure must be incurred wholly and exclusively for the purposes of the business for section 37(1), and on certain specified items in relation to the export business for section 35B. Eligibility of an expenditure was first to be tested with reference to section 35B. If it so fell, it was to earn weighted deduction. If not, it might still have fallen for allowance under section 37(1).

LexisNexis

Allowability under section 35B not to be affected by restrictive provisions of section 37.—It cannot be contended that the assessee is not entitled to weighted deduction under section 35B in respect of an expenditure because such expenditure is not eligible for deduction under section 37. Sections 37 and 35B are two independent sections and the mere fact that a particular expenditure may not be fully allowable or allowable subject to certain conditions under section 37 would not stand in the way of the assessee claiming the deduction under section 35B if the assessee has satisfied the conditions prescribed under section 35B. Both the above sections operate in independent fields and the restriction found in section 37 cannot be automatically imparted or imposed while considering the claim under section 35B. In that view of the matter, merely because a portion of the expenditure may not be allowable under section 37 would not disentitle the assessee to claim the benefit of section 35B, if the conditions of section 35B are complied with [*CIT v. Madras Rubber Factory Ltd.,* (1998) 146 CTR (Mad) 785, 791-92 = (2000) 241 ITR 770, 777 (Mad)]. In the Madras case, the assessee was held entitled to weighted deduction for assessment year 1976-77 in respect of expenditure on export promotion as also in respect of foreign delegate expenses even though there was element of entertainment in the said expenditure.

No deduction for qualifying expenditure under any other provision.—Sub-section (2) made it clear that where a deduction under section 35B(1) was claimed and allowed in any year, deduction shall not be allowed in respect of such expenditure under any other provision for the same or any other assessment year.

Rectification not possible if allowance was not claimed.—Section 35B stood on its own terms and allowance under this section had no comparison with allowance of depreciation under section 32. If the assessee had not claimed any weighted deduction and the assessment was completed without giving any weighted deduction, there was no mistake apparent from the record and the assessee could not successfully apply for rectification by allowance of weighted deduction [see, *Paramount Trading Corporation v. ITO,* (1980) 124 ITR 55 (All)].

The above Allahabad decision [124 ITR 55 (All)] has been **dissented from** by the Madhya Pradesh High Court in *CIT v. K.N. Oil Industries* [(1983) 142 ITR 13 (MP)] which held that if it is apparent from the record that the assessee was entitled to weighted deduction under section 35B, such deduction can be granted through rectification proceedings even though the assessee did not claim it in his return.

In the facts of *CIT v. Baldeo Ram Salig Ram Pvt. Ltd.* [(1991) 188 ITR 470, 476 (All)], it has been held that there was no material on record justifying the Tribunal's finding that there was an obvious mistake which could be rectified under section 154.

Claim made for the first time before the appellate authority.—In the facts of the following cases, the appellate authority was held justified in entertaining a claim under section 35B raised before it for the first time:—

1. *Madhu Jayanti Pr. Ltd. v. CIT,* (1985) 154 ITR 277 (Cal).
2. *CIT v. Gordhandas Jerambhai,* (1985) 154 ITR 288 (Cal).
3. *CIT v. Oswal Woollen Mills Ltd.,* (1987) 163 ITR 484 (Punj).
4. *CIT v. Amritsar Swadeshi Woollen Mills,* (1989) 179 ITR 304 (Punj).

However, in the facts of *Silver Plastochem* (*P.*) *Ltd. v. CIT* [(1985) 20 Taxman 381 (Bom)], the appellate authority was held not justified in entertaining the claim under section 35B made before it for the first time.

Claim for weighted deduction can be made under more than one of the sub-clauses of section 35B(1)(*b*).—It is quite possible in a given case that an assessee, depending on its activities contemplated under section 35B as also rule 6AA, may claim the benefit of weighted deduction under more than one of the sub-clauses of section 35B(1)(*b*). In other words, the activities contemplated in the different sub-clauses of section 35B(1)(*b*) and rule 6AA are not necessarily mutually exclusive of each other. The relevant consideration in a given case would however be as to whether there are evidentiary facts in support of the claim for weighted deduction under different heads of expenditure as set out under section 35B as well as rule 6AA. As a corollary, therefore, if an assessee claims the benefit of weighted deduction under any one of the sub-clauses of section 35B(1)(*b*), he is not debarred in a particular case to claim similar benefit under a different sub-clause as well provided the facts and circumstances justify such a claim [*Assam Co.* (*India*) *Ltd. v. CIT,* (2002) 256 ITR 423, 433 (Gauh)]. In the facts of that case, the matter has been remanded to the Tribunal because the Tribunal has erred in not considering the contention of the assessee-company that the warehouse charges were covered by section 35B(1)(*b*)(*iv*) only on the ground that the assessee had not filed any appeal or cross-objection. The High Court has made it absolutely clear that in case the basic facts relating to the claim under section 35B(1)(*b*)(*iv*) are not available on record, the assessee-company would not be permitted to urge that ground and the Tribunal would pass appropriate orders as it would deem fit in accordance with law.

Onus on the assessee.—If an assessee claimed the benefit of weighted deduction under section 35B, the onus squarely rested upon him to satisfy the revenue authorities and the Tribunal that the purpose for which the expenditure concerned was incurred falls within any of the sub-clauses of section 35B(1)(*b*). If he could not establish this, he was not entitled to any weighted deduction [*CIT v. Eldee Wire Ropes Ltd.,* (1978) 114 ITR 485, 486 (Bom)].

In order to be eligible for weighted deduction under section 35B, it is required to be established by the assessee that the expenditure for which such deduction is being claimed had been incurred wholly and exclusively for the specified purposes [*Birla Jute Mfg. Co. Ltd. v. CIT,* (1986) 162 ITR 413, 419 (Cal)]. Also see, *CIT v. Navabharat Enterprises,* (1988) 170 ITR 332, 363 (AP); *M. Qasim Bros. v. CIT,* (1991) 187 ITR 675 (J & K); *Brooke Bond India Ltd. v. CIT,* (1992) 193 ITR 390, 403-04 (Cal); *CIT v. Dunlop India Ltd.,* (1992) 197 ITR 34, 41 (Cal); *Walchandnagar Industries Ltd. v. CIT,* (1994) 206 ITR 328, 331 (Bom); *Peico Electronics and Electrical Ltd. v. CIT,* (1992) 107 CTR (Cal) 120, 124; *CIT v. Hindusthan Gas & Industries Ltd.,* (1992) 107 CTR (Cal) 155, 158; *Needle Industries* (*India*) *Ltd. v. CIT,* (2000) 242 ITR 186, 194 (Mad); *CIT v. K. Pattabhirama Reddy,* (2001) 250 ITR 423, 430 (AP).

In order to get deduction under section 35B, the onus lies heavily on the assessee to prove that the expenditure falls within any of the purposes set out in the various sub-clauses of clause (*b*) of section 35B(1). Merely because some activities took place outside India that will not qualify the expenditure for the deductions mentioned in section 35B [*CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 174, 175, 177, 178, 179, 183 (SC)]. In other words, it is for the assessee to prove that the entire expenditure involved was wholly and exclusively for the purposes mentioned in clause (*b*) of section 35B(1) [*CIT v. Hero Cycles Pvt. Ltd.,* (1997) 228 ITR 463, 468, 469, 470, 475 (SC)]. Also see, *CIT v. India Cements Ltd.,* (2000) 244 ITR 185, 186 (Mad); *Exportos India v. CIT,* (2000) 246 ITR 1, 7 (Del); *CIT v. South India Corporation* (*Agencies*) *Ltd.,* (2000) 246 ITR 581, 585-86 (Mad); *CIT v. Export House,* (2002) 256 ITR 603, 614 (Punj); *CIT v. Romin Consulting Services* (*P.*) *Ltd.,* (2003) 262 ITR 357, 360 (Del); *CIT v. O.K. Hosiery Mills,* (1997) Tax LR 1049, 1050, 1051 (Punj) = (1999) 236 ITR 405, 408 (Punj).

Thus, there cannot be any blanket allowance of the expenditure and if the expenditure does not fall in any of the categories mentioned in the sub-clauses of section 35B(1)(*b*), weighted deduction cannot be allowed. In other words, every expenditure, on which weighted deduction has been claimed, has to be examined in the light of the provisions in the various sub-clauses and the onus to prove that he is entitled to weighted deduction under section 35B lies on the assessee [*Navin Chemicals Manufacturing & Trading Co.* (*P.*) *Ltd. v. CIT,* (2003) 259 ITR 111, 113 (Del)].

To put it differently, the benefit of section 35B can be claimed only if the expenditure incurred can be brought under any one of the sub-clauses of section 35B(1)(*b*) [*P. Muttulal Lalah & Sons v. CIT,* (2003) 259 ITR 236, 237 (Mad)].

What the section requires is that the assessee must establish that the expenses were incurred outside India for the specified activities performed outside India. The burden is on the assessee to prove that fundamental fact. It is not sufficient that the assessee sold goods to foreign buyers or that it was assisted by a commission agent in connection with the sale of those goods, but the burden is on the assessee to prove that the commission paid was wholly and exclusively for the specified activities conducted outside the country. The object of the special concession allowed under section 35B is to facilitate export trade; and, only in regard to expenditure incurred outside the country, although paid in India, can the assessee claim the benefit. In other words, once it is proved that the expenditure was incurred outside India wholly and exclusively for the specified activities, the assessee would not be disqualified for the deduction, even if payment towards such expenditure was actually made in India. The wording of the section, which is intended to facilitate export trade, does not justify the narrower construction that, not only the expenditure should have been incurred outside India, but the payment also should have been made outside India [*CIT v. C. Tharian & Sons,* (1987) 166 ITR 607, 609, 610 (Ker), **dissenting from** *CIT v. Southern Sea Foods P. Ltd.,* (1983) 140 ITR 855 (Mad) and *CIT v. Jay Engineering Works,* (1984) 149 ITR 297 (Del); *CIT v. P. Alikunju, M.A. Nazir, Cashew Industries,* (1987) 166 ITR 611 (Ker); *CIT v. Orion Coir Mats and Matting Manufacturers* (*P.*) *Ltd.,* (1987) 166 ITR 616 (Ker)].

What kind of evidence is needed for claiming weighted deduction under section 35B.—In this regard, it is proper to state the law as follows:

(*i*) A person who claims that he has made certain expenditure is expected to have some documentary evidence.

(*ii*) In the absence of the above, he is expected to say how he incurred the expenditure and why there is no documentary proof for such expenditure, and if he has any satisfactory evidence to show that documentary evidence has been lost or destroyed, he may take recourse to secondary evidence, *viz.*, certified copies or attested copies of such documents, or copies made from the original by the mechanical processes which in themselves ensure the accuracy of the copy, and copies compared with such copies, copies made from or compared with the original; counter-parts of documents as against the parties who did not execute them; and oral accounts of the contents of a document given by some person who has himself seen it.

(*iii*) Circumstantial evidence in such cases as proof of expenditure by the assessee shall be rare and exceptional, and if at all, in the aid of the assessee, it shall so come to remove doubts as to the expenditure and to establish genuineness of the claim which is otherwise sought to be proved by direct evidence or secondary evidence.

(*iv*) It will be difficult to assume that such expenditure has been incurred on the basis of a presumption that such expenditure must have been incurred because the assessee is engaged in the trade of export and he is expected to incur expenses to promote the sale of his goods abroad [*CIT v. Southern Sea Foods Ltd.,* (1995) 215 ITR 176, 184 (Mad)]. In the facts of that case, the Madras High Court inclined, for the above reasons, to disagree with the view taken by the Tribunal and the High Court has held that the Tribunal has not acted legally in proceeding to make some sort of best judgment assessment itself without following the proper procedure in that regard. Further, the High Court has, with regard to the question of law referred, held that where the expenses are incurred for any of the purposes set out in section 35B(1)(*b*)(*i*), (*ii*) and (*v*) for the purpose of promotion of exports, such expenses would qualify for deduction as per section 35B. For the purpose of arriving at a figure, the Appellate Assistant Commissioner has to decide on the proof with materials produced by the assessee before it. Also see, *CIT v. Southern Sea Foods* (*P.*) *Ltd.,* (1997) Tax LR 558, 559 (Mad).

Each case has to be examined in the light of the statutory provisions and the facts proved.—In order to get weighted deduction under section 35B, the assessee will have to prove that the expenditure was incurred during the previous year wholly and exclusively for the purposes set out in various sub-clauses of section 35B(1)(*b*). There cannot be any blanket allowance of the expenditure nor can there be any blanket disallowance. Every case has to be discussed specifically and the expenditure must be found to be of the nature mentioned in

LexisNexis

any one of the sub-clauses. If the expenditure does not fall in any of these categories it cannot be allowed as a deduction. Some of the sub-clauses provide that if the expenditure is incurred in India, it cannot be allowed but in some of the sub-clauses this requirement is not there. In such cases, the expenditure may or may not be incurred in India. Every case will have to be examined in the light of the provisions of the sub-clauses and the facts proved by the assessee [*CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 175 (SC)].

In that view of the matter, the Tribunal would be wrong in allowing the claim of the assessee for weighted deduction under section 35B without going into the facts of the case. Further, as the onus of proving the facts and getting the benefit of the deduction lies on the assessee, the Tribunal cannot allow the claim on assumption of facts where the assessee has not proved anything either before the ITO or the AAC [*CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 180 (SC)].

Thus, from the above Supreme Court ruling [228 ITR 171 (SC)], it is clear that a claim for weighted deduction under section 35B cannot be allowed unless and until it is shown that it related to any of the activities specified in the sub-clauses of section 35B(1)(*b*). In such a situation, the claim in respect of export establishment cannot be said to be eligible for weighted deduction under section 35B [*CIT v. Victor Tools Corporation,* (1998) 146 CTR (Punj) 794, 805 = (1999) 237 ITR 640, 651 (Punj)].

In view of the above Supreme Court ruling [228 ITR 171 (SC)], the decision in *CIT v. Punjab Bone Mills* [(1998) 96 Taxman 555, 559-60 (Punj), delay condoned and notice issued on SLP : (1998) 232 ITR (St.) 4 (SC)] **cannot be said to have laid down the correct law on the point** in holding that the Tribunal was right in law in allowing weighted deduction under section 35B on proportionate expenditure without specifically relating the expenditure to any of the sub-clauses of section 35B(1)(*b*). The Punjab decision [(1998) 96 Taxman 555 = (1998) 232 ITR 795 (Punj)] has been **affirmed in** *CIT v. Punjab Bone Mills* [(2001) 251 ITR 780, 781 (SC)], without much discussion.

Claim cannot be enlarged in fresh assessment.—Where a fresh assessment is completed in pursuance of the appellate order of the first appellate authority, the assessee is not entitled to enlarge its claim for weighted deduction at the stage of such fresh assessment [*Malwa Vanaspati & Chemicals Co. Ltd. v. CIT,* (1997) 228 ITR 668, 669, 671 (MP)].

Illustrative cases on weighted deduction under section 35B.—In the facts of the following cases, the weighted deduction under section 35B was **held allowable**:—

(1) *Handicrafts and Handloom Export Corporation of India v. CIT,* (1983) 140 ITR 532 (Del) [custom duty paid by the foreign office of the assessee for goods exported]. Also see, *Faqir Chand Raghunath Dass v. CIT,* (1994) 206 ITR 696, 698 (Del).

(2) *CIT v. Godrej & Boyce Mfg. Co. Pr. Ltd.,* (1984) 149 ITR 594 (Bom), special leave petition dismissed by the Supreme Court : (1990) 186 ITR (St.) 71 (SC) [commission paid to a foreign agent for securing business, for publicising assessee's products in the agent's territory and for maintaining a show room at agent's expense]. Also, see, *CIT v. Oswal Woollen Mills Ltd.,* (1987) 163 ITR 484 (Punj); *CIT v. Apeego Corporation Maker,* (1997) 141 Taxation 627, 628 (Bom).

(3) *CIT v. Indo Marine Agencies* (*Kerala*) *Pr. Ltd.,* (1986) 158 ITR 604 (Ker) [expenses on storage at a place outside India and local duties paid there]. Also see, *CIT v. Asiatic Sea Foods,* (1986) 160 ITR 869 (Ker); *CIT v. Indo-Marine Agencies* (*Kerala*) (*P.*) *Ltd.,* (1988) 169 ITR 146 (Ker).

(4) *CIT v. Vippy Solvex Product Pr. Ltd.,* (1986) 159 ITR 487 (MP) [interest paid to bank on export packing credit loan account which was opened after receipt and execution of contract for supply of goods to a foreign country].

(5) *CIT v. Pooppally Foods,* (1986) 161 ITR 729 (Ker), **impliedly** been **overruled in** *Aravinda Paramila Works v. CIT*, (1999) 237 ITR 284 (SC) [commission paid to a foreign agent for promotion of export trade]. Also see, *CIT v. Chloride India Ltd.,* (1992) 193 ITR 355 (Cal).

(6) *CIT v. J.B. Advani & Co.* (*Mysore*) (*Private*) *Ltd.,* (1987) 163 ITR 638 (Karn) [sums paid by the assessee for the promotion of sales of goods outside India]. Also see, *CIT v. Orient Goa Pr. Ltd.,* SLP (Civil) Nos. 7894-7896 of 1980: (1983) 141 ITR (St.) 50 (SC).

(7) *Union Carbide India Ltd. v. CIT,* (1987) 165 ITR 558 (Cal) [payment of export inspection agency fees for obtaining certificate which was pre-requisite for selling goods in foreign countries]. Also see, *CIT v. Union Carbide India Ltd.,* (1993) 203 ITR 301, 302 (Cal); *Lucas TVS Ltd.v. CIT,* (1997) 224 ITR 282, 286-87 (Mad). The Calcutta view [165 ITR 558 (Cal)] has been **dissented from in** *Lucas TVS Ltd. v. CIT* [(2000) 242 ITR 136, 139-40 (Mad)], which has been discussed at serial No. (81), *post*, under section 35B [discussing the cases wherein the weighted deduction under section 35B was held not allowable].

LexisNexis

(8) *CIT v. Navabharat Enterprises* (*P.*) *Ltd.,* (1988) 170 ITR 326 (AP) [premium for export credit guarantee insurance]. Also see, *CIT v. Navabharat Enterprises* (*P.*) *Ltd.,* (1988) 170 ITR 332, 362-63, 366 (AP); *CIT v. Tungabhadra Industries Ltd.,* (1992) 196 ITR 912, 915 (Cal).

(9) *CIT v. Sahney Steel & Press Works* (*P.*) *Ltd.,* (1989) 177 ITR 354 (Bom) [commission paid in India for services rendered outside India].

(10) *CIT v. Chaman Silk Mills,* (1989) 178 ITR 610 (Punj) [expenditure incurred by the assessee on payment of commission in consideration for the booking of orders outside India for the supply of goods by the assessee outside India].

(11) *CIT v. Bata India Ltd.,* (1989) 178 ITR 669 (Cal) [expenditure incurred on the conference held in India for promotion of exports].

(12) *CIT v. Steel Tubes of India Ltd.,* (1990) 181 ITR 90 (MP) [commission paid by the assessee to the Indian agents].

(13) *CIT v. Orient Charterers,* (1990) 185 ITR 354 (Bom), **followed in** *CIT v. N.J. Albert*, (2000) 241 ITR 141, 144 (Ker) [expenditure on obtaining information as to the exporters of goods and the availability of the ships falls under sub-clause (*ii*) of section 35B(1)(*b*); expenditure on foreign travel falls under sub-clause (*vii*) of section 35B(1)(*b*)].

(14) *Kesaria Tea Co. Ltd. v. CIT,* (1991) 189 ITR 374, 377 (Ker) [cost of printing cartons used for exporting the assessee's products].

(15) *CIT v. G.E.C. of India Ltd.,* (1991) 192 ITR 559, 562 (Cal) [commission paid by the assessee to one P through whom the export of the goods was effected]. Also see, *CIT v. Texmaco Ltd.,* (1994) 209 ITR 620, 625 (Cal).

(16) *CIT v. Kerala Nut Food Co.,* (1991) 192 ITR 585 (Ker), **impliedly** been **approved in** *N.J. Albert v. CIT*, (2000) 10 SCC 238, 239 [commission paid in India to agents for exports of goods outside India]. Also see, *Kerala State Cashew Development Corporation Ltd. v. CIT,* (1993) 202 ITR 127 (Ker).

(17) *CIT v. Bombay Dyeing & Manufacturing Co. Ltd.,* (1992) 193 ITR 250, 252 (Bom) [expenditure incurred on insurance of stock of cloth in branch shop, opened for the purpose of facilitating export of cloth by the assessee outside India, in England and as interest on bank overdraft abroad, held eligible for weighted deduction under section 35B(1)(*b*)(*iv*)].

(18) *Srivilas Cashew Co. v. CIT,* (1992) 196 ITR 887, 889-90 (Ker), **followed in** *CIT v. Kerala Nut Food Co.*, (1999) 239 ITR 127, 129 (Ker) [commission paid to foreign agents, held eligible for weighted deduction under section 35B(1)(*b*)(*iv*) even though the agents did not act exclusively for the assessee in India]. Also see, *CIT v. Cadila Laboratories* (*P.*) *Ltd.,* (1996) 221 ITR 35, 37-38 (Guj).

(19) *CIT v. Tungabhadra Industries Ltd.,* (1992) 196 ITR 912, 916-17 (Cal) [postage, telephone and truck-call expenses relating to export business and expenditure on purchase of foreign periodicals].

(20) *Western India Industries v. CIT,* (1992) 197 ITR 680 (Guj) [expenditure incurred in the foreign country on analysis of exported goods].

(21) *CIT v. Continental Device India Ltd.,* (1992) 198 ITR 680, 684-85 (Del) [part of the expenses under the head salary, bonus, postage and telegrams, telephone and telex, travelling and printing and stationery].

(22) *Jayashree Tea & Industries Ltd. v. CIT,* (1993) 202 ITR 695 (Cal) [proportionate head office expenses pertaining to export].

(23) *Chief CIT v. H.M.T.* (*International*) *Ltd.,* (1993) 203 ITR 573, 578-79 (Karn) [expenditure incurred on foreign delegates and in giving away complimentary articles to them for export promotion].

(24) *CIT v. Aspinwall & Co. Ltd.,* (1993) 204 ITR 225, 229 (Ker) [50% of the total salary, provident fund, medical expenses, etc., incurred on the staff employed and 50% of the amount paid to a person employed as the export adviser, held eligible for weighted deduction as covered under sub-clauses (*ii*), (*v*) and (*vi*) of section 35B(1)(*b*) even though incurred in India].

(25) *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 235, 243 (Guj) [50% of the salary paid to the employee in charge of the export department; expenditure on work of fabrication of towers outside India].

(26) *CIT v. Associated Cement Co. Ltd.,* (1994) 206 ITR 396, 398-99 (Bom) [expenditure in connection with preparation and submission of tenders for supply or provision outside India of goods, services or facilities, held eligible under section 35B(1)(*b*)(*v*) even though such expenditure was incurred in India].

(27) *CIT v. Alleppey Co. Ltd.,* (1994) 207 ITR 598, 605 (Ker) [premium paid to the Export Credit Guarantee Corporation for obtaining information about the creditworthiness of the particular foreign

buyers, their reputation, etc., held eligible under section 35B(1)(*b*)(*ii*)]. Also see, *CIT v. N.C. John and Sons Ltd.,* (1994) 208 ITR 57, 59 (Ker); *Lucas TVS Ltd. v. CIT,* (1997) 224 ITR 282, 288 (Mad); *CIT v. N.C. John & Sons Ltd.,* (1997) 226 ITR 934, 939 (Ker); *CIT v. Motor Industries Co. Ltd.,* (1998) 229 ITR 137, 149 (Karn); *CIT v. Farice Prime Tannery,* (1997) Tax LR 468, 469 (Mad); *CIT v. R.S. & Sons,* (1997) Tax LR 518 (Mad) = (1999) 240 ITR 921 (Mad); *CIT v. Mehta Pharmaceuticals Pvt. Ltd.,* (1998) 146 CTR (Punj) 773, 774 = (1999) 238 ITR 898, 899 (Punj); *CIT v. K. Haji Md. Ghouse Saheb & Co.,* (1999) 240 ITR 920, 921 (Mad).

(28) *CIT v. Indian Products Ltd.,* (1994) 207 ITR 647, 653 (Cal) [entire foreign travelling expenses].

(29) *CIT v. Hukumchand Jute and Industries Ltd.,* (1994) 208 ITR 257, 265 (Cal) [brokerage paid in rupees on export sales].

(30) *CIT v. Hindustan Monark P. Ltd.,* (1994) 208 ITR 396, 400 (Del) [commission paid outside India to the foreign agents who introduced buyers, held eligible under section 35B(1)(*b*)(*ii*)].

(31) *CIT v. Travel Corporation of India Ltd.,* (1994) 209 ITR 555, 557 (Bom) [providing technical know-how as the finding of the Tribunal was that the assessee had carried on business in that line].

(32) *Associated Cement Co. Ltd. v. CIT,* (1994) 210 ITR 69, 74 (Bom) [expenditure incurred for the supply of services to the Government of Bhutan in Bhutan in connection with execution of contract with that Government for supply of such services].

(33) *CIT v. Birla Bros.* (*P.*) *Ltd.,* (1993) 68 Taxman 291, 294 (Cal) [expenditure incurred for rendering technical services outside India].

(34) *CIT v. Peico Electronics and Electricals Ltd.,* (1994) 73 Taxman 524, 526 (Cal) [entertainment expenses incurred by the assessee in its Nepal office].

(35) *CIT v. Texmaco Ltd.,* (1994) 209 ITR 620, 625 (Cal) [commission paid at Malaysia for maintenance of a foreign branch].

(36) *CIT v. Nowrusjee Wadia & Sons* (*P.*) *Ltd.,* (1994) 74 Taxman 147, 148 (Bom) [commission payments made to foreign parties, held eligible under section 35B(1)(*b*)(*iv*)].

(37) *CIT v. Khodiyar Pottery Works Ltd.,* (1993) 115 Taxation 50, 52 (Guj) [bank charges, postages, export advertisement and telephone charges incurred within India].

(38) *Associated Stone Industries Ltd. v. CIT,* (1994) 210 ITR 821, 827 (Raj) [salary paid to staff was held allowable to the extent of 75 per cent. which related to export business].

(39) *CIT v. Usha Telehoist Ltd.,* (1995) 212 ITR 177, 183-84 (Cal), **dissenting from** *Chief CIT v. Mysore Sales International Ltd.,* (1992) 195 ITR 457 (Karn) [commission paid to the foreign agents was held entitled to weighted deduction; no need to maintain an office or agency outside India]. Also see, *CIT v. Graphite India Ltd.,* (1996) 221 ITR 420, 423 (Cal); *CIT v. Assam Frontier Tea Ltd.,* (1997) 224 ITR 398, 402-03 (Gauh); *CIT v. Macneill Magore Ltd.,* (1998) 99 Taxman 305, 307-08 (Cal) = 233 ITR 945, 948-49 (Cal). The Calcutta decision [212 ITR 177 (Cal)] has been **impliedly overruled** and the Karnataka decision [195 ITR 457 (Karn)] has been **impliedly approved in** *Aravinda Paramila Works v. CIT* [(1999) 237 ITR 284 (SC)], which has been discussed, *ante*, under section 35B and at serial No. (65), *post*, under section 35B.

(40) *CIT v. Orissa Cement Ltd.,* (1995) 215 ITR 409, 411 (Del) [commission payments under agency agreement].

(41) *CIT v. Jaipur Metals & Electricals Ltd.,* (1995) 215 ITR 413, 417, 418 (Bom) [guarantee charges; commission; miscellaneous expenses like telephone and trunk call charges, letter of credit charges, bank charges, etc.].

(42) *CIT v. Indo Asian Switch-Gears* (*P.*) *Ltd.,* (1996) 222 ITR 772, 791 (Punj) [commission paid to the Indian agents for services rendered outside India; 20% of the miscellaneous expenses (establishment expenses and salary) as allowed by the Tribunal]. Also see, *CIT v. Hansa Agencies P. Ltd.,* (1998) 230 ITR 272, 277-78 (Punj); *CIT v. F.C. Sondhi & Co.* (*India*) *Pvt. Ltd.,* (1998) 230 ITR 279, 285 (Punj).

(43) *CIT v. George Williamson* (*Assam*) *Ltd.,* (1997) 225 ITR 256, 262 (Gauh) [expenses for maintenance of warehouse outside India, held eligible under section 35B(1)(*b*)(*iv*)].

(44) *V.D. Swami & Co. Ltd. v. CIT,* (1997) 225 ITR 439, 446-47 (Mad) [50% of expenses on paying salary and allowance to the staff, held deductible under section 35B(1)(*b*)(*v*) as the assessee was doing business in both local sales as well as in export sales and he has not furnished details of the quantum of foreign trade].

LexisNexis

(45) *N. Sundareswaran v. CIT,* (1997) 226 ITR 142, 150-51 (Ker) [commission paid in India for gathering information regarding markets outside India].

(46) *CIT v. National Palayacot Co.,* (1997) 228 ITR 476 (SC) [expenditure on maintaining the branch in Penang (Malaysia) of the assessee for promotion of sales of its products].

(47) *Malwa Vanaspati & Chemicals Co. Ltd. v. CIT,* (1997) 228 ITR 668, 669, 671 (MP) [office rent (50%); miscellaneous expenditure (50%); stationery charges (75%); postage expenses (75%); salary to staff (75%); telephone charges (75%)].

(48) *CIT v. Farida Prime Tannery,* (1998) 231 ITR 233, 238-39 (Mad) [commission paid to the local agents of foreign buyers]. Also see, *CIT v. R.S. & Sons,* (1997) Tax LR 518, 519 (Mad) = (1999) 240 ITR 921, 923 (Mad).

(49) *CIT v. Hansa Agencies* (*P.*) *Ltd.,* (1998) 230 ITR 272, 279 (Punj) [expenditure incurred on receiving and treating foreign buyers qualify for deduction under section 35B(1)(*b*)(*ix*)].

(50) *CIT v. F.C. Sondhi & Co.* (*India*) *Pvt. Ltd.,* (1998) 230 ITR 279, 286 (Punj) [printing and stationery, vehicle repairs, meeting fees, export promotion expenses, travelling expenses, foreign telex and telephone expenses and foreign postage].

(51) *CIT v. Chika Ltd.,* (1997) 138 Taxation 752 (Bom) [expenditure incurred on foreign indenting business].

(52) *CIT v. Polyset Plastics Pvt. Ltd.,* (1997) 141 Taxation 633 (Bom) [commission paid on exports].

(53) *CIT v. Subhdial Khanna,* (1998) 232 ITR 264, 267 (Punj) [salary and bonus as also expenditure incurred on telex and stationery, held eligible].

(54) *CIT v. Ganeshi Lal & Sons,* (1998) 232 ITR 914, 916, 919, 920 (All) [part of expenditure on advertisement, printing, postage and telephone expenses; expenditure on salaries relatable to exports].

(55) *Widia* (*India*) *Ltd. v. Chief CIT,* (1998) 233 ITR 1, 9 (Karn) [export guarantee commission].

(56) *CIT v. A. Rafeeq Ahmed & Co.,* (1999) 236 ITR 929, 930-31 (Mad) [commission paid to State Trading Corporation]. But see, serial No. (67), *post*, under section 35B [discussing the cases wherein the weighted deduction under section 35B was held not allowable].

(57) *Oriental Science Apparatus Workshops v. CIT,* (1999) 237 ITR 869, 871 (Punj) [expenditure incurred by the assessee on air freight on goods sent for exhibition, which came back, held eligible].

(58) *CIT v. India Pistons Repco Ltd.,* (1999) 240 ITR 59, 61-62 (Mad) [in view of the finding arrived at by the Tribunal, weighted deduction held eligible in respect of commission paid for export promotion]. Also see, *CIT v. India Pistons Repco Ltd.,* (1999) 240 ITR 656, 659 (Mad).

(59) *CIT v. India Pistons Repco Ltd.,* (1999) 240 ITR 656, 659-60 (Mad) [expenditure on participation in an exhibition in a foreign country held eligible].

(60) *CIT v. N.J. Albert,* (2000) 241 ITR 141, 142, 143, 146 (Ker) [expenses incurred by way of samples, postage, cables, overseas trunk calls and foreign travelling expenses by the assessee engaged in providing services to exporters in India by obtaining information regarding market outside India for services and other facilities, held eligible].

(61) *CIT v. Mahavir Plantations Ltd.,* (2000) 244 ITR 571, 574 (Ker) [commission paid by the assessee-company abroad in respect of its exports].

(62) *Beardsell Ltd. v. CIT,* (2000) 246 ITR 505, 506-07 (Mad) [Tribunal was held justified in allowing weighted deduction under section 35B in respect of 75 per cent. of the expenditure incurred on the export division].

(63) *CIT v. Ashok Leyland Ltd.,* (2001) 250 ITR 452 (Mad) [fees paid to the Export Promotion Council as the Council provided export market development information to the assessee]. Also see, *CIT v. Ashok Leyland Ltd.,* (2002) 253 ITR 425, 426-27 (Mad); *CIT v. Mehta Pharmaceuticals* (*P.*) *Ltd.,* (1998) Tax LR 676, 678 (Punj).

(64) *CIT v. Vijaya & Suresh Combines,* (2001) 252 ITR 255, 257 (Mad) [expenditure on publicity materials provided to overseas exploiter].

(65) *Engine Valves Ltd. v. CIT,* (2002) 256 ITR 449, 451 (Mad) [export inspection fees].

(66) *P. Muttulal Lalah & Sons v. CIT,* (2003) 259 ITR 236, 237, 238 (Mad) [steamer freight and insurance, held eligible for weighted deduction under section 35B(1)(*b*)(*viii*) for the assessment year 1980-81. This case has proceeded on the wrong assumption that section 35B(1)(*b*)(*iii*) was not operative in the assessment year 1980-81. In fact, section 35B(1)(*b*)(*iii*) has been omitted (w. e. f. 1-4-

LexisNexis

1981) by the Finance (No. 2) Act, 1980 (44 of 1980). Thus, the said section 35B(1)(*b*)(*iii*) was operative for assessment year 1980-81].

(67) *CIT v. Walchandnagar Industries Ltd.,* (2003) 262 ITR 212, 218, 219-20 (Bom) [guarantee charges payable to the Export Credit Guarantee Corporation of India, a Government of India undertaking for getting information regarding the credit worthiness and reputation of its foreign constituents; commission paid to Tata Exports for monitoring and doing liaisoning work outside India].

(68) *CIT v. Mehta Pharmaceuticals* (*P.*) *Ltd.,* (1998) Tax LR 676, 678 (Punj) [50 per cent. of office rent].

(69) *CIT v. Jansons & Co.*, (2006) 283 ITR 175 (All) [the assessee clearly fell within the meaning of 'small scale exporter' as defined under the *Explanation* to section 35B(1A) and was eligible for deduction under section 35B(1)].

(70) *CIT v. Zenith Steel Pipes & Industries Ltd.*, (2009) 315 ITR 95 (Bom) [the expenditure on giving gifts to foreign parties was entitled to weighted deduction].

(71) *Wazir Chand & Co. P. Ltd. v. CIT*, (2007) 290 ITR 626 (All) [the expenses which had been incurred on advertisement and publicity outside India alone are eligible for weighted deduction].

(72) *CIT v. United Trading Corporation*, (2005) 275 ITR 248 (All) [the Export House Certificate had been issued for the year 1978-79 which would cover the period in question, even though its validity had been specified from the date of issue, *i.e.*, 19-2-1979 to 30-6-1979 thus, the assessee was exigible for weighted deduction for assessment year 1979-80].

Also see, *CIT v. Machinery Mfg. Corporation Ltd.,* SLP (Civil) No. 9502 of 1981: (1984) 147 ITR (St.) 3 (SC); *CIT v. Kirloskar Diesel Engines Ltd.,* SLP (Civil) No. 11818 of 1991: (1991) 191 ITR (St.) 4-5 (SC); *CIT v. B.P. Singh,* SLP (Civil) No. 509 of 1985 : (1992) 193 ITR (St.) 1 (SC); *CIT v. Stepwel Industries,* SLP (Civil) No. 4329 of 1992 : (1992) 195 ITR (St.) 136 (SC); *CIT v. Meera & Co.,* SLP (Civil) No. 970 of 1987 : (1992) 197 ITR (St.) 404-05 (SC); *CIT v. New Heaven Bearing Pvt. Ltd.,* (1992) 198 ITR 567 (Guj); *CIT v. Baumgartan and Wallia* (*Bottling*) *Ltd.,* SLP (Civil) Nos. 17239-17240 of 1992: (1993) 199 ITR (St.) 78 (SC); *CIT v. Mercantile and Industrial Development Co.,* SLP (Civil) No. 8684 of 1993: (1993) 201 ITR (St.) 64 (SC); *CIT v. Greatway Ltd.,* SLP (Civil) No. 7195 of 1994: (1994) 207 ITR (St.) 13 (SC); *CIT v. Gannon Dunkerly & Co.,* (1993) 114 CTR (Bom) 56; *CIT v. Trade Wings Ltd.,* (1994) 205 ITR 540 (Bom); *Cynamid India Ltd. v. CIT,* (1994) Tax LR 895, 901-02 (Bom); *CIT v. Best & Crompton Engineering,* SLP (Civil) No. 6552 of 1994 : (1995) 212 ITR (St.) 52-53 (SC); *CIT v. Colour Chemicals,* SLP (Civil) Nos. 1738-1740 of 1995 : (1995) 212 ITR (St.) 365 (SC); *CIT v. Guide Knitwear P. Ltd.,* SLP (Civil) Nos. 2381-2382 of 1995 : (1995) 212 ITR (St.) 367-68 (SC); *CIT v. Gujarat State Export Corporation Ltd.*, (2005) 279 ITR 477 (Guj); *Velvet Carpet & Co. Ltd. v. CIT*, (2017) 395 ITR 515, 519 (SC).

In the facts of the following cases, the weighted deduction under section 35B was **held not allowable**:—

(1) *CIT v. K.N. Oil Industries,* (1982) 134 ITR 651 (MP) [expenditure on carriage of goods to their foreign destination and that on the transit insurance of such goods]. Also see, *Handicrafts & Handloom Export Corporation of India v. CIT,* (1983) 140 ITR 532 (Del); *D. & H. Secheron Electrodes Pr. Ltd. v. CIT,* (1984) 149 ITR 400 (MP); *Bharat General & Textile Industries Ltd. v. CIT,* (1985) 153 ITR 747 (Cal); *Indian Textiles v. CIT,* (1986) 157 ITR 112 (Mad); *K. Vensimal & Sons v. CIT,* (1986) 157 ITR 807 (Mad); *K.E. Kesavan & Co. v. CIT,* (1986) 158 ITR 608 (Ker); *Organon* (*India*) *Ltd. v. CIT,* (1988) 172 ITR 354 (Cal); *M.M. Khambhatwala v. CIT,* (1992) 198 ITR 140, 143-44 (Guj); *CIT v. M.M. Khambhatwala,* (1992) 198 ITR 144, 146 (Guj); *Jayshree Tea & Industries Ltd. v. CIT,* (1993) 202 ITR 695, 696 (Cal); *Union Carbide India Ltd. v. CIT,* (1993) 203 ITR 584, 592 (Cal); *Jayashree Tea & Industries Ltd. v. CIT,* (1995) 80 Taxman 169, 173 (Cal); *Ganapathy Engineering Manufacturers* (*P.*) *Ltd. v. CIT,* (1997) 143 CTR (Mad) 150, 152 = (2000) 245 ITR 203 (Mad).

(2) *CIT v. Southern Sea Foods Pr. Ltd.,* (1983) 140 ITR 855 (Mad) [commission paid in India for procuring orders from foreign buyers in respect of goods exported].

(3) *V.D. Swami & Co. P. Ltd. v. CIT,* (1984) 146 ITR 425 (Mad) [clearing and forwarding charges and other expenses incurred in India].

(4) *CIT v. Madras Rubber Factory Ltd.,* (1984) 149 ITR 411 (Mad), **followed in** *CIT v. Madras Rubber Factory Ltd.*, (2001) 248 ITR 814, 816 (Mad) [royalty paid to a foreign collaborator under a technical know-how agreement]. Also see, *CIT v. Madras Rubber Factory Ltd.,* (1995) 216 ITR 277, 287 (Mad); *CIT v. Madras Rubber Factory Ltd.,* (1998) 146 CTR (Mad) 785, 788 = (2000) 241 ITR 770, 773 (Mad).

LexisNexis

(5) *CIT v. Quilon Marine Produce Co.,* (1986) 157 ITR 448 (Ker) [trading discount is not an expenditure within the meaning of section 35B]. Also see, *CIT v. Orion Coir Mat and Mattings Manufacturers* (*P.*) *Ltd.,* (1987) 166 ITR 616 (Ker).

(6) *CIT v. C. Tharian & Sons,* (1987) 166 ITR 607 (Ker) [commission paid to agent in India in connection with export of goods to foreign country, there being no evidence to prove that such expenses were actually incurred outside India]. Also see, *CIT v. P. Alikunju, M.A. Nazir, Cashew Industries,* (1987) 166 ITR 611 (Ker); *K. Ravindranathan Nair v. CIT,* (1988) 170 ITR 409 (Ker); *CIT v. K. Ravindranathan Nair,* (1988) 170 ITR 411 (Ker), *CIT v. Western India Plywoods Ltd.,* (1990) 183 ITR 638 (Ker), special leave petition granted by the Supreme Court: (1988) 171 ITR (St.) 52 (SC)]. In *N.J. Albert v. CIT* [(2000) 10 SCC 238, 239], it has been held that the Kerala decision in *CIT v. Kerala Nut Food Co.* [(1991) 192 ITR 585 (Ker)] has, after taking note of circular, dated 28-12-1981, rightly concluded that the Kerala decision [166 ITR 607 (Ker)] was *per incuriam.*

(7) *Duncan Bros. & Co. Ltd. v. CIT,* (1987) 168 ITR 311 (Cal) [amount of penalty paid to the foreigner for delay in shipment of goods].

(8) *CIT v. Navabharat Enterprises* (*P.*) *Ltd.,* (1988) 170 ITR 332, 362-63, 366-68 (AP) [agmarka charges; export licence fee and inspection charges; subscription to export promotion council and trade associations; and translation charges].

(9) *Pierce Leslie India Ltd. v. CIT,* (1988) 174 ITR 623 (Karn) [commission paid in India to Indian agents, which was proved to be paid 'in its usual course of business'].

(10) *Tara Agencies v. CIT,* (1989) 180 ITR 102 (Ker) [amount paid for obtaining a certificate of fitness, not covered by section 35B(1)(*b*)(*v*) (operative up to assessment year 1980-81)].

(11) *HMM Ltd. v. CIT,* (1990) 184 ITR 236 (Punj) [expenditure on inspection and supervision of export goods, bank charges, cost of excise revenue stamps and hundi papers and miscellaneous expenditure].

(12) *Kesaria Tea Co. Ltd. v. CIT,* (1991) 189 ITR 374, 377 (Ker) [cost of cartons themselves which were u sed for exporting the assessee's products].

(13) *Brooke Bond India Ltd. v. CIT,* (1992) 193 ITR 390, 404 (Cal) [packing credit interest, post-due/overdue interest on export, bank charges including cost of remittance, exchange losses in export, freight and insurance, and packing and handling]. Also see, *Brooke Bond India Ltd. v. CIT,* (1991) 59 Taxman 82, 84 (Cal).

(14) *Chief CIT v. Mysore Sales International Ltd.,* (1992) 195 ITR 457, 461 (Karn), **impliedly** been **approved in** *Aravinda Paramila Works v. CIT*, (1999) 237 ITR 284 (SC) [commission paid by the assessee, an agent to effect sales of sandalwood oil and other goods manufactured by a public sector undertaking, to a sub-agent for procuring a particular sale, held not commission for promotion of sale outside India so as to attract section 35B(1)(*b*)(*iv*)].

(15) *CIT v. Jay Industries,* (1992) 196 ITR 313, 315 (Guj) [interest paid to the bank in India on packing credit as the same falls within the exclusionary clause of section 35B(1)(*b*)(*iii*)]. Also see, *CIT v. Girdharlal Vithaldas,* (1992) 196 ITR 316 (Guj); *I.C. Gandhi Silk Mills Pvt. Ltd. v. CIT,* (1992) 196 ITR 495 (Guj); *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 236-38 (Guj); *K.V. Patel & Co. v. CIT,* (1994) 122 CTR (Guj) 297, 298-99; *CIT v. Windsor Foods Ltd.,* (1998) 146 CTR (Guj) 207, 213 = (1999) 235 ITR 249, 253-54 (Guj).

(16) *Western India Industries v. CIT,* (1992) 197 ITR 680 (Guj) [expenditure incurred in purchasing the quota rights, godown rent, loss on account of difference in weight and quality of the exported goods, a part of Kharajat expenses representing port charges for loading, unloading, shifting, survey fees, marking charges, etc., because all these expenses were incurred in India and, therefore, fell within the exclusionary clause of section 35B(1)(*b*)(*iii*)].

(17) *Shri Ambica Mills Ltd. v. CIT,* (1992) 198 ITR 99, 102-03 (Guj) [expenditure by way of export inspection fees, in the absence of the material particulars and break-up of the purpose and nature, etc., of the said expenditure; foreign travelling expenses which were referable and related to starting a new project]. Also see, *Parshuram Pottery Works Co. Ltd. v. CIT,* (1993) 204 ITR 458, 461 (Guj).

(18) *Parshuram Pottery Works Co. Ltd. v. CIT,* (1993) 204 ITR 458, 461 (Guj) [octroi expenses]. Also see, *Parshuram Pottery Works Co. Ltd. v. CIT,* (1996) 131 CTR (Guj) 549, 551.

LexisNexis

(19) *Isabgul Export Corporation v. CIT,* (1994) 205 ITR 227, 229 (Guj) [expenditure on packing material and interest paid to bank and bank charges]. Also see, *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 242 (Guj); *Wintex Mills Ltd. v. CIT,* (1994) 205 ITR 476, 478 (Guj).

(20) *Testeels Ltd. v. CIT,* (1994) 205 ITR 230, 241, 242 (Guj) [expenditure incurred on membership fees as no details were furnished]. Also see, *Wintex Mills Ltd. v. CIT,* (1994) 205 ITR 476, 478 (Guj).

(21) *Forbes Forbes Campbell & Co. Ltd. v. CIT,* (1994) 206 ITR 495, 499 (Bom) [freight charges, export inspection charges, brokerage, insurance, bank charges and clearing charges, held not eligible either under section 35B(1)(*b*)(*iii*) or under section 35B(1)(*b*)(*viii*)].

(22) *CIT v. N.C. John & Sons Ltd.,* (1994) 208 ITR 57, 60-61 (Ker) [amount of the levy by the Coir Board which was refunded to the assessee during a subsequent year, held not eligible as the same could not be considered as 'expenditure' incurred by the assessee]. Also see, *CIT v. Orion Coir Mats & Mattings Manufacturers* (*I.*) *Ltd.,* (1995) 211 ITR 700, 702 (Ker).

(23) *Dawn Apparels Ltd. v. CIT,* (1994) 208 ITR 93 (Bom) [expenses on travel outside India].

(24) *Standard Mills Co. Ltd. v. CIT,* (1994) 209 ITR 85, 87 (Bom) [export freight and expenses and bank guarantee commission].

(25) *CIT v. Dunlop India Ltd.,* (1992) 103 CTR (Cal) 422, 424, **following,** *CIT v. Dunlop India Ltd.,* (1992) 197 ITR 34 (Cal) [expenses incurred for its export department].

(26) *Shahibag Enterpreneurs Pvt. Ltd. v. CIT,* (1994) 210 ITR 998, 1001 (Guj) [expenses on foreign tours of the director and the employees of the assessee-company for the purpose of establishing joint venture units in foreign countries, held not eligible for weighted deduction as the expenses were of capital nature].

(27) *CIT v. Texmaco Ltd.,* (1994) 209 ITR 620, 625 (Cal) [audit fee].

(28) *Rajnikant Bros. v. CIT,* (1996) 217 ITR 272, 273 (Bom) [bank interest, reassortment charges, assortment charges and motor-car expenses].

(29) *Apeego Corporation v. CIT,* (1995) 215 ITR 697, 699, 700 (Bom) [bank interest and bank charges; loss on account of fluctuations in the rate of exchange].

(30) *Carona Sahu Co. Ltd. v. CIT,* (1995) 213 ITR 106, 108 (Bom) [expenditure incurred by the assessee by way of export inspection fees, trade discount on sales, interest paid to the State Trading Corporation of India and freight and forwarding charges for export of goods, consular fees paid to the consulate and wages to export godown workers, held not eligible for weighted deduction]. Also see, *CIT v. Walchandnager Industries Ltd.,* (1997) 141 Taxation 619, 620 (Bom).

(31) *Bhansali & Co. v. CIT,* (1995) 78 Taxman 501, 511-13 (Cal) [interest paid to bank on export packing credit account and bank charges paid in India; port duty and shipping charges; goods forwarding charges incurred for export business: held, not eligible for weighted deduction].

(32) *Hindusthan Gas & Industries Ltd. v. CIT,* (1995) 79 Taxman 151, 153 (Cal) [export inspection charges paid to export inspection agency and bank charges paid for negotiation of export bills, held not eligible for weighted deduction.]

(33) *Blue Star Ltd. v. CIT,* (1996) 217 ITR 514, 516 (Bom) [expenditure in respect of insurance, freight and inspection].

(34) *Jayashree Tea & Industries Ltd. v. CIT,* (1995) 80 Taxman 169, 173-74 (Cal) [Tribunal was held justified in restricting the claim of Rs. 1,87,978 to only Rs. 1,08,155 being the proportionate head office expenses under section 35B].

(35) *CIT v. Jaipur Metals & Electricals Ltd.,* (1995) 215 ITR 413, 417 (Bom) [interest on advances by banks for manufacture of goods which were ultimately exported outside India]. Also see, *CIT v. Maharashtra Oil Industries,* (1998) 143 Taxation 283, 284 (Bom).

(36) *Lucas TVS Ltd. v. CIT,* (1996) 217 ITR 382, 404 (Mad), **followed in** *Lucas TVS Ltd. v. CIT*, (2000) 242 ITR 136, 138 (Mad); *CIT v. Nishat Garments & Leathers*, (2000) 243 ITR 822, 823 (Mad); *CIT v. A. Rafeeq Ahmed & Co. : A. Abdul Shukoor & Co.*, (2001) 251 ITR 557, 558 (Mad) [interest on export packing credit paid to the State Bank of India]. Also see, *Southern Asbestos Cements Ltd. v. CIT,* (1998) Tax LR 229, 230 (Mad).

(37) *CIT v. Sahney Kirkwood Pvt. Ltd.,* (1996) 217 ITR 601, 604 (Bom) [expenses incurred on travelling from abroad to India, held not covered by section 35B(1)(*b*)(*vii*)].

(38) *Associated Cement Companies Ltd. v. CIT,* (1996) 221 ITR 215, 220, 233 (Bom) [expenditure incurred by the assessee in India on account of travelling].

LexisNexis

(39) *Geoffrey Manners & Co. Ltd. v. CIT,* (1996) 221 ITR 695, 699-700 (Bom) [expenses on duty and clearing charges, delivery charges, insurance and freight charges].

(40) *Lucas TVS Ltd. v. CIT,* (1997) 224 ITR 282, 288 (Mad) [export pre-shipment advance interest, held not allowable]. Also see, *Lucas TVS Ltd. v. CIT,* (1997) Tax LR 552, 553 (Mad).

(41) *Colour Chem Ltd. v. CIT,* (1997) 225 ITR 164, 170-71 (Bom) [overriding commission, which, in reality, was a rebate on goods supplied].

(42) *V.D. Swami & Co. Ltd. v. CIT,* (1997) 225 ITR 439, 447 (Mad) [expenses on attestation and legalisation of export invoices and legal expenses in connection with the export of flats].

(43) *CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 174, 175 (SC) [commission payment].

(44) *CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 174-75, 176, 182 (SC) [commission paid to STC for sales made by it to parties outside India; commission paid to middleman for purchase of goods for and on behalf of foreign buyer; custom duty paid for sending goods to foreign branches].

(45) *CIT v. Hero Cycles Pvt. Ltd.,* (1997) 228 ITR 463, 473, 474, 475 (SC) [contribution to a general body for promotion of export; expenditure on establishment, bonus, leave with wages, salary to directors, postage, telephone and telegram and printing and stationery and rent]. Also see, *CIT v. Victor Tools Corporation,* (1998) 146 CTR (Punj) 794, 806-07, 807 = (1999) 237 ITR 640, 652 (Punj); *Oriental Insurance Co. Ltd. v. CIT*, (2013) 351 ITR 270 (Del).

(46) *Malwa Vanaspati & Chemicals Ltd. v. CIT,* (1997) 228 ITR 668, 669, 671 (MP) [storage charges and rent on de-oiled cake stored on way to Bombay awaiting shipment; rent for tarpaulin to protect the de-oiled cake stored at Bombay Port Trust godown; clearing and forwarding charges paid; survey fees and quality fitness report, etc., of de-oiled cake; fumigation charges; sundry expenses, *i.e.*, the cost of stamps, etc., charges recovered by banks for the letter of credit, collection of bills, payments, etc., travelling expenses, conveyance, export duty, ocean freight].

(47) *Vijay Kumar Aggarwal v. CIT,* (1998) 232 ITR 179, 188, 190, 191 (Punj) [shipping port fee; packing materials; export inspecting agency charges; bank commission].

(48) *CIT v. E.S. Patanwala,* (1997) 138 Taxation 568 (Bom) [commission paid in India and advertisement expenditure in India pertaining to exports].

(49) *Khaders International Constructions Ltd. v. CIT,* (1998) 229 ITR 452, 457 (Ker) [expenditures incurred in relation to the construction work in Libya].

(50) *Advani Oerlikon Ltd. v. CIT,* (1997) 141 Taxation 394, 395 (Bom) [export document legalisation charges, freight, insurance premium, interest and bank charges].

(51) *Ganapathy Engineering Manufacturers* (*P.*) *Ltd. v. CIT,* (1997) Tax LR 860, 861 (Mad) [steamer freight, lorry freight and shipping expenses; packing materials].

(52) *CIT v. Hindustan Lever Ltd.,* (1997) 141 Taxation 758 (Bom) [inspecting and testing fees paid in India; interest paid on export packing credit].

(53) *CIT v. Bandekar Brother Pvt. Ltd.,* (1997) 141 Taxation 759, 760 (Bom) [port dues, stevedoring charges, demurrage, barge hiring charges, sampling and analysis and packing credit interest].

(54) *CIT v. O.K. Hosiery Mills,* (1997) Tax LR 1049, 1052 (Punj) = (1999) 236 ITR 405, 410 (Punj) [packing credit interest].

(55) *CIT v. Coromandel Agro Products Oil Ltd.,* (1998) 230 ITR 335, 339-40, 342 (AP) [interest paid to bank on packing credit loan, held not eligible for weighted deduction].

(56) *CIT v. Maharashtra Oil Industries,* (1998) 143 Taxation 283, 285 (Bom) [expenditure incurred for obtaining export quota, held not eligible].

(57) *Indian Aluminium Cables v. CIT,* (1998) 232 ITR 192, 193, 197 (Del) [insurance charges on export sales and ocean freight, not eligible].

(58) *Faqir Chand Raghunath Dass v. CIT,* (1998) 232 ITR 259, 260, 261 (Del) [custom duty paid, not eligible].

(59) *Widia* (*India*) *Ltd. v. Chief CIT,* (1998) 233 ITR 1, 9 (Karn) [interest on packing credit]. Also see, *CIT v. A. Rafeeq Ahmed & Co.,* (1999) 236 ITR 929, 930 (Mad); *CIT v. Aspinwall Co.* (*Travancore*) *Ltd.,* (2000) 245 ITR 33, 36 (Ker); *CIT v. Oswal Woollen Mills Ltd.,* (2002) 256 ITR 694, 695 (Punj); *CIT v. Oswal Woollen Mills Ltd.,* (2002) 257 ITR 737, 740-41 (Punj); *CIT v. Smt. Sudesh Madhok,* (2003) 179 CTR (Del) 211, 212; *CIT v. Mehta Parikh & Co. Pvt. Ltd.,* (2003) 174 Taxation 554, 556 (Guj).

LexisNexis

(60) *CIT v. International Exporters,* (1998) 233 ITR 23, 26-27 (Del) [commission paid in India; expenditure incurred on foreign telephones; part of salaries, rent and printing and stationery expenses; insurance; sale promotion expenses].

(61) *Kewal Silk Emporium v. CIT,* (1998) 234 ITR 767 (Del) [expenditure on account of sale of goods to foreign tourists in India] against foreign currency [*Kamal Silk Emporium v. CIT,* (2003) 264 ITR 520, 521 (Del)]. Also see, *CIT v. Indian Handicrafts Emporium,* (2000) 155 Taxation 687, 689 (Del).

(62) *CIT v. National Agricultural Co-operative Marketing Federation of India Ltd.*, (1999) 236 ITR 766, 773 (Del) [inspection fee paid to a third party, not eligible].

(63) *Wings Wear Pvt. Ltd. v. CIT,* (1999) 236 ITR 912, 913 (Del) [transport charges incurred within India].

(64) *Kansal Woollen & Hosiery Mills* (*P.*) *Ltd. v. CIT,* (1999) 237 ITR 93, 95, 100, 101 (Punj) [manufacturing expenditure or the cost of samples; expenditure on quality control and on the purchase of foreign trade periodicals and journals; expenditure on advertisement and samples; expenditure on export promotion and commission].

(65) *Aravinda Paramila Works v. CIT,* (1999) 237 ITR 284, 286, 287-88 (SC); **impliedly approving** *Chief CIT v. Mysore Sales International Ltd.,* (1992) 195 ITR 457 (Karn), **impliedly overruling** *CIT v. Assam Frontier Tea Ltd.,* (1997) 224 ITR 398 (Gauh); *CIT v. Pooppally Foods,* (1986) 161 ITR 729 (Ker); and *CIT v. Usha Telehoist Ltd.,* (1995) 212 ITR 177 (Cal) [commission to agents outside India who had procured orders, not eligible for weighted deduction under section 35B(1)(*b*)(*iv*) because requirements of that section were far from satisfied]. It is pertinent to note that the Gauhati decision [224 ITR 398 (Gauh)] has been **affirmed on facts in** *CIT v. Assam Frontier Tea Ltd.* [(2002) 253 ITR 549 (SC), which has been discussed, *ante*, under section 35B] even though the said Gauhati decision [224 ITR 398 (Gauh)] has **followed** the Calcutta decision [212 ITR 177 (Cal)].

(66) *CIT v. Oriental Fire & General Insurance Co. Ltd.,* (1999) 237 ITR 542, 543 (Del) [entertainment expenses incurred outside India].

(67) *CIT v. Swadeshi Karyalay,* (1999) 237 ITR 544, 544-45 (Punj), **following** *CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171 (SC) [commission paid to the State Trading Corporation, not eligible].

(68) *CIT v. Rajaram Bandekar & Sons* (*Shipping*) *Pvt. Ltd.,* (1999) 237 ITR 628, 629 (Bom) [expenses incurred on stevedoring charges and port dues for loading and unloading iron ore for export].

(69) *CIT v. Nagesh Knitwears,* (1999) 237 ITR 832, 833-34 (Punj) [commission, service charges and subscription to various agencies, not eligible].

(70) *Oriental Science Apparatus Workshops v. CIT,* (1999) 237 ITR 869, 870, 871-72 (Punj) [expenditure on sea and air freight and marine insurance; expenditure on customs duty paid on designs received from foreign countries; expenditure on internal telex, *i.e.,* within the country].

(71) *CIT v. Aristocraft International* (*P.*) *Ltd.,* (1999) 238 ITR 83, 84-85 (Del) [payment of commission to Indian agent in India for procuring orders for export and on expenses incurred for entertaining foreign customers in India].

(72) *Avon Cycles Pr. Ltd. v. CIT,* (1999) 238 ITR 85, 88 (Punj) [payment of commission and interest to the bank on foreign bills; clearing and forwarding charges].

(73) *Gedore Tools Pvt. Ltd. v. CIT,* (1999) 238 ITR 268, 272-73 (Del) [commission paid in India though on export sales; expenditure on export promotion; expenditure on export guarantee insurance; interest on post-shipment export credit loan; difference in exchange rates; ocean freight charges on export consignment; forwarding charges on consignments; inland freight on export consignments; inspection fee on exports].

(74) *CIT v. Victor Tools Corporation,* (1999) 238 ITR 770, 771, 773 (Punj) [expenses incurred and debited under the heads inland travelling, printing and stationery, telephone, rent, car expenses, advertisement, workers' welfare, gratuity, property tax and miscellaneous expenses not eligible because none of the expenditures fell within any of the sub-clauses of section 35B(1)(*b*)].

(75) *Indian Trade Promotion Organisation v. CIT,* (1999) 238 ITR 901, 904-05 (Del) [expenditure on freight taking and handling, insurance and customs bonded warehouse; part of participation charges and construction/decoration].

(76) *Lucas TVS Ltd. v. CIT,* (1999) 239 ITR 534, 536 (Mad) [certification charges, warranty claims, etc.].

LexisNexis

(77) *CIT v. Dr. Beck & Co.* (*India*) *Ltd.,* (1999) 239 ITR 561, 563, 566 (Bom) [commission; expenses incurred on loading and unloading; expenditure on export inspection charges paid to Government agencies in relation to assessment years 1977-78 and 1978-79].

(78) *CIT v. Habib & Co.,* (2000) 241 ITR 253, 255 (Mad) [commission paid to the local agent of the foreign buyer]. Also see, *CIT v. Far East Tanning Company,* (2000) 244 ITR 576, 577 (Mad).

(79) *Fenner* (*India*) *Ltd., v. CIT,* (2000) 241 ITR 797, 798, 800, 801, 802 (Mad) [bank charges incurred in connection with export, not eligible as the same did not fall under any of the sub-clauses of section 35B(1)(*b*); expenditure incurred on travel in India, not eligible under section 35B(1)(*b*)(*vii*)].

(80) *CIT v. National Palayacot Co.,* (2000) 242 ITR 112, 113-14 (Mad) [customs duty and sales tax incurred in respect of foreign offices; expenses incurred in India for maintaining foreign office].

(81) *Lucas TVS Ltd. v. CIT,* (2000) 242 ITR 136, 139-40 (Mad) [expenditure incurred on export inspection agency fee paid in India and expenditure incurred on obtaining certificates of origin in India].

(82) *Needle Industries* (*India*) *Ltd. v. CIT,* (2000) 242 ITR 186, 195-96 (Mad) [sum incurred in negotiating sale documents for the goods exported outside India].

(83) *CIT v. Chika Ltd.,* (2000) 243 ITR 5, 5-6 (SC), **applying** *CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171 (SC) [expenditure incurred for foreign indenting business as the services in this connection were rendered in India].

(84) *CIT v. New Light Tannery,* (2000) 244 ITR 5, 9-10 (All) [expenditure incurred in India on insurance, shipment, freight, despatch, clearing and transportation charges in respect of the goods being sent to their foreign destination, held not eligible under section 35B(1)(*b*)(*viii*) for the assessment year 1978-79].

(85) *CIT v. Official Liquidator, Ahmedabad Manufacturing & Calico Printing Co. Ltd.,* (2000) 244 ITR 156, 163, 164 (Guj) [expenditure on the carriage of goods to their destination outside India or on the insurance of such goods while in transit, held not eligible for deduction under section 35B(1)(*b*)(*iii*)]. Also see, *Mihir Textiles Ltd. v. CIT,* (2001) 252 ITR 686, 688 (Guj).

(86) *CIT v. India Cements Ltd.,* (2000) 244 ITR 185, 187 (Mad) [service charges paid to the State Trading Corporation].

(87) *CIT v. Nath Brothers Exim International Ltd.,* (2000) 244 ITR 538, 541-42 (Del) [expenditure incurred in India on hospitality to foreign buyers].

(88) *Yuvaraj International v. CIT,* (2000) 244 ITR 641, 644 (Mad) [interest, commission and bank charges not eligible].

(89) *Exportos India v. CIT,* (2000) 246 ITR 1, 8-9 (Del) [interest and bank charges on foreign bills; payment on account of exchange rate differences, held not eligible].

(90) *CIT v. South India Corporation* (*Agencies*) *Ltd.,* (2000) 246 ITR 581, 586 (Mad) [expenditure incurred by the assessee on its goodwill chartering business].

(91) *CIT v. Indo Oceanic Shipping Co. Ltd.,* (2001) 247 ITR 247, 259 (Bom) [brokerage and commission on freight paid in foreign countries].

(92) *CIT v. Modern Carpet Co.,* (2001) 248 ITR 316, 323 (J&K) [commission on particular sales].

(93) *CIT v. Ashok Leyland Ltd.,* (2001) 250 ITR 452, 452-53 (Mad) [salary paid to employees engaged in export work, interest paid on post-shipment credit, bank charges and commission, all incurred in India; interest paid to the bank on export bill discounted]. Also see, *CIT v. Ashok Leyland Ltd.,* (2002) 253 ITR 425, 426-27 (Mad).

(94) *CIT v. Goodricke Group Ltd.,* (2001) 251 ITR 187, 189 (Cal) [payment of commission to the U.K. selling agent].

(95) *Agrimmoor P. Ltd. v. CIT,* (2001) 251 ITR 726, 727 (Mad) [expenses incurred on Agmark coupons, not eligible under section 35B(1)(*b*)(*viii*); fumigation charges, carriage of export goods, marine insurance and certificate of origin, not eligible under section 35B(1)(*b*)(*iii*) because these are incurred for the carriage of goods in India].

(96) *CIT v. Vijaya & Suresh Combines,* (2001) 252 ITR 255, 259 (Mad) [cost of positive prints].

(97) *CIT v. Patidar Oil Cake Industries,* (2001) 252 ITR 450, 452 (Guj) [expenditure incurred in India for analysis of product for obtaining certificate of standard, held not eligible under section 35B(1)(*b*)(*iii*)].

LexisNexis

(98) *Mihir Textile Ltd. v. CIT,* (2001) 252 ITR 686, 688 (Guj) [export packing charges and export stitching charges].

(99) *H.M.M. Ltd. v. CIT,* (2001) 252 ITR 842, 843 (Punj) [freight expenses, octroi duty, insurance charges and other expenses such as loading, unloading and conveyance expenses].

(100) *Krishnakeshsav Laboratories Ltd. v. CIT,* (2002) 254 ITR 149, 151 (Guj) [expenditure on freight and insurance].

(101) *Madura Coats Ltd. v. CIT,* (2002) 256 ITR 442, 446 (Mad) [commission paid to dealers in India].

(102) *Engine Valves Ltd. v. CIT,* (2002) 256 ITR 449, 451 (Mad) [expenses on visit of delegation from a foreign country as there was no evidence to establish any connection between delegation and export business of the assessee].

(103) *CIT v. Export House,* (2002) 256 ITR 603, 616-17, 618 (Punj) [freight, clearing and inspection charges incurred in India].

(104) *Navin Chemicals Manufacturing & Trading Co.* (*P.*) *Ltd. v. CIT,* (2003) 259 ITR 111, 113 (Del) [expenditure incurred on shipping and forwarding, audit fee, insurance, filing fee, legal and professional fees, charity and donation and miscellaneous expenses].

(105) *P. Muttulal Lalah & Sons v. CIT,* (2003) 259 ITR 236, 237 (Mad) [establishment charges].

(106) *CIT v. Mahavir Plantations* (*P.*) *Ltd.*, (2003) 260 ITR 233, 238 (Ker) [packing materials; interest paid on shipping loan and bank charges; commission paid to agent abroad].

(107) *R.Y. Gaitonde & Co. v. CIT,* (2003) 260 ITR 330, 333 (Mad) [expenditure incurred on transmitting information about market conditions in India to principals abroad].

(108) *CIT v. Registhan Pvt. Ltd.,* (2003) 261 ITR 757, 760 (Raj) [salary paid to technical director for services rendered in India, not eligible]. Also see, *CIT v. Registhan* (*P.*) *Ltd.,* (2003) 180 CTR (Raj) 380; *CIT v. Registhan* (*P.*) *Ltd.*, (2003) 132 Taxman 2 (Raj).

(109) *CIT v. Walchandnagar Industries Ltd.,* (2003) 262 ITR 212, 220-21 (Bom) [administrative expenses on proportionate export sales].

(110) *CIT v. Madura Coats Ltd.,* (2003) 263 ITR 241, 243 (Mad) [bank charges paid in India].

(111) *CIT v. Ivory Mart,* (2004) 265 ITR 409, 410 (Del) [entire expenditure incurred in India on sales effected in India though against foreign currency].

(112) *Industrial Cables* (*India*) *Ltd. v. CIT,* (1999) 156 CTR (Punj) 185, 186 [ocean freight and insurance, not eligible under section 35B(1)(*b*)(*iii*)].

(113) *V. Guruvaiah Naidu & Sons v. CIT,* (2002) 174 CTR (Mad) 100, 101 (FB) [expenses on packing materials, not eligible].

(114) *CIT v. Oswal Woollen Mills Ltd.,* (2002) 175 CTR (Punj) 181, 183 [bank interest on packing credit].

(115) *Modi Spinning & Weaving Mills v. CIT,* (2002) 177 CTR (Del) 114, 115-16 [expenditure incurred on freight and cartage for carrying the goods to their destination].

(116) *CIT v. Sarangpur Cotton Mfg. Co. Ltd.,* (2002) 177 CTR (Guj) 467, 468-69 [commission payments to agents in India].

(117) *Sind Knitwears* (*P.*) *Ltd. v. CIT,* (2002) 178 CTR (Del) 328, 329 [expenditure on packing of exports, forwarding expenses for exports and insurance of such goods while in transit; interest amount on the factory type account and interest on packing credit].

(118) *Jay Engineering Works Ltd. v. CIT,* (2003) 183 CTR (Del) 326, 328, 329 [expenditure on certificate of original fee, stamp on export bills, freight charges, insurance charges, clearing agent commission/port charges, inspection charges, octroi, service charges (payment to shipping agents), port charges, coolie charges, not eligible for weighted deduction].

(119) *CIT v. Associated Stone Industries,* (2002) 168 Taxation 463, 464 (Raj) [freight inclusive of transport charges, cartage, coolie and BPT charges].

(120) *CIT v. Amber Tours* (*P.*) *Ltd.,* (2002) 171 Taxation 438, 439 (Del) [expenditure incurred in India on foreign tourists visiting India].

(121) *Indian Overseas Bank v. CIT*, (2004) 179 Taxation 5, 6-7 (SC) [interest paid by the assessee's branch in Bangkok to its customers on deposits made by them would not qualify for weighted deduction under section 35B(1)(*b*)(*iv*)].

(122) *CIT v. Zenith Steel Pipes & Industries Ltd.*, (2009) 315 ITR 95 (Bom) [in view of the admitted fact that as a major percentage of the goods advertised were in fact sold within India, it could not be said

LexisNexis

that the expenditure was incurred wholly and exclusively for the sale of exported goods as such the expenditure on advertisement and publicity was not entitled to weighted deduction].

(123) *KEC International Ltd. v. CIT*, (2010) 322 ITR 465 (Bom) [mere obtaining of a packing credit loan or payment of interest thereon in India cannot be said to entail the performance of any service outside India as such the expenditure would not be entitled to weighted deduction].

(124) *HMM Ltd. v. CIT*, (2009) 313 ITR 401 (Punj) [no weighted deduction under section 35B was held eligible in respect of freight expenses of Rs. 5,25,548, octroi duty of Rs. 2,972, bank charges of Rs. 427, trunk call charges of Rs. 3,439 and insurance charges of Rs. 53,161].

(125) *CIT v. Roadmaster Industries of India* (*P.*) *Ltd.*, (2009) 315 ITR 66 (Punj—FB) [since provisions of section 35B(1)(*iii*) negatived the claim of the assessee, the assessee held not entitled to deduction in respect of the claim specifically disallowed under section 35B(1)(*iii*)].

(126) *CIT v. Tara Agencies*, (2007) 292 ITR 444 (SC) [the activity of the assessee did not amount to 'manufacture' while the same may amount to 'processing', the assessee was not entitled to the deduction under section 35B, as the word 'processing' was not included in section 35B(1A)].

(127) *CIT v. Rajjab Carpets*, (2010) 328 ITR 42 (All) [the assessee cannot be said to maintain the agency of the foreign party outside India where it was only required to pay commission in accordance with the contract order procured by the foreign agency and in such type of case, the foreign agency is not entitled to weighted deduction].

(128) *Wazir Chand & Co. P. Ltd. v. CIT*, (2007) 290 ITR 626 (All) [the expenses on stationery, printing and postage did not fall under any of the clauses of section 35B(1)(*b*) thus, were not admissible for weighted deduction].

(129) *CIT v. J. C. Bhatia*, (2006) 287 ITR 356 (All) [the facts considered by the authorities had no relevance to whether the assessee was a small-scale exporter and in the absence of any finding that the assessee owned any industrial undertaking, the assessee could not be called a 'small scale exporter' and, therefore, was not exigible for weighted deduction].

(130) *CIT v. Zenith Steel Pipes & Industries Ltd.*, (2009) 315 ITR 95 (Bom) [the fees paid for certificates of origin, legalization of export documents and stamp fees on such documents would not amount to expenditure on performance of services outside India or expenditure on activities for the promotion of sale outside India and, such expenditure could not be granted weighted deduction].

(131) *Mobarak Ali Khan & Sons v. CIT*, (2007) 291 ITR 67 (All) [HHEC is a corporation which is meant for the promotion of export of various items like handicrafts, handlooms, gold jewellery and also exports of hand knotted woollen carpets from India. It had been helping the Indian exporters and not especially the assessee. The payment was made to procure foreign orders and the assessee had not established any branch or agency outside India hence, the assessee was not entitled to weighted deduction].

(132) *Orient Arts and Crafts v. CIT*, (2005) 279 ITR 581 (All) [the Tribunal had recorded a finding that no material was placed before it by the assessee to establish that it had installed machinery and plant in assessment year in question, for the purposes of its business within the meaning of *Explanation* (*2*) below section 32A(2) therefore, the assessee was not entitled to weighted deduction].

(133) *CIT v. Velvet Carpet & Co.*, (2008) 296 ITR 252 (All) [the expenditure by way of commission to the Belgium agent not qualified for weighted deduction within the meaning assigned under section 35B(1)(*b*)(*iv*) for assessment year 1983-84].

(134) *CIT v. Zenith Steel Pipes & Industries Ltd.*, (2009) 315 ITR 95 (Bom) [on inspection charges, weighted deduction was not admissible].

(135) *Bajaj Auto Ltd. v. CIT* [(2016) 389 ITR 259, 266 (Bom) [packing expenses of goods exported did not qualify for an allowance under section 35B(1)(*b*)].

(136) *Bombay Suburban Electric Supply Ltd. v. CIT*, (2016) 389 ITR 273, 280 (Bom) [the Tribunal held that what was done by the assessee was done only for BHEL as a sub-contractor & not for a person outside India. Accordingly, it did not entitle the assessee to any deduction under section 35B].

(137) *CIT v. K. C. P. Ltd.*, (2018) 409 ITR 436 (T & AP) [assessee had not discharged the onus of establishing that the expenditure was wholly or exclusively incurred for the purposes mentioned in section 35B(1)(*b*)(*iv*). Hence, the assessee was not entitled to weighted deduction].

Also see, *Taylor Instrument Co. of India Ltd. v. CIT,* SLP (Civil) No. 6932 of 1982: (1984) 150 ITR (St.) 78 (SC); *Belliss & Morcom* (*I*) *Ltd. v. CIT,* (1991) 93 CTR (Cal) 272, 275; *Gedore Tools* (*India*) (*P.*) *Ltd. v. CIT,* (1998) 99 Taxman 245, 246-47 (Del) = 233 ITR 712, 714 (Del).

LexisNexis

So far as general administrative expenses incurred by the assessee in India are concerned, these may qualify for weighted deduction only to the extent these can be correlated, on analysis, to any of the activities listed in sub-clauses (*i*) to (*viii*) of section 35B(1)(*b*) and not beyond that [*Handicrafts & Handloom Export Corporation of India v. CIT,* (1983) 140 ITR 532 (Del). Also see, *CIT v. Raunaq International Ltd.,* (1986) 158 ITR 701 (Del)].

On the point of allowability of weighted deduction under section 35B, reference may also be made to *CIT v. Jay Engineering Works,* (1984) 149 ITR 297 (Del); *CIT v. Orion Coir Mats and Mattings Manufacturers* (*P.*) *Ltd.,* (1987) 166 ITR 616 (Ker); *Bremco Corporation v. CIT,* (1990) 181 ITR 281 (All).

Disallowance, where involved a question of law.—Whether in the circumstances of a particular case a weighted deduction was, or was not, allowable, might be a question of law since in such determination, principles of the law need scrutiny and eligibility for applicability. But the question on what amount the weighted deduction was allowable was, ordinarily, a question of fact only [see, *CIT v. Piramal Spng. & Wvg. Mills,* (1980) 124 ITR 408 (Bom)]. At the same time, where the question before the Tribunal was whether the amount expended by the assessee represented expenditure wholly and exclusively incurred on export promotion, the Tribunal was to approach the matter correctly and quote the sub-clause of section 35B(1)(*b*) as may, in its opinion, be, or not be, applicable. In other words, the Tribunal should localise the expenditure in question with specific reference to the sub-clause in clause (*b*) of section 35B(1) and proceed to determine whether the expenditure had been wholly and exclusively incurred for any of the purposes listed therein [*CIT v. Cochin Co. P. Ltd.,* (1979) 119 ITR 157 (Ker)]. Also see, *CIT v. Tata Engineering and Locomotive Co. Ltd.,* (1981) 131 ITR 19 (Bom).

In the facts of the following cases, the Tribunal was directed to state the case to the High Court and refer the questions of law:

(1) *CIT v. Oswal Woollen Mills Ltd.,* (1987) 163 ITR 207 (Punj).
(2) *CIT v. Premier Traders,* (1987) 163 ITR 719 (All).
(3) *Aero Engineering Works v. CIT,* (1983) 34 CTR (Punj) 276.
(4) *CIT v. Bhagat Bros.,* (1987) 165 ITR 660 (Punj).
(5) *Jain Exports Pr. Ltd. v. CIT,* (1987) 168 ITR 304 (Del).
(6) *CIT v. Kraft Place,* (1987) 167 ITR 236 (All).
(7) *CIT v. Ivory Mart,* (1988) 67 CTR (Del) 16.
(8) *CIT v. Bharat Commerce & Industries Ltd.,* (1990) 184 ITR 90, 95 (Del).
(9) *CIT v. Kerala Nut Food Co.,* (1990) 185 ITR 150 (Ker).
(10) *CIT v. Associated India Exports,* (1991) 188 ITR 125 (Del).
(11) *CIT v. Mali Ram Pooran Mal,* (1991) 190 ITR 322 (Raj).
(12) *CIT v. Arvind Construction Co. Pvt. Ltd.,* (1992) 193 ITR 330 (Del).
(13) *CIT v. Mahajan International,* (1992) 194 ITR 278 (Punj).
(14) *CIT v. Continental Devices India Ltd.,* (1992) 196 ITR 571, 573 (Del).
(15) *CIT v. Escorts Ltd.,* (1993) 201 ITR 504 (Del).
(16) *CIT v. Mahavir Plantations Ltd.,* (1995) 213 ITR 485, 489, 491 (Ker).
(17) *CIT v. J.K. Synthetics Ltd.,* (1995) 125 CTR (Del) 414, 416, 417-18.
(18) *CIT v. J.K. Synthetics Ltd.,* (1995) 215 ITR 593, 596 (Del).
(19) *CIT v. Poyilakada Fisheries* (*P.*) *Ltd.,* (1996) 221 ITR 692, 694 (Ker).
(20) *CIT v. Bhandari Hosiery Mills* (*P.*) *Ltd.,* (1997) 226 ITR 956, 958 (Punj).
(21) *CIT v. Roadmaster Industries of India P. Ltd.,* (2001) 248 ITR 451, 452 (SC).

LexisNexis

But, in the facts of *CIT v. York Hosiery Mills Pr. Ltd.* [(1986) 51 CTR (Del) 276], it was held that no question of law arose. Also see, *CIT v. Lall's International,* (1987) 167 ITR 237 (All); *K. Ravindranathan Nair v. CIT,* (1988) 170 ITR 409 (Ker); *CIT v. Electric Construction & Equipment Co. Ltd.,* (1990) 185 ITR 147 (Del); *CIT v. Usha Sales Ltd.,* (1990) 182 ITR 452 (Del); *CIT v. Usha Sales Ltd.,* (1990) 182 ITR 453 (Del); *CIT v. A. Yunus Kunju,* (1991) 189 ITR 672, 679 (Ker); *CIT v. National Palayacot Co.,* (1999) 154 CTR (Mad) 262, 263-64.

Where the Tribunal has not recorded any finding with regard to the claim for weighted deduction under section 35B, it is not necessary for the High Court to answer the question regarding such claim [*Warner Hindusthan Ltd. v. CIT,* (1988) 171 ITR 224, 231 (AP)]. Also, where the statement of facts was found to be inadequate the question

about allowance of weighted deduction was returned unanswered [*Zenith Steel Pipes Ltd. v. CIT,* (1990) 186 ITR 500 (Bom); *Zenith Steel Pipes Ltd. v. CIT,* (1990) 185 ITR 281 (Bom); *Zenith Steel Pipes Ltd. v. CIT,* (1990) 186 ITR 594 (Bom).

A question about proportion of a particular expenditure eligible for weighted deduction has been held to be a question of fact [*CIT v. Novelty Trading Corporation,* (1984) 150 ITR 453 (All); *K. Vensimal & Sons v. CIT,* (1986) 157 ITR 807 (Mad); *CIT v. Raunaq International Ltd.,* (1986) 158 ITR 701 (Del); *CIT v. Indian Aluminium Cables Ltd.,* (1990) 184 ITR 587 (Del); *CIT v. Geskets and Radiators Pvt. Ltd.,* (1991) 192 ITR 509, 514 (Guj); *CIT v. Tungabhadra Industries Ltd.,* (1992) 196 ITR 912, 916 (Cal); *Jayshree Tea & Industries Ltd. v. CIT,* (1993) 202 ITR 695, 697 (Cal). Similarly, the finding that a particular expenditure is covered by a particular sub-clause of section 35B(1)(*b*) is also one of fact [*CIT v. Indian Aluminium Cables Ltd.,* (1990) 184 ITR 587 (Del).

Whether particular expenses were wholly or exclusively for a particular purpose or partly for that purpose within the meaning of section 35B(1)(*b*), is a question of fact [*Indian Trade Promotion Organisation v. CIT,* (1999) 238 ITR 901, 904 (Del)].

Where a particular question of law has been referred to the High Court, another question involving a different aspect of the same question could not be asked to be referred to the High Court [*CIT v. Triveni Sheet Glass Works Ltd.,* (1991) 190 ITR 38, 39 (All)].

Where, after considering the facts, the Tribunal has taken the correct view, in allowing weighted deduction in respect of certain expenses incurred by the assessee, in the light of the express provisions contained in various sub-clauses of clause (*b*) of section 35B(1), no question of law arises [*CIT v. Smithkline Beecham Consumer Brands Ltd.,* (1997) 226 ITR 764, 773 (Punj)].

In *Shri Ambica Mills Ltd. v. CIT* [(1992) 198 ITR 99, 104 (Guj)], the Tribunal was held justified in refusing to entertain the additional ground relating to allowance of weighted deduction under section 35B in respect of customs duty. Also see, *Brooke Bond India Ltd. v. CIT,* (1991) 59 Taxman 82, 84 (Cal).

Question of fact.—The quantum which should be allowed to the assessee by way of weighted deduction is a question of estimation to be arrived at on the basis of the facts and the materials on the record [*CIT v. BOI*, (2008) 296 ITR 88 (Bom)].

Remand to CIT(A).—Since the CIT(A) and the Tribunal had not gone into the correctness of the findings recorded by the AO with reference to the provisions of section 35B(1)(*b*), the matter has been remanded to the CIT(A) for fresh decision in accordance with law [*CIT v. O.K. Hosiery Mills*, (2008) 304 ITR 110 (Punj)].

Remand to the Tribunal.—In the facts of the following cases, the matter was remanded to the Tribunal for fresh consideration:—

(1) *CIT v. Dunlop India Ltd.,* (1992) 197 ITR 34, 41 (Cal).

(2) *CIT v. Bakul Cashew Co.,* (1992) 197 ITR 135, 138 (Ker).

(3) *CIT v. K. Ravindranathan Nair,* (1993) 200 ITR 766 (Ker).

(4) *Kerala State Cashew Development Corporation Ltd. v. CIT,* (1993) 202 ITR 127 (Ker).

(5) *CIT v. Aspinwall & Co.* (*Travancore*) *Ltd.,* (1994) 206 ITR 58 (Ker).

(6) *CIT v. Tribeni Tissues Ltd.,* (1996) 217 ITR 846, 848 (Cal).

(7) *CIT v. Orion Coir Mats & Mattings Manufacturers* (*I.*) *Ltd.,* (1995) 211 ITR 700, 702 (Ker).

(8) *V.D. Swami & Co. Ltd. v. CIT,* (1995) 216 ITR 129, 136 (Mad).

(9) *Lucas TVS Ltd. v. CIT,* (1996) 217 ITR 382, 404 (Mad) (in so far as the expenditure on export inspection agency fees was concerned).

(10) *CIT v. Stepwell Industries Ltd.,* (1997) 228 ITR 171, 175-76, 177, 179, 179-80, 181, 183 (SC).

(11) *CIT v. Hero Cycles Pvt. Ltd.*, (1997) 228 ITR 463, 469, 470, 471, 473, 474, 475 (SC).

(12) *CIT v. Farice Prime Tannery,* (1997) Tax LR 468, 469 (Mad).

(13) *CIT v. Victor Tools Corporation,* (1998) 146 CTR (Punj) 794, 808-09 = (1999) 237 ITR 640, 654 (Punj).

(14) *CIT v. Somany Pilkington Ltd.,* (1999) 238 ITR 149, 152 (Punj) [for finding out whether the commission fell under any of the sub-clauses of section 35B(1)(*b*) in the light of Supreme Court ruling: 228 ITR 171(SC)].

(15) *CIT v. Madurai Mills Co. Ltd.,* (1999) 238 ITR 927, 931 (Mad) [for recording a specific finding whether the expenditure fell under one or more sub-clauses of section 35B(1)(*b*) in the light of the Supreme Court rulings: 228 ITR 171 (SC) and 228 ITR 463 (SC)]. Also see, *CIT v. Meenakshi & Co.,* (1999) 239 ITR 153, 155 (Mad); *T. Abdul Wahid & Co. v. CIT,* (1999) 239 ITR 346, 349 (Mad); *CIT*

LexisNexis

v. India Cements Ltd., (2000) 244 ITR 185, 187 (Mad); *CIT v. Indo Carpet Factory,* (2001) 247 ITR 777, 782 (J&K); *CIT v. Goodricke Group Ltd.,* (2001) 251 ITR 187, 189 (Cal); *CIT v. Oswal Woollen Mills Ltd.,* (2002) 254 ITR 666, 669 (Punj); *CIT v. Indo Asian Switchgears* (*P.*) *Ltd.,* (2002) 257 ITR 645, 647 (Punj); *CIT v. Mahavir Plantations* (*P.*) *Ltd.,* (2003) 260 ITR 233, 237-38 (Ker); *CIT v. Romin Consulting Services* (*P.*) *Ltd.,* (2003) 262 ITR 357, 360 (Del); *CIT v. Kerala Shipping Corporation Ltd.,* (1999) 106 Taxman 577, 579 (Ker); *CIT v. Indo Asian Switchgears* (*P.*) *Ltd.,* (2002) 121 Taxman 69, 69-70 (Punj).

(16) *CIT v. Poyilakada Fisheries P. Ltd.,* (1999) 240 ITR 445, 447 (Ker) [for recording a specific finding on the question whether the assessee had maintained an office or agency outside India so as to attract section 35B(1)(*b*)(*iv*)].

(17) *Fenner* (*India*) *Ltd. v. CIT,* (2000) 241 ITR 797, 801 (Mad) [for considering the matter with reference to section 35B(1)(*b*)(*ii*)].

(18) *CIT v. C.W.S.* (*India*) *Ltd.,* (2000) 242 ITR 429, 433 (Ker) [for recording a finding on the question whether the assessee is maintaining an agency outside India so as to attract section 35B(1)(*b*)(*iv*), as also to consider the claim for weighted deduction in respect of warehousing charges under rule 6AA].

(19) *Ganapathy Engineering Manufacturing P. Ltd. v. CIT*, (2000) 245 ITR 203, 210 (Mad), which has been discussed, *ante*, under section 35B.

(20) *CIT v. Noor Handicrafts,* (2000) 245 ITR 309, 311-12 (All) [for examining the nature of each item of expenditure incurred and for finding whether the same fell under any one or more of the sub-clauses of section 35B(1)(*b*) and then to allow the same if it is so found].

(21) *CIT v. Madras Rubber Factory Ltd.,* (2001) 248 ITR 814, 816 (Mad) [for rechecking certain items of expenditure and to pass appropriate orders].

(22) *CIT v. Avon Cycles* (*P.*) *Ltd.,* (2002) 173 CTR (Punj) 267, 269 [for considering afresh after giving the parties an opportunity to prove their respective claims].

(23) *CIT v. Material Dress Engineering Foundry*, (2005) 275 ITR 308 (Punj) [the findings of the Tribunal for assessment year 1979-80 been set aside on the issue and the matter was remitted to the Tribunal for fresh adjudication under various sub-clauses of section 35B(1)(*b*)].

In the facts of *CIT v. Aluminium Industries Ltd.* [(1990) 182 ITR 172 (Ker)], the matter was remanded to the Tribunal for deciding the same afresh. Also see, *Asuma Cashew Co. v. CIT,* (1990) 182 ITR 175 (Ker), special leave petition dismissed by the Supreme Court: (1989) 180 ITR (St.) 39 (SC); *CIT v. Grand Cashew Corporation,* (1990) 182 ITR 194 (Ker); *CIT v. Grand Cashew Corporation,* (1990) 182 ITR 216 (Ker); *CIT v. P. Balakrishna Pillai, International Cashew Traders,* (1990) 182 ITR 449 (Ker).

Remand to the AO.—In *CIT v. Jay Engineering Works Ltd.* [(1998) 233 ITR 433, 434 (Del)], the assessee did not make a claim for deduction under section 35B before the AO but raised such claim for the first time before the first appellate authority, which did not admit the claim. On second appeal, the Tribunal admitted the claim of the assessee but directed the AO to consider the assessee's claim and decide the issue on the merits. The Tribunal was held justified in so directing because the Tribunal could not allow the claim on assumption of facts.

In *CIT v. Sivanandha Steels Ltd.* [(2000) 243 ITR 770, 774, 773-74 (Mad)], the matter has been remitted to the Assessing Officer with a direction to give an opportunity to assessee to place the relevant material before him and thereafter to decide the extent to which the assessee is entitled to the benefit of weighted deduction under section 35B(1)(*b*)(*iv*) in respect of expenditure incurred on maintenance of an agency in a foreign country for the purpose of promoting sales of its products.

Where the agreement between the assessee and the agent does not bifurcate the payments made towards the costs of maintaining the agent's office, and the profitability of the agent on the sales concluded with its assistance. It is the duty of the assessee to make such allocation on a rational basis and if such allocation is found to be acceptable by the Assessing Officer, the claim to the extent allowable would have to be considered under section 35B(1)(*b*)(*iv*).

Departmental circulars.—The following departmental circular also clarifies the provisions of sections 35B and 35C:—

Sections 35B and 35C of the Income-tax Act, 1961—Expenditure incurred indirectly through joint export promotion arrangements or through an approved association or body—Admissibility of deduction in relation to—Instructions regarding.—"The Finance Act, 1968, made provisions in sections 35B and 35C of the Income-tax Act, 1961, respectively, for the grant of "export markets development allowance" and "agricultural development allowance" in computing the profits and gains from business. Under section 35B, an assessee, being a domestic company or a resident non-corporate person, who incurs expenditure under specified heads for

development of export markets for Indian goods on a long-term basis, is entitled to a weighted deduction of a sum equal to 1⅓ times the amount of the qualifying expenditure in the computation of his business profits. Under section 35C, a company[15] engaged in any agro-based industry, which incurs expenditure in the provision of agricultural inputs and extension services of the specified categories to independent farmers, cultivators, or producers in India of the products of agriculture, animal husbandry or dairy or poultry farming, is entitled to a deduction of a sum equal to 1⅕ times the amount of the qualifying expenditure in the computation of its business profits. [The details of these provisions have been explained in paragraphs 42-46[16] and 54-59[17] of Board's Circular No. 6-P of 1968, dated the 6th July, 1968]. The weighted deduction under both these sections is available not only with reference to the qualifying expenditure incurred directly by the assessee but also with reference to such expenditure incurred indirectly by him. In the case of the export markets development allowance, expenditure incurred by the assessee in association with any other person also qualifies for the allowance. In the case of agricultural development allowance, expenditure incurred through an association or body approved in this behalf by the prescribed authority, also qualifies for the allowance.

2. A question has been raised as to the circumstances in which, and the conditions, if any, subject to which expenditure incurred by an assessee indirectly, as stated above, will count for the weighted deduction contemplated under sections 35B and 35C. This is particularly important in the case of expenditure incurred by export houses for development of export markets on behalf of their constituents, or by associations, such as IJMA, providing agricultural inputs and extension services to jute growers with a view to improving the productivity and quality of jute. While it is not possible to lay down any general rule in this regard which would be applicable in all situations, it may be stated that individual members or constituents of an association or body which undertakes export markets development or agricultural development on behalf of or for the benefit of its members, will qualify for the weighted deduction under section 35B or 35C with reference to their share in the expenditure incurred by the association or body, provided:—

(*a*) the expenditure falls under one or more of the several qualifying categories specified in the respective sections and the rules, if any, framed thereunder;

(*b*) where the expenditure incurred by the association or body includes any expenditure on activities other than those which fall under the specified heads, such expenditure is isolated; and

(*c*) the net amount of expenditure incurred by the association or body under the specified heads [*i.e.*, after excluding the expenditure referred to in (*b*) above, and after taking credit for any grant or subsidy received by it from the Government or any other source for carrying on the said activities] is apportioned among the members of the association or body on a rational basis and recovered from them.

To facilitate verification, it is necessary that proper accounts are maintained in respect of expenditure incurred by an association or body with reference to which the allowance under section 35B or 35C is claimed by its members or constituents.

3. It is to be noted that the weighted deduction under section 35C by way of agricultural development allowance for expenditure incurred by an assessee under specified heads through an association or body is available only if such association or body has been approved in this behalf by the prescribed authority[18]. The authorities which are to grant approval in such cases will be notified[19] shortly in the Income-tax Rules." [*Circular No. 27, dated 16th August, 1969*.]

The following **departmental instructions** are also relevant to section 35B:—

'Instruction No. 1441—XXVII/1/93—Deduction under section 35B—ITAT's decision in the case of J. Hemchand and Company (*ITA Nos. 3255 and 3330/BOM of 1976-77, dated 17-6-1978*)*—Clarification regarding.*—[*F. No. 268/738/SI-ITJ, dated 28-12-1981, from Central Board of Direct Taxes, reproduced from the judgment in CIT v. Kerala Nut Food Co.,* (1991) 192 ITR 585, 592-94 (Ker)].

'Instruction No. 1441—XXVII/1/93—Deduction under section 35B—ITAT's decision in the case of J. Hemchand and Company (ITA Nos. 3255 and 3330/BOM of 1976-77, dated June 17, 1978)—Clarification regarding.— Attention is drawn to the Board's Instruction No. 1302, dated January 29, 1980. It was clarified therein that the sole question to be determined in considering the admissibility of weighted deduction is whether the expenditure in question is one covered by any of the sub-clauses of clause (b). The Board also accepted that in case there is composite expenditure a part of which may relate to any of the purposes mentioned in the sub-clauses, the claim can be allowed in respect of and to the extent the expenditure can be said to be incurred wholly and exclusively with reference to any of the items specified in clause (b) of section 35B(1). In particular, the instruction (para 4)

15. Also, a co-operative society, for and from assessment year 1976-77.
16. See under section 35B, *ante.*
17. See under section 35C, *post*.
18. For *"Prescribed authority"* see, u/s. 35C, *post*.
19. See rule 6A(1) of the Income-tax Rules, 1962.

LexisNexis

referred to expenses claimed on export division and emphasised that after critical examination of the nature of such expenditure, the extent to which such expenditure could be said to fall wholly and exclusively within the meaning of one or more sub-clauses of clause (b) of sub-section (1) can be determined.

2. Attention may also be drawn to the decision of the Bombay High Court in the case of *Eldee Wire Ropes Ltd.* [1978] 114 ITR 485 which had been accepted by the Board. The High Court had held that except for items covered under clause (*iii*) there is no warrant for excluding expenditure incurred in India as is covered in any sub-clause of clause (*b*). The court further held that the assessee will have to satisfy the Income-tax Officer that the purpose for expenditure, *whether incurred outside India or in India, is one which is satisfied by reference to the language of the section.* The court further observed that where the Legislature desired to exclude the expenditure incurred in India for the purpose of giving benefit of weighted deduction, it expressly did so by specifically mentioning such exclusion in sub-clause (*iii*).

3. Then came the decision of the Special Bench of the Tribunal at Bombay in the case of J. Hemchand and Co.[20] which laid down the following propositions of law in paras 22 and 23 of its order dated June 17, 1978. These are as under:—

(*a*) Except for the purpose of sub-clause (*iii*), the place where the expenditure is incurred is irrelevant and any expenditure satisfying the conditions laid down in sub-clauses (*i*), (*ii*), and (*iv*) to (*viii*) will get the benefit of weighted deduction irrespective of *whether the same is incurred in or outside India.*

(*b*) Under sub-clause (*iii*), though expenditure incurred wholly and exclusively on distribution, supply or provision outside India of such goods, services or facilities would generally qualify for weighted deduction, the rule is, however, subject to the notable exception that expenditure incurred in India in connection with such distribution, supply or provision as also expenditure, wherever incurred, on the carriage of such goods to their destination outside India and on the insurance of such goods while in transit, will not all the same get such benefit.

(*c*) Wherever common expenses are incurred by an assessee that could properly and fairly be apportioned to any of the activities referred to in the sub-clauses, such proportionate expense can be taken for the purpose of this section as wholly and exclusively spent on such activity.

4. *It may be clarified that the Board agrees with the above interpretation of the provisions of section 35B.* The Tribunal has also correctly stated in the said order that whether a particular claim made by an assessee falls under any one or more of the activities specified in those sub-clauses, *can at best be judged only with reference to the facts of the particular case and the nature of the claim.* The Tribunal thereafter examined the various items of expenses. It appears to the Board that the decision of the Tribunal in respect of some items of expenses treating them as admissible for weighted deduction wholly or proportionatly, may be controversial and not acceptable to the Department. In particular its decision to allow 75% of salary of persons handling export business could still be a matter of dispute, because though accepting that the assessee's employees as part of their duty could not have avoided attending also to such work as falls within the excluded category in sub-clause (*iii*), it decided to apportion only 25% of the expenditure on salaries, etc., attributable to excluded activities. But for upholding 75% thereof as admissible for weighted deduction it did not at all discuss the nexus of such expenses with the purposes or activities specified in other sub-clauses. In other words, the claim with regard to 75% of the salaries could not be proved to be falling under any one or more of the activities specified in other sub-clauses.

5. The Board have also noticed subsequent decisions of different Benches of the Tribunal which, while dealing with the claim of admissibility with regard to salaries paid to Export Department personnel, are merely following the Full Bench decision and are apportioning 75% of the expenses as admissible for weighted deduction. In some of the cases the Tribunal did mention that part of such expenses were attributable to preparation and submission of tenders for the supply outside India of goods, services, etc. Even in such a case, though on facts part of the activity may have nexus with sub-clause (*v*), the question may still remain whether apportionment at 75% is reasonable or excessive. Such issue would be basically a finding of fact and can be further contested, depending on the state of revenue involved, by seeking reference to the High Court by raising appropriate questions of law on the ground of perversity. Therefore, each case should be considered in the light of whatever is stated above and framing of the question of law should be done carefully.

6. It may also be clarified that the Full Bench decision with regard to admissibility of weighted deduction in respect of insurance amount paid to the Export Credit Guarantee Corporation is not correct. In fact, on this issue, a special leave petition had been filed in the Supreme Court in the case of *CIT, Karnataka v. Orient Co. (P.) Ltd.* (F. No. 270/155/80-ITJ).

LexisNexis

20. This decision has been reported as *J.H. & Co. v. Second ITO* [(1982) Selected Orders of ITAT (SOT) 150, Vol. 1].

7. The above instructions may please be brought to the notice of all the officers working in your charge.' [*F. No. 268/738/SI-ITJ, dated December 28, 1981, from Central Board of Direct Taxes, reproduced from the judgment in CIT v. Kerala Nut Food Co., (1991) 192 ITR 585, 592-94 (Ker).*]

On the basis of the abovesaid circular, the assessee has been held entitled to weighted deduction under section 35B in respect of—

—the commission payment made to parties to bring about the export sales [*CIT v. Kerala Nut Food Co.,* (1991) 192 ITR 585, 594 (Ker), **impliedly** been **approved in** *N.J. Albert v. CIT*, (2000) 10 SCC 238, 239; *Kerala State Cashew Development Corporation Ltd. v. CIT,* (1993) 202 ITR 127 (Ker)];

—the expenses on salary and expenses on the staff engaged in the export sale [*CIT v. Bakul Cashew Co.,* (1992) 197 ITR 135, 137 (Ker)],

irrespective of the fact whether the same was incurred in India or outside India.

In *CIT v. Chemmeens* [(1994) 207 ITR 909, 924 (Ker)] and *Rathi Gum Industries v. CIT* [(1996) 218 ITR 583, 588 (Raj)], the matter was remanded to the Tribunal to consider the same afresh in the light of the abovesaid departmental circular dated 28-12-1981.

Binding nature of a circular.—It is well-settled that circulars can bind the Assessing Officer but will not bind the appellate authority or the Tribunal or the court or even the assessee. With regard to a circular dated 9-4-1981/13-4-1981, on which reliance has been placed by the assessee for claiming weighted deduction under section 35B, the Supreme Court has stated that the so-called circular does not appear to be a circular at all. It is a letter written to one Shri D'Souza with reference to a letter written by his predecessor. There is nothing in the alleged circular which supports the contention of the assessee. It merely says that each case has to be examined and the issue would be basically a finding of fact [*CIT v. Hero Cycles Pvt. Ltd.,* (1997) 228 ITR 463, 469-70 (SC)].

LexisNexis

Omitted/Phased-out provisions of section 35C of the 1961 Act

[1][**S. 35C. * * * *]**

AGRICULTURAL DEVELOPMENT ALLOWANCE (FOR ASSESSMENT YEARS 1968-69 TO 1984-85)

Withdrawal of agricultural development allowance.—The Finance Act, 1983 (11 of 1983), withdrew the weighted element from the allowance. The Finance Act, 1984 (21 of 1984), has withdrawn the agricultural development allowance in respect of any expenditure incurred after 29-2-1984.

Agricultural Development Allowance.—Introduced by **the Finance Act, 1968** (19 of 1968), with effect from 1-4-1968, the **new section 35C** provided, in the case of any company[2] engaged in the manufacture or processing of articles or things out of, or by using, any product of agriculture, animal husbandry or dairy or poultry farming, a deduction in an amount equal to one and one-fifth times[3] the amount of expenditure (Rs. 120 for Rs. 100) incurred by it, after 29-2-1968[4], in the provision of agricultural inputs and extension services to a cultivator, grower or producer in India of the agricultural raw materials used by it. The agricultural inputs may be by way of supply of fertilizers, seeds, pesticides, tools or implements; the extension of services include dissemination of information on modern agricultural techniques, advice on such techniques and demonstration of modern agricultural techniques or methods, etc. The deduction was available where the expenditure was incurred directly by the company and also where it was incurred through an association or body which has been approved in this behalf by the prescribed authority.[5]

The provisions of section 35C, as originally enacted, have been elaborated in the following portion of the departmental **circular**:—

F. No. 1(*234*)*/68-TPL—Circular No. 6-P* (*LXXVI-66*) *of 1968, dated 6-7-1968.*—"**53.** The Finance Act, 1968 (19 of 1968), has made certain provisions in the Income-tax Act with a view to encouraging industry to incur expenditure on providing inputs and extension services for improvement of agricultural productivity; scientific research in the spheres of agriculture, animal husbandry and fisheries; and developing and producing improved

LexisNexis

---

1. Section 35C has been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989). Prior to its omission by the Direct Tax Laws (Amendment) Act, 1987, with effect from 1st April, 1989, stood as follows:—

"[**S. 35C. Agricultural development allowance.—**](1)(*a*) Where any company [b][or a co-operative society] is engaged in the manufacture or processing of any article or thing which is made from, or uses in such manufacture or processing as raw material, any product of agriculture, animal husbandry, ordairy or poultry farming, and has incurred, after the 29th day of February, 1968, [c][but before the 1st day of March, 1984,] whether directly or through an association or body which has been approved for the purposes of this section by the prescribed authority, any expenditure in the provision of any goods, services or facilities specified in clause (*b*) to a person [not being a person referred to in clause (*b*) of sub-section (2) of section 40A] who is a cultivator, grower or producer of such product in India, [d][the company or co-operative society] shall, subject to the provisions of this section, be allowed a deduction of [e][* * * *] the amount of such expenditure incurred during the previous year.

(*b*) The goods, services or facilities referred to in clause (*a*) are the following:—

(*i*) fertilisers, seeds, pesticides, concentrates for cattle and poultry feed, tools or implements, for use by such cultivator, grower or producer;

(*ii*) dissemination of information on, or demonstration of, modern techniques or methods of agriculture, animal husbandry, or dairy or poultry farming, or advice on such techniques or methods;

(*iii*) such other goods, services or facilities as may be prescribed.

Explanation.—In computing the [f][expenditure which is to be allowed as deduction under this section], the amount, if any, received by [g][the company or co-operative society] in consideration of, or as compensation for, such goods, services or facilities shall be deducted.

(2) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure of the nature specified in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]'.

---

a. Ins. by the Finance Act, 1968 (19 of 1968), s. 5 (w. e. f. 1-4-1968).

b. Ins. by the Taxation Laws (Amendment) Act, 1975 (41 of 1975), s. 9(*i*) (w. e. f. 1-4-1976).

c. Ins. by the Finance Act, 1984 (21 of 1984), s. 7 (w. e. f. 1-4-1984).

d. Subs., for "the company", by the Taxation Laws (Amendment) Act, 1975 (41 of 1975), s. 9(*ii*) (w. e. f. 1-4-1976).

e. The words "a sum equal to one and one-fifth times" were omitted by the Finance Act, 1983 (11 of 1983), s. 14(*a*) (w. e. f. 1-4-1984).

f. Subs., for "expenditure with reference to which deduction under this section is to be allowed", by Act 11 of 1983, s. 14(*b*) (w. e. f. 1-4-1984).

g. Subs., for "the company", by the Taxation Laws (Amendment) Act, 1975 (41 of 1975), s. 9(*ii*) (w. e. f. 1-4-1976).

2. Also, a co-operative society, for and from assessment year 1976-77.

3. This weighted element from the allowance was withdrawn by the Finance Act, 1983, for and from assessment year 1984-85.

4. By the Finance Act, 1984, the Agricultural Development Allowance has been withdrawn in relation to expenditure incurred after the 29th day of February, 1984.

5. For *"Prescribed authority"*, see, u/s. 35C, *post*.

high-yielding and disease-resistant strains of seeds, concentrates for cattle and poultry feed and also vegetable oils and oilcakes by the solvent extraction process. These provisions are explained in the following paragraphs.

54. *Agricultural development allowance.*—The Finance Act, 1968 (19 of 1968), has introduced a new section 35C in the Income-tax Act under which companies engaged in agro-based industries will be eligible for a weighted deduction, in the computation of their business income, with reference to expenditure incurred by them in providing agricultural inputs and extension services to independent cultivators, growers or producers of the products of agriculture, animal husbandry or dairy or poultry farming. The weighted deduction will be in an amount equal to 1.2 times[6] the amount of the qualifying expenditure. The companies which are eligible for the weighted deduction are those which use the products of agriculture, animal husbandry or dairy or poultry farming as raw material for their industry or process such products. The expenditure which will qualify for the weighted deduction is that incurred by the company after 29-2-1968,[7] in the provision of the goods, services or facilities specified hereunder:—

(*i*) Fertilisers, seeds, pesticides, concentrates for cattle and poultry feed, tools or implements, for use by cultivator, grower or producer of the products of agriculture, animal husbandry or dairy or poultry farming.

(*ii*) Dissemination of information on, or demonstration of, modern techniques or methods of agriculture, animal husbandry or dairy or poultry farming, or advice on such techniques or methods.

(*iii*) Such other goods, services or facilities as may be prescribed.[8]

55. It may be noted that expenditure on the provision of the goods, services or facilities, as stated above, will qualify for the weighted deduction only where these are provided to independent cultivators, growers or producers in *India*. Expenditure in the form of cash assistance to cultivators, growers or producers does not qualify for the weighted deduction. Where the company receives any consideration or compensation for the goods, services or facilities provided, whether from the cultivator, grower or producer or from any other source, the expenditure qualifying for the weighted deduction will be computed after excluding such consideration or compensation. Expenditure on providing inputs and extension services to related persons or associate concerns referred to in new section 40A ..... will not qualify for the weighted deduction.

56. The weighted deduction has been provided only[9] in the case of companies engaged in agro-based industries, *i.e.*, those which use as raw material, or process, the products of agriculture, animal husbandry, dairy or poultry farming. Accordingly, companies which are engaged in agro-industries (as distinct from those engaged in agro-based industries) such as those manufacturing fertilisers, seeds, pesticides, tractors, implements, etc., are not eligible for the weighted deduction even though they may incur expenditure on supply of fertilisers, seeds, pesticides, tractors or other implements to the farmers or on demonstration of the use of these products for their benefit. This is because such expenditure would be incurred by these companies as part of their sales promotion effort and it is not the intention to allow a weighted deduction in relation to expenditure on such activities. The weighted deduction will also not be available where the company engaged in an agro-based industry owns its own farm and incurs expenditure on seeds, fertilisers, etc., used for cultivation of such farm.

57. Expenditure under the qualifying heads may be incurred by the company either directly or through an association or body which has been approved for the purposes of this section by the prescribed authority.

58. The question as to whether any further goods, services or facilities need to be included for the purpose of the weighted deduction and, if so, what these should be, is under consideration[10]. The authority which is to grant approval to associations or bodies as stated in the preceding paragraph will also be notified[11] in the Income-tax Rules.

59. Some of the items of expenditure which qualify for the weighted deduction under section 35C may be allowable as a deduction in computing business profits under the existing law. However, where any such expenditure has been admitted as the base for computing the weighted deduction, no deduction shall be allowed in respect of such expenditure under any other provision of the Income-tax Act for the same or any other assessment year [*vide,* section 35C(2)].".

It may be noted that Circular No. 27, dated 16-8-1969, is also relevant on the point and has been reproduced under section 35B, *ante.*

---

6. This weighted element from the allowance was withdrawn by the Finance Act, 1983, for and from assessment year 1984-85.

7. By the Finance Act, 1984, the Agricultural Development Allowance has been withdrawn in relation to expenditure incurred after the 29th day of February, 1984.

8. For *"Prescribed services"*, see u/s. 35C, *post*.

9. Also in the case of co-operative societies, for and from assessment year 1976-77.

10. Now, rule 6A(2) prescribes such services or facilities.

11. See, rule 6A(1) of the Income-tax Rules, 1962.

Legislative amendments.—I. *The Taxation Laws* (*Amendment*) *Act, 1975.*—This Act was amended section 35C so as to extend, for and from assessment year 1976-77, the agricultural development allowance under that section to co-operative societies also, besides companies.

II. *The Finance Act, 1983 (11 of 1983).*—By this Act, section 35C was amended so as to withdraw the weighted element. The scope and effect of such amendments have been elaborated in the following portion of the departmental **circular** No. 372, dated 8-12-1983:—

'(*xix*) *Withdrawal of weighted element of agricultural development allowance—Section 35C.*—**27.1** Under section 35C of the Income-tax Act, 1961 (43 of 1961), a company or a co-operative society which uses any product of agriculture, animal husbandry or dairy or poultry farming as raw materials or processes such products is eligible for a weighted deduction of the expenditure incurred, whether directly or through an approved association or body, in the provision of agricultural inputs and extension services to cultivators, growers or producers of such products. The weighted deduction is allowed on an amount equal to one and one-fifth times the amount of the qualifying expenditure.

27.2 The Finance Act, 1983 (11 of 1983), has amended section 35C with a view to withdrawing the weighted element in this deduction (which is 20 per cent. of the qualifying expenditure) and restricting the deduction admissible only to 100 per cent. of the amount of the qualifying expenditure.

27.3 The amendment will take effect from 1-4-1984, and will, accordingly, apply in relation to assessment year 1984-85, and subsequent years. [Section 14 of the Finance Act, 1983 (11 of 1983)]'.

III. *The Finance Act, 1984 (21 of 1984).*—By this Act, section 35C was amended so as to withdraw the agricultural development allowance in relation to expenditure incurred after the 29-2-1984.

The scope and effect of this amendment have been elaborated in the following portion of the departmental **circular** No. 387, dated 6-7-1984:—

'(*vi*) *Withdrawal of agricultural development allowance.*—**12.1** Under section 35C of the Income-tax Act, 1961 (43 of 1961), a company or a co-operative society which uses the products of agriculture, animal husbandry or dairy or poultry farming as raw material or processes such products is eligible for a deduction of the amount of expenditure incurred, whether directly or through an approved association or body, in the provision of agricultural inputs and extension services to cultivators, growers or producers of such products.

12.2 As expenditure-linked tax concessions are liable to misuse, the Finance Act, 1984 (21 of 1984), has discontinued the tax concession under section 35C of the Income-tax Act in respect of any expenditure incurred after the 29-2-1984.

LexisNexis

12.3 The amendment takes effect from 1-4-1984, and will accordingly apply in relation to the assessment year 1984-85 and subsequent years.'.

IV. *The Direct Tax Laws* (*Amendment*) *Act, 1987 (4 of 1988).*—By this Act, section 35C has been omitted, with effect from 1-4-1989.

Relevant rule.—Old Rule 6A of the Income-tax Rules, 1962 **omitted** by **the Income-tax (32nd Amendment) Rules, 1999**, specifies prescribed authority, services, etc., for the purposes of agricultural development allowance.

Introduction.—Section 35C, providing for agricultural development allowance, was inserted by the Finance Act, 1968 (19 of 1968), with effect from 1-4-1968, *i.e.*, for and from assessment year 1968-69. Queerly, the concession has no direct application to agricultural operations proper, but the concession, in its application to agro-based industries, indirectly benefits the cultivators, etc.

Effect of the withdrawal.—It is pertinent to note that the deduction under the then section 35C was withdrawn by the Finance Act, 1984 (21 of 1984), in respect of any expenditure incurred after 29-2-1984. In this regard, the following departmental **circular** is relevant:—

'Allowability of expenditure incurred by sugar factories in case of development programmes—Effect of withdrawal of agricultural development allowance under section 35C of the Income-tax Act, 1961, by the Finance Act, 1984.—Under the provisions of section 35C of the Income-tax Act, 1961, a company or a co-operative society, which uses any product of agriculture, animal husbandry or dairy or poultry farming as raw material or processes such products, was eligible for a deduction of the amount of expenditure incurred, whether directly or through an approved association or body, for the provision of agricultural inputs and extension services to cultivators, growers or producers of such products.

2. This deduction was withdrawn by the Finance Act, 1984, in respect of expenditure incurred on or after March 1, 1984.

3. Section 37(1) of the Income-tax Act, 1961, however, provides that any expenditure, not being in the nature of capital expenditure or personal expenses of the taxpayers, laid out or expended wholly and exclusively for the purposes of his business, is to be allowed as deduction in computing the income chargeable under the head "Profits and gains of business or profession". Hence, any expenditure incurred by a sugar factory on cane development programmes would be eligible for deduction in computing the taxable profits if, having regard to the facts and circumstances of the case, the Assessing Officer is satisfied that the conditions laid down in section 37(1) of the Act are fulfilled. The withdrawal of the tax concession under section 35C would not affect this position.' [*Circular No. 578, dated 12th September, 1990*].

Requisite conditions.—The requisite conditions for attracting the provisions of section 35C have been discussed in *CIT v. Navabharat Enterprises Pr. Ltd.* [(1987) 165 ITR 603 (AP)].

For requisite conditions for attracting the provisions of section 35C reference may also be made to *Kaira District Co-operative Milk Producers Union Ltd. v. CIT* [(2002) 253 ITR 766, 771-72 (Guj)].

It is necessary for the application of section 35C(1) that the assessee should use in the manufacture or process of any article, any 'product of agriculture' as raw material. Secondly, the assessee should have incurred expenditure in providing, *inter alia*, services of the types specified in clause (*b*) of section 35C(1) to a person who is a cultivator, grower or producer of such product in India. The words 'such product' have a direct reference to the product which is used by the assessee as raw material. The services which are specified in the said clause (*b*) include, *inter alia*, dissemination of information on or demonstration of modern techniques or methods of agriculture or advice on such techniques or methods. In the context of section 35C, which is designed to encourage development of agriculture, the term 'agricultural product' or 'product of agriculture' requires to be considered liberally to include not merely the primary product as it actually grows but also a product which undergoes a simple agricultural operation in order to make it more saleable or more usable. Rice husk is a direct outcome of such operation [*Cynamid India Ltd. v. CIT,* (1994) Tax LR 895, 899, 901 (Bom), **affirmed in** *CIT v. Cynamid India Ltd.*, (1999) 237 ITR 585, 587 (SC)]. In that case, the assessee manufactured an animal feed known as 'Aurofac' in which the raw material mainly used was rice husk. The assessee also has a good team of scientists regularly co-ordinating with the All India Rice Improvement Project and its sub-centres, in plant protection aspects of rice for increased yield. For this purpose, the assessee distributed literature, pamphlets, etc., amongst the cultivators and farmers who were growing rice thereby disseminating information on modern techniques and methods of agriculture. Expenditure incurred by the assessee in disseminating such information has been held eligible for weighted deduction under section 35C for the assessment year 1974-75.

Eligible assessees.—Originally, the concession under **section 35C** was made available to companies engaged in the manufacture or processing of any article or thing which is made from, or which uses in such manufacture or processing as raw materials, any product of agriculture, animal husbandry, or dairy or poultry farming. For and from assessment year 1976-77, the benefit was also made available to co-operative societies engaged as aforesaid.

Scheme.—The scheme of **section 35C** was to allow, in the computation of business income, a weighted deduction in an amount equal to 1 1/5 times the amount of eligible (qualifying) expenditure incurred on or after 1-3-1968. The qualifying expenditure might have been incurred either directly by the eligible assessee or through an approved association or body. As a result of the **amendment** made by **the Finance Act, 1983** (11 of 1983), the weighted element was, for and from assessment year 1984-85, withdrawn from the allowance. Further, the allowance itself was withdrawn by the Finance Act, 1984 (21 of 1984), in relation to expenditure incurred after 29-2-1984.

Qualifying expenditure.—The expenditure qualifying for a weighted deduction under **section 35C** was that incurred in the provision of the following goods, services or facilities:—

(*i*) fertilisers, seeds, pesticides, concentrates for cattle and poultry feed, tools or implements, for use by cultivator, grower or producer of the products of agriculture, animal husbandry or dairy or poultry farming;

(*ii*) dissemination of information on, or demonstration of, modern techniques or methods of agriculture, animal husbandry or dairy or poultry farming, or advice on such techniques or methods;

(*iii*) dissemination of information on, or demonstration of, modern techniques or methods of processing, marketing and storage of seeds; services or facilities given to seed growers for the purposes of storage, transport or insurance of seeds.

Of course, any such expenditure, in order that the same might qualify for the weighted deduction, must have been provided to independent cultivators, growers or producers in India, who were not related persons or associate concerns of the eligible assessees [*Ramnugger Cane and Sugar Co. Ltd. v. CIT,* (1981) 128 ITR 716 (Cal)]. Also, if any amount was received by the eligible assessee in consideration of, or as compensation for, such goods, services or facilities, the same was to be deducted in order to arrive at the qualifying expenditure.

LexisNexis

Where the assessee has provided the goods and extended the facilities for agricultural produce in its own farm and for the benefit of itself and not extended these facilities to the third person, *i.e.,* a person distinct from the assessee, the assessee is not entitled for weighted deduction under section 35C. This is so because the word 'person' occurring in section 35C does not include the assessee itself which provides the goods or facilities to itself [*CIT v. General Fibre Dealers* (*P.*) *Ltd.,* (2001) 248 ITR 622, 626, 625 (Cal)]. Thus, the assessee was held not entitled to allowance under section 35C in respect of expenses incurred by it through its employees [*CIT v. General Fibre Dealers*, (2000) 246 ITR 686, 688, 690 (Cal)].

It is in section 35C(1)(*a*) that the nexus between the supplier of raw material to the assessee and the providing of service by the assessee has been stipulated. Though the nexus may not be direct yet the requirement is to the effect that the assessee to qualify for deduction shall incur expenditure of the specified nature to provide the goods, services or facilities to a person who would in turn be the supplier of raw material [*Kaira District Co-operative Milk Producers Union Ltd. v. CIT,* (2002) 253 ITR 766, 773 (Guj)].

In *Kaira District Co-operative Milk Producers Union Ltd. v. CIT* [(2002) 253 ITR 766, 774 (Guj)], it has been held that in so far as the item of fodder growing expenditure is concerned, the said activity would fall within section 35C(1)(*b*)(*i*) in view of the fact that the assessee is actually distributing seeds, fertilizers, etc., and further providing irrigation facilities. The assessee is also undertaking levelling and developing the land which would also be an activity which would fall within the provisions of services. Therefore, in relation to this item, the assessee's claim would fall both within the provisions of sub-clauses (*i*) and (*ii*) of section 35C(1)(*b*).

It is not possible to read in section 35C(1)(*b*)(*ii*) that the activities specified therein have to be restricted only for the limited purpose of educating the agriculturist, grower or producer and if over and above the process of educating such recipient some more services or facilities are rendered the assessee should be denied the benefit of weighted deduction under section 35C. Thus, where the assessee has undertaken activities of artificial insemination, cross breeding, etc., which would result ultimately in improving the breed of the milch cattle and as a consequence improve yield both in quantity and quality resulting in better supply of raw material to the assessee, it cannot be stated that the purpose for which section 35C is enacted does not stand fulfilled, because once the breed of milch cattle is improved there is development all around in relation to the recipient and the area in which such recipient is situated [*Kaira District Co-operative Milk Producers Union Ltd. v. CIT,* (2002) 253 ITR 766, 774 (Guj)].

LexisNexis

In *Gangeshwar Ltd. v. CIT* [(2002) 254 ITR 589, 590 (Del)], it has been held that where the aerial spray of insecticides was done by the Cane Development Council, which was not an association or body approved by the prescribed authority for the purposes of section 35C, the assessee was not entitled to the weighted deduction under section 35C in respect of expenditure incurred in that regard. Further, expenditure in connection with road repairs as also contribution for construction of new roads have been held not eligible for weighted deduction under section 35C read with rule 6A.

In *CIT v. Sakthi Sugar Ltd.* [(2002) 254 ITR 605, 606 (Mad)], it has been held that where the Tribunal has found that the expenditure incurred by way of salary, bonus, *ex gratia* production incentive, etc., to the employees of the assessee-company engaged in rendering service to the agriculturists, the assessee is entitled to weighted deduction in respect of such expenditure.

In *Mehsana District Co-operative Milk Producers Union Ltd. v. CIT* [(2002) 256 ITR 322, 324, 325 (Guj)], it has been held that the entire expenditure incurred on dissemination of information or demonstration of modern techniques and methods of agricultural animal husbandry or dairy or poultry farming or advice on such technique or method was eligible for deduction under section 35C. Also see, *Mehsana District Co-operative Milk Producers Union Ltd. v. CIT,* (2003) 130 Taxman 281, 283 (Guj); *Kaira District Co-operative Milk Producer Union Ltd. v. CIT,* (2003) 260 ITR 141, 142 (Guj).

In *Sakthi Sugars Ltd. v. CIT* [(2005) 273 ITR 320 (Mad)], the Tribunal had not gone into the details of the expenditure however, considering the meagre amount involved and also taking note of the lapse of period of long twenty years from the assessment year in question, the weighted deduction in respect of the expenditure incurred on the transport of fertilizer under section 35C was to be allowed.

The claim of the assessee with regard to weighted deduction under section 35C on fertilizer subsidy to farmers as cash subsidy amounting to Rs. 2,78,384 held allowable [*Richardson Hindustan Ltd. v. CIT*, (2009) 315 ITR 283 (Bom)].

In *Indian Leaf Tobacco Development Co. Ltd. v. CIT* [(1982) 137 ITR 827 (Cal)], the assessee was held entitled to a weighted deduction on account of agricultural development allowance under section 35C in respect of depreciation on assets used for the purpose of providing goods, services or facilities as laid down in section 35C(1)(*b*). Also see, *CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1990) 184 ITR 64 (AP); *Vazir Sultan Tobacco Co. Ltd. v. CIT,* (1990) 184 ITR 70 (AP).

In *CIT v. Cadbury India Ltd.* [(2001) 249 ITR 475, 476, 477-78 (Bom)], it has been held that the depreciation allowance is an expenditure to be considered for weighted deduction under section 35C. Also see, *CIT v. Hindustan Cocoa Products Ltd.,* (2001) 168 CTR (Bom) 440, 441.

In *Okayti Tea Co. Ltd. v. ITO* [(1986) 160 ITR 487 (Cal)], the Tribunal was held justified in refusing to consider the claim made for the first time before it in respect of agricultural development allowance under section 35C.

In *Vazir Sultan Tobacco Co. Ltd. v. CIT* [(1990) 184 ITR 70 (AP)], the reserve for bad debts has been held to constitute expenditure and to qualify for weighted deduction under section 35C.

In *CIT v. Navbharat Enterprises* (*P.*) *Ltd.* [(1999) 238 ITR 754, 755, 756 (AP)], the assessee, a company engaged in the business of processing and export of tobacco, has been held entitled to deduction, under section 37(1) only in respect of the interest on the amount spent upon the land used for raising tobacco and not the whole of the amount of Rs. 91,000 being the interest paid on agricultural loans.

In *CIT v. K.C.P. Ltd.* [(2001) 250 ITR 285, 286-87 (AP)], it has been held that the amount contributed by the assessee to the Cane Development Council, which is not an approved association or body in terms of section 35C read with rule 6A [omitted (w. e. f. 19-11-1999)] is not eligible for weighted deduction under section 35C.

Available to agro-based, and not to agro industries.—The weighted deduction under **section 35C** was provided to be available to companies (and later to co-operative societies) engaged in agro-based industries, *i.e.*, those which used as raw material or process, the products of agriculture, animal husbandry, dairy or poultry farming. Accordingly, the eligible assessees which were engaged in agro-industries, such as those manufacturing fertilisers, seeds, pesticides, tractors, implements, etc., were not entitled to claim this weighted deduction, even though they might incur expenditure on supply of fertilisers, seeds, pesticides, tractors or other implements to the farmers or on demonstration of the use of those products for their benefit. Even if an eligible assessee incurred any such expenditure on seeds, fertilisers, etc., on its self-owned farm, the expenditure did not qualify for the weighted deduction.

In *Kaira District Co-operative Milk Producers Union Ltd. v. CIT* [(2002) 253 ITR 766, 772 (Guj)], it has been pointed out that paragraph 56 of the **departmental circular** No. 6-P (LXXVI-66) of 1968, dated 6-7-1968, draws distinction between agro-based industries and agro-industries.

Prescribed authority.—According to **rule 6A(1)**, for the purposes of clause (*a*) of sub-section (1) of section 35C, the 'prescribed authority', up to 30-10-1977, was the Secretary, Department of Agriculture, Ministry of Food, Agriculture, Community Development and Co-operation, Government of India, or any other officer of that Department nominated by him in that behalf and, with effect from 1-11-1977, was the Secretary, Department of Agriculture, Ministry of Agriculture and Irrigation, Government of India.

LexisNexis

Approved association or bodies.—The following institutions were approved by 'the prescribed authority' for the purposes of clause (*a*) of sub-section (1) of section 35C:—

	Institutions	*Notification No. & Date*
1.	The Vanaspati Manufacturers Association of India.	S.O. 2384, dt. 1-6-1971
2.	National Dairy Development Board, Anand	S.O. 1317, dt. 23-12-1971
3.	Indian Cotton Mills Federation Cotton Development and Research Association, Bombay	S.O. 1093, dt. 23-3-1974
4.	The Sima Cotton Development and Research Association, Coimbatore.	S.O. 2060, dt. 22-5-1975[12]
5.	Gujarmal Modi Science Foundation, Modinagar (w. e. f. 1-4-1978)	S.O. 2220, dt. 11-4-1978
6.	Kerala Agricultural University, Trichur, Extension Education Division (w. e. f. 1-4-1982)	S.O. 1097, dt. 10-12-1982

Prescribed services, etc.—According to **rule 6A(2)**, for the purposes of sub-clause (*iii*) of clause (*b*) of sub-section (1) of section 35C, the prescribed services and facilities were as follows, namely:—

(*i*) dissemination of information on, or demonstration of, modern techniques or methods of processing, marketing and storage of seeds;

(*ii*) services or facilities given to seed growers for the purposes of storage, transport and insurance of seeds.

12. The approval was extended for a further period of three years w. e. f. 1-4-1976 [S.O. 810, dt. 28-1-1977]. Again extended up to 31-3-1982 [S.O. 217, dt. 14-12-1979].

Remand to the AO.—In *CIT v. Navbharat Enterprises* (*P.*) *Ltd.* [(1999) 238 ITR 754, 756 (AP)], the matter has been remanded by the Tribunal to the Income-tax Officer to decide the same afresh. The High Court has observed that while passing final orders, the Officer shall decide whether the amount spent upon the lands utilised for raising tobacco crop can be deducted under section 35C. It has been made clear that the same amount could not be deducted simultaneously under two provisions—section 35C and section 37(1). It must fall under one or the other.

LexisNexis

Omitted/Phased-out provisions of section 35CC of the 1961 Act

[1][S. 35CC. * * * *]

RURAL DEVELOPMENT ALLOWANCE (FOR ASSESSMENT YEARS 1978-79 TO 1985-86)

Introduction.—Section 35CC was inserted by the Finance (No. 2) Act, 1977 (29 of 1977), with effect from 1-9-1977, *i.e.*, for and from assessment year 1978-79.

The scope and effect of section 35CC, as originally inserted, have been elaborated in the following portion of the departmental **circular** No. 229, dated 9-8-1977, as follows:—

'Rural development allowance—New section 35CC.—**14.1** The Finance (No. 2) Act, 1977 (29 of 1977), has introduced a new section 35CC in the Income-tax Act under which companies and co-operative societies will be entitled to a deduction in the computation of their taxable profits of the expenditure incurred by them during the previous year on any programme of rural development [*vide* sub-section (1) of new section 35CC].

The deduction will be allowed only where the company or co-operative society has obtained the prior approval of the prescribed authority[2] in respect of the programme of rural development before incurring such expenditure. The expression "programme of rural development" has been defined to include any programme for promoting the social and economic welfare of, or the uplift of, the public in any rural area. The term "rural area" would mean any area other than (*a*) an area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand (according to the last preceding census of which relevant figures have been published before the first day of the previous year), or (*b*) an area within such distance (up to a maximum of fifteen kilometres) from the local limits of such municipality or

---

1. Section 35CC has been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989). Prior to its omission by the Direct Tax Laws (Amendment) Act, 1987, with effect from 1st April, 1989, stood as follows:—

"[a]**[S. 35CC. Rural development allowance.—**](1) Where the assessee, being a company or a co-operative society, incurs any expenditure on any programme of rural development, the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of the amount of such expenditure incurred during the previous year:

Provided that the approval of the prescribed authority has been obtained by the assessee in respect of such programme before incurring the expenditure:

[b][*Provided further* that the prescribed authority shall not approve any programme unless such programme is a programme falling within any such class or category of programmes of rural development as may be specified by the Central Government in this behalf:]

[c][*Provided also* that no programme shall be approved under this section after the 16th day of March, 1985.]

Explanation.—For the purposes of this sub-section,—

(*a*) "programme of rural development" includes any programme for promoting the social and economic welfare of, or the uplift of, the public in any rural area;

(*b*) "rural area" means any area other than—

(*i*) an area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(*ii*) an area within such distance, not being more than fifteen kilometres, from the local limits of any municipality or cantonment board referred to in sub-clause (*i*), as the Central Government may, having regard to the stage of development of such area (including the extent of, and scope for, urbanisation of such area) and other relevant considerations, specify in this behalf by notification in the Official Gazette.

(2) Where the expenditure referred to in sub-section (1) results in the acquisition or creation of an asset, being building, machinery, plant or furniture, and the assessee does not divest itself of the ownership of such asset before the end of the previous year, no deduction in respect of such expenditure shall be allowed under sub-section (1) but the assessee shall be entitled to the allowance for depreciation in respect of the asset so acquired or created as if such asset was used for the purposes of the business and the provisions of sections 32, 34, 41 and 43 shall, so far as may be, apply accordingly.

(3) No deduction shall be allowed in respect of the expenditure referred to in sub-section (1) unless the assessee furnishes, along with the return of income for the assessment year for which the deduction is claimed, a statement of such expenditure in the prescribed form duly signed and verified by an accountant as defined in the *Explanation* below sub-section (2) of section 288 and setting forth such particulars as may be prescribed.

(4) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]'.

---

a. Ins. by the Finance (No. 2) Act, 1977 (29 of 1977), s. 10 (w. e. f. 1-9-1977).

b. Ins. by the Finance Act, 1983 (11 of 1983), s. 15 (w. e. f. 1-4-1983).

c. Ins. by the Finance Act, 1985 (32 of 1985), s. 9 (w. e. f. 17-3-1985).

2. See, rule 6AAA of the Income-tax Rules, 1962.

LexisNexis

cantonment board as the Central Government may specify in this behalf by notification[3] in the Official Gazette. Such notification is to be issued by the Central Government only where it is satisfied that the stage of development of the area outside any such municipality or cantonment board (including the extent of, and scope for, urbanisation of such area), justifies its being regarded as an urban or non-rural area. For the purposes of this provision, the term "municipality" will include a municipal corporation, notified area committee, town area committee, town committee or other similar authority by whatever name called.

14.2 Where the expenditure incurred on the programme of rural development results in the acquisition or creation of an asset, being building, machinery, plant or furniture, and the assessee does not divest itself of the ownership of such asset before the end of the previous year in which the expenditure is incurred, the assessee will not be allowed a deduction in respect of such expenditure under sub-section (1) of the new provision. Instead, the assessee will be allowed depreciation in respect of the asset so acquired or created as if such asset was used by the assessee for the purposes of the business and the provisions of section 32 (depreciation); section 34 (conditions for depreciation allowance, etc); section 41 (profits chargeable to tax); and section 43 (definitions of certain terms relevant to income from profits and gains of business or profession) will, so far as may be, apply accordingly.

14.3 No deduction will be allowed under sub-section (1) of section 35CC in respect of expenditure incurred on any programme of rural development unless the assessee furnishes, along with the return of income for the assessment year for which the deduction is claimed, a statement of such expenditure in the prescribed form duly signed and verified by a chartered accountant or other qualified accountant, and setting forth such particulars as may be prescribed.[4]

14.4 Where a deduction under sub-section (1) of section 35CC is claimed and allowed for any assessment year in respect of any expenditure on any programme of rural development, no deduction shall be allowed in respect of such expenditure under any other provision of the Income-tax Act for the same or any other assessment year.

14.5 The new section 35CC will come into force with effect from 1-9-1977, and will accordingly apply in relation to the assessment year 1978-79 and subsequent years.'.

Legislative amendments.—I. *The Finance Act, 1983 (11 of 1983).*—By this Act, the second proviso was inserted (w. e. f. 1-4-1983) in section 35CC(1). The scope and effect of the insertion of the second proviso have been elaborated in the following portion of the departmental **circular** No. 372, dated 8-12-1983:—

'(*xx*) *Amendment of provision relating to rural development allowance—Section 35CC.*—**28.1** Under section 35CC of the Income-tax Act, 1961 (43 of 1961), relating to rural development allowance, where an assessee being a company or a co-operative society incurs any expenditure on any programme of rural development, a deduction is allowed of the amount of such expenditure incurred during the previous year provided that such programme has been approved by the prescribed authority. Where any approved programme of rural development undertaken by a company or a co-operative society is executed or carried out by it through another person engaged by it to do the work in respect of the programme on its behalf, the expenditure incurred by the company or co-operative society on the execution of the programme through such other person also qualifies for deduction under this section as such expenditure has to be regarded as expenditure incurred by it.

28.2 The Finance Act, 1983 (11 of 1983), has inserted a new proviso to sub-section (1) of the said section to the effect that the prescribed authority shall not approve any programme of rural development unless such programme is a programme falling within any such class or category of programmes of rural development as may be specified[5] by the Central Government in this behalf.

28.3 The amendment takes effect from 1-4-1983, and, as such, the prescribed authority will be precluded from granting approval to any programme of rural development on or after 1-4-1983, unless the programme falls within the specified class or category of programmes. This provision will, however, not apply in relation to programmes which have been approved by the prescribed authority before 1-4-1983. [Section 15 of the Finance Act, 1983 (11 of 1983)]'.

II. *The Finance Act, 1985 (32 of 1985).*—By this Act, the third proviso was inserted (w. e. f. 17-3-1985). The scope and effect of the 1985-amendment have been elaborated in the following portion of the departmental **circular** No. 421, dated 12-6-1985, as follows:

'Withdrawal of deduction relating to rural development allowance.—**16.1** Section 35CC of the Income-tax Act relating to rural development allowance provides that where a company or a co-operative society incurs any expenditure on any programme of rural development, the expenditure so incurred shall be deducted in

3. See, u/s. 35CC, *post*.
4. See, rule 6AAB of the Income-tax Rules, 1962 and Form No. 3AB appended to those Rules.
5. See, u/s. 35CC, *post*.

computing the taxable profits. The deduction is to be allowed only if the approval of the prescribed authority has been obtained in respect of the programme before incurring the expenditure.

16.2 The concession is open to abuse as the correctness of claims in respect of expenditure incurred on rural development programmes is difficult to verify. The Finance Act, 1985 (32 of 1985), has discontinued this concession, except in relation to programmes of rural development which have been approved by the prescribed authority before 17-3-1985, by providing that no such programme shall be approved after 16-3-1985.'.

Eligible persons.—Companies and co-operative societies alone were entitled to claim deduction under **section 35CC** in respect of expenditure incurred by them during the previous year on any approved programme of rural development.

Approval necessary.—The deduction under **section 35CC** was allowable only where the eligible person had obtained prior approval of the prescribed authority (see **rule 6AAA**) in respect of the programme of rural development before incurring the expenditure.

Expenditure incurred prior to the effective date of approval, not eligible for deduction.—From the provisions of section 35CC(1) it is clear that undertaking the implementation of the rural programme *per se* with whatever laudable objective it may be, does not entitle an assessee to claim deduction of expenditure on such rural development programme. It is only the approval of the prescribed authority that entitles an assessee to claim deduction of the expenditure incurred by it in respect of such programme. Therefore, the order of approval passed by the prescribed authority becomes relevant. Thus, it must necessarily follow that the extent of deductibility of such expenditure depends upon the scope of the order granting approval. In that view of the matter, where the approval order shows that the programme has been approved for the period beginning 21-2-1978 upto the end of the previous year commencing after 21-2-1978, no deduction could be allowed in respect of the expenditure incurred prior to 21-2-1978 [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1996) 219 ITR 727, 730, 731, 732 (AP)].

Specified classes and categories of programmes of rural development for the purposes of the second proviso to section 35CC(1).—The following notification, as subsequently amended, is relevant on the point:—

'In exercise of the powers conferred by the second proviso to sub-section (1) of section 35CC of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby specifies the following classes and categories of programmes of rural development for the purposes of the said section, namely:—

(*i*) construction and maintenance of rural link roads, village streets, pavements, drainage and sanitary latrines;

(*ii*) construction and maintenance of drinking water projects including installation of pump-sets, digging of wells, tubewells and laying of pipes for supply of drinking water;

(*iii*) construction and maintenance of hospitals, dispensaries and family planning centres;

(*iv*) development of community pastures or community forests on community land, that is to say, land belonging to Government or Gram Panchayat;

(*v*) construction of minor irrigation tanks, installation of pump-sets as also digging and commissioning of irrigation tubewells for community use;

(*vi*) establishment of veterinary dispensaries and artificial insemination centres;

(*vii*) establishment and running of educational and vocational training centres;

[6][(*viii*) establishment and running of new and renewable sources of energy systems.]'.

[*Notification No. GSR 47(E), dated 28th January, 1984*].

No programme to be approved on or after 17-3-1985.—As a result of the **insertion** (w. e. f. 17-3-1985) of the **third proviso to section 35CC(1)** by **the Finance Act, 1985** (32 of 1985), no programme shall be approved under section 35CC(1) after the 16-3-1985.

Programme of rural development and rural area.—As defined in **clause (*a*) of the *Explanation* to section 35CC(1)**, a "programme of rural development" included any programme for promoting the social and economic welfare of, or the uplift of, the public in any rural area.

The term "rural area" meant—

(*a*) an area which is not comprised within the jurisdiction of a municipality, etc., or a cantonment board and which has a population of less than 10,000; and

(*b*) an area which is not within such distance (up to a maximum of 15 kilometres) from the local limits of such municipality or cantonment board as the Central Government may specify in that behalf by a

6. Ins. by Notification No. GSR 720(E), dated 12th October, 1984.

notification in the Official Gazette [For the notification, see, *Notification No. S.O. 691(E), dated 29-9-1977*, under section 35CC, *post*].

Disqualifying circumstance for capital expenditure.—Where the expenditure incurred on the programme of rural development resulted in the acquisition or creation of an asset, being building, machinery, plant or furniture, and the eligible assessee did not divest itself of the ownership of such asset before the end of the previous year in which the expenditure was incurred, the assessee would not be entitled to get a deduction in respect of such expenditure under **section 35CC(1)**.

However, even in such a circumstance, the assessee shall be entitled to the allowance for depreciation in respect of asset so acquired or created as if such asset was used for the purposes of the business. In this regard, the provisions of sections 32, 34, 41 and 43 [depreciation, terminal allowance, and balancing charge] shall have application.

It was clarified by the Central Board of Direct Taxes that "assets of permanent nature created under section 35CC and proposed to be handed over to the local authority/State Government after completion do not constitute a gift. This is a donation and does not attract any gift-tax. Such assets are exempt under section 5(1)(*iv*) and (*v*) of the Gift-tax Act." [*Vide Letter No. RD/1/665 dated 5-8-1981, issued by PHDCCI, New Delhi, to its members*].

Submission of statement of expenditure in Form No. 3AB necessary.—In order to obtain a deduction under **section 35CC(1)**, the eligible assessee must furnish, along with its return of income for the assessment year for which the deduction was claimed, a statement of such expenditure in the prescribed **Form No. 3AB** duly signed and verified by a chartered accountant or other qualified accountant, setting forth the prescribed particulars.

Provisions of section 35CC(3), directory.—The provisions of sections 80J(6A) and 35CC(3) are in *pari materia* to the extent one requires filing of statement of expenses or audit report. If that be so, the interpretation put by the court on the provision of section 80J(6A) shall hold equally good so far as the requirement of filing of the statement along with the return of income under section 35CC(3) is concerned and the same view would be justified. In the above view of the matter, the provisions of section 35CC(3) which provide for filing of statement of expenses along with the return for that particular assessment year are directory [*CIT v. K.C.A. Ltd.*, (2006) 283 ITR 65 (Bom)].

Relevant rules.—See, **rules 6AAA** and [6AAB omitted by the Income-tax (32nd Amendment) Rules, 1999] and rule 6AAC, and Form No. 3AB [omitted by the Income-tax (32nd Amendment) Rules, 1999].

Guidelines for approval under section 35CC.—The following departmental circular No. 231, dated 14-11-1977, indicates the guidelines for approval of rural development programmes under section 35CC:—

'Section 35CC of the Income-tax Act, 1961—Guidelines for approval of programme of rural development.— The Finance (No. 2) Act, 1977, has introduced a new section 35CC in the Income-tax Act under which companies and co-operative societies will be entitled to a deduction, in the computation of their taxable profits, of the expenditure incurred by them during the previous year on any programme of rural development. The deduction will be allowed only where the company or co-operative society has obtained the prior approval of the prescribed authority in respect of the programme before incurring such expenditure. The provisions of this section have been explained in paragraph 14 of Circular No. 229 (F. No. 131/9/77-TPL)[7] dated 9th August, 1977, of the Central Board of Direct Taxes.

2. The Central Board of Direct Taxes had issued a notification on 27th August, 1977, designating the Committee consisting of the following officers as the prescribed authority[8] for approving programmes of rural developments:—

(1) Secretary, Department of Agriculture.	Chairman
(2) Secretary, Department of Industrial Development.	Member
(3) Secretary, Department of Expenditure.	Member

LexisNexis

---

7. See, u/s. 35CC, *ante.*

8. As per rule 6AAA (formerly rule 6AA) of the Income-tax Rules, 1962, as substituted by the Income- tax (Third Amendment) Rules, 1979 [(1979) 118 ITR (St.) 28], and as renumbered by the Income-tax (Eighth Amendment) Rules, 1981, and as, subsequently, amended (w. r. e. f. 1-4-1988) by the Income- tax (Fifth Amendment) Rules, 1989, the "prescribed authority" shall be the Committee consisting of the following, namely:—

(*a*) the Chief Commissioner or Commissioner of Income-tax, having jurisdiction over the principal office of association, etc., or the place where the programme of rural development is to be carried out ..Chairman;

(*b*) an officer not below the rank of a Secretary to the Government of the State concerned, wherein the principal office of the association, etc., is situated, or the place wher the programme of rural development is to be carried out ..Member.

(4) Chairman, Central Board of Direct Taxes. Member

Areas falling outside local limits of specified municipalities and cantonment boards, which will not be regarded as "rural areas" for the purpose of section 35CC have been specified in notification issued by the Central Government on 29th September, 1977 (Annexure I).

3. Keeping in view the objective underlying this incentive and the requirements of the statutory provisions, the prescribed authority has evolved an illustrative list of categories of projects of rural development which would be considered by it for approval for the purposes of section 35CC of the Income-tax Act (Annexure II). It may be pointed out that this list is merely illustrative and not exhaustive and the items mentioned therein may be modified or supplemented in due course in the light of the different types of cases which come up for approval.

4. Some of the more important points which the applicants should keep in view while formulating schemes for rural development for approval under section 35CC are given in Annexure III.

5. It would facilitate prompt disposal of applications for approval under section 35CC by the prescribed authority, if six copies of the application giving information on the points indicated in Annexure IV, duly signed and certified to be correct by a person authorised to sign the return of income of the applicant company/co-operative society, are furnished together with six copies of a note setting out details of the programme of rural development for approval under section 35CC by the prescribed authority.

6. The programmes of rural development have been defined in the *Explanation* below sub-section (1) of section 35CC to include any programme for promoting the social and economic welfare of, or the uplift of, the public in any rural area. The projects or schemes which the applicants may like to develop in the rural areas should be formulated keeping in view the local needs, resources of the community and the plans and programmes of the State Government for that area.

7. Applications for approval of programmes of rural development along with relevant enclosures as stated above may be addressed to the Secretary, Central Board of Direct Taxes, Room No. 47-B, North Block, New Delhi-110 001. One copy of the application along with the relevant enclosures should also be forwarded to the Chief Secretary of the concerned State or the officer nominated by him in this behalf.' [*Circular No. 231, dated November 14, 1977*].

ANNEXURE I

[*Notification No. S.O. 691(E), dated September 29, 1977*]

In pursuance of sub-clause (*ii*) of clause (*b*) of the *Explanation* to sub-section (1) of section 35CC of the Income-tax Act, 1961 (43 of 1961), the Central Government, having regard to the stage of development (including the extent of, and scope for, urbanisation) of the areas concerned and other relevant considerations, hereby specifies the areas shown in column (3) of the Schedule hereto annexed and falling outside the local limits of the municipality or cantonment board, as the case may be, shown in the corresponding entry in column (2) thereof, for the purposes of the above mentioned provisions of the Income-tax Act, 1961 (43 of 1961).

SCHEDULE

Serial No.	Name of the municipality or cantonment board	Details of the area
1	2	3
1.	Bombay, Calcutta, Delhi, Hyderabad, Madras and New Delhi.	Areas up to a distance of 15 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
2.	Ahmedabad, Bangalore, Kanpur, Lucknow, Nagpur and Pune.	Areas up to a distance of 12 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
3.	Agra, Allahabad, Amritsar, Bhopal, Cochin, Coimbatore, Dhanbad, Gwalior, Indore, Jabalpur, Jaipur, Jamshedpur, Ludhiana, Madurai, Patna, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Varanasi (Banaras) and Vadodara (Baroda).	Aras up to a distance of 10 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
4.	Any other municipality or cantonment board.	Areas up to 8 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.

LexisNexis

ANNEXURE II

Illustrative list of categories of projects for rural development to be considered for approval by the prescribed authority for the purposes of section 35CC of the Income-tax Act, 1961

1. Assistance in the setting up of rural industries in selected areas by the rural weak to provide them self-employment.

2. (*a*) Establishment, and (*b*) running of dispensaries, maternity and child welfare centres and family welfare centres.

3. Nutrition programmes for school children.

4. (*a*) Establishment, and (*b*) running of educational and vocational training centres.

5. (*a*) Construction, and (*b*) maintenance of rural link roads, village streets, pavements and drainage.

6. (*a*) Construction, and (*b*) maintenance of drinking water projects, such as wells, tubewells, etc., and cleaning of wells and ponds.

7. Rural electrification, *i.e.*, provision of street lighting in villages and electrification of Harijan/tribal homes.

8. Assistance to the weaker sections in constructing houses on sites provided in rural areas by Government, village panchayats, etc.

9. Minor irrigation schemes, including boring of tubewells and installation of pumping sets for the benefit of groups of small/marginal farmers.

10. Supply of improved varieties of seeds and provision of facilities for seed testing to groups of small/marginal farmers and assistance to such farmers for establishing seed farms.

11. Supply of fertilisers and insecticides to groups of small/marginal farmers and giving guidance and training to such farmers in the use of fertilisers, insecticides, etc.

12. Supply of plant protection equipment, sprayers, farm machinery, implements, etc., to the village panchayat for the use of groups of small/marginal farmers.

13. Animal husbandry—assisting the farmers in cattle improvement through establishment of veterinary dispensaries, artificial insemination centres, etc., dairy products processing and marketing.

14. Assistance to goups of small/marginal farmers, landless labourers, etc., in poultry farming, horticulture, pisciculture, etc.

15. Establishment of workshops for servicing and repair of farm machinery and training of artisans, mechanics, etc.

LexisNexis

ANNEXURE III

Important points to be kept in view in formulating programmes of rural development

(*i*) The benefit of the programme of rural development should flow to the public in general (as against individuals) in the rural area, and not to the applicant company/co-operative society itself.

(*ii*) Section 35CC envisages that a company or co-operative society should undertake a specific programme of rural development and obtain the approval of the prescribed authority in respect of such programme. Hence, mere contributions to a programme of rural development undertaken by another person would not qualify for deduction under section 35CC.

(*iii*) Where the expenditure incurred by the applicant results in the acquisition or creation of a capital asset, 100 per cent. deduction of such expenditure would be allowed only if the assessee has divested itself of the ownership of such asset in favour of the village panchayat, local authority, etc., before the end of the accounting year in which the expenditure is incurred.

(*iv*) Ordinarily, the programme will be approved for an initial period of one accounting year. In case the programme extends beyond one accounting year, it may be informally approved for the successive years but a formal approval order will, however, be passed for each year separately if the prescribed authority is satisfied that the programme has been implemented properly. For this purpose, the prescribed authority may monitor the implementation of the programme.

(*v*) The application for approval of the programme for rural development should contain complete details of the programme and indicate the rural area where the programme is to be executed. The application should in particular provide information in respect of the following:—

(*a*) Particulars of the "rural area" and evidence to show that it qualifies as a "rural area" within the meaning of the expression as defined in clause (*b*) of the *Explanation* to sub-section (1) of section 35CC.

(*b*) The total period during which the programme is expected to be completed and the total monetary outlay involved. Year-wise break-up of capital as well as revenue expenditure should be given.

(*c*) If the programme is to be executed in different phases, the monetary outlay of each phase and its coverage should be given.

(*d*) If the whole or a part of the programme is to be executed on behalf of the applicant by any agent or contractor appointed by it, please furnish the name/address of such agent or contractor, the work to be executed by them and the remuneration to be paid to them.

(*e*) If the expenditure results in the acquisition or the creation of a capital asset, at what stage and in what manner the applicant proposes to divest itself of the ownership of such assets? Whether proper arrangements have been made for the continued maintenance of such assets?

ANNEXURE IV

Basic information to be furnished in the application for approval of programme of rural development under section 35CC of the Income-tax Act, 1961

(*i*) Name and address of the applicant

(*ii*) Status (whether company or co-operative society)

(*iii*) Residential status (whether resident/non-resident)

(*iv*) Name of District/Ward/Circle where assessed to income-tax and Permanent Account Number

(*v*) Nature of the business with place where offices/factories/farms/ orchards are located

(*vi*) Does the applicant (including its directors) have any property in the rural area where the programme for rural development is proposed to be executed.

(*vii*) What facilities are available with the applicant for executing the programme?

(*viii*) Whether the applicant is in a position to execute the programme on its own or it would require assistance or co-ordination with some other private, public or Government agency?

(*ix*) Has the applicant undertaken similar programme of rural development in the past? If so, details thereof.

(*x*) Audited Balance-sheet and Profit and Loss Account for the latest year for which they are available.

Date …… *Signature* ……

LexisNexis

Omitted/Phased-out provisions of section 35CCA of the 1961 Act

[1]**[S. 35CCA. Expenditure by way of payment to associations and institutions for carrying out rural development programmes.—**[2][(1) Where an assessee incurs any expenditure by way of payment of any sum—

(*a*) to an association or institution, which has as its object the undertaking of any programme of rural development, to be used for carrying out any programme of rural development approved by the prescribed authority; or

(*b*) to an association or institution, which has as its object the training of persons for implementing programmes of rural development; [3][or]

[4][(*c*) to a rural development fund set up and notified by the Central Government in this [5][behalf; or]]

[6][(*d*) to the National Urban Poverty Eradication Fund set up and notified by the Central Government in this behalf,]

the assessee shall, subject to the provisions of sub-section (2), be allowed a deduction of the amount of such expenditure incurred during the previous year.]

[7][(2) The deduction under clause (*a*) of sub-section (1) shall not be allowed in respect of expenditure by way of payment of any sum to any association or institution referred to in the said clause unless the assessee furnishes a certificate from such association or institution to the effect that—

(*a*) the programme of rural development had been approved by the prescribed authority before the 1st day of March, 1983; and

(*b*) where such payment is made after the 28th day of February, 1983, such programme involves work by way of construction of any building or other structure (whether for use as a dispensary, school, training or welfare centre, workshop or for any other purpose) or the laying of any road or the construction or boring of a well or tube-well or the installation of any plant or machinery, and such work has commenced before the 1st day of March, 1983.

(2A) The deduction under clause (*b*) of sub-section (1) shall not be allowed in respect of expenditure by way of payment of any sum to any association or institution unless the assessee furnishes a certificate from such association or institution to the effect that—

(*a*) the prescribed authority had approved the association or institution before the 1st day of March, 1983; and

(*b*) the training of persons for implementing any programme of rural development had been started by the association or institution before the 1st day of March, 1983.

[8][*Explanation*.—The deduction, to which the assessee is entitled in respect of any sum paid to an association or institution for carrying out the programme of rural development referred to in sub-section (1), shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee, the approval granted to such programme of rural development, or as the case may be, to the association or institution has been withdrawn.]

LexisNexis

---

1. Section 35CCA has been inserted by the Finance Act, 1978 (19 of 1978), s. 7 (w. e. f. 1-6-1978).

2. Subs. by the Finance Act, 1979 (21 of 1979), s. 5 (w. e. f. 1-6-1979), for the following:—

"(1) Where an assessee incurs any expenditure by way of payment of any sum, to an association or institution to which this section applies, to be used for carrying out any programme of rural development approved by the prescribed authority, the assessee shall be allowed a deduction of the amount of such expenditure incurred during the previous year.".

3. Ins. by the Finance Act, 1983 (11 of 1983), s. 16(*a*) (w. e. f. 1-4-1983).

4. Ins. by the Finance Act, 1983 (11 of 1983), s. 16(*a*) (w. e. f. 1-4-1983).

5. Subs., for "behalf,", by the Finance Act, 1995 (22 of 1995), s. 9(*a*) (w. e. f. 1-4-1996).

6. Ins. by Act 22 of 1995, s. 9(*b*) (w. e. f. 1-4-1996).

7. Sub-sections (2), (2A) and (2B) have been substituted by Act 11 of 1983, s. 16(*b*) (w. e. f. 1-4-1983), for the following:—

'(2) ‡[The deduction under sub-section (1) shall not be allowed with respect to expenditure by way of payment of any sum to any association or institution, unless such association or institution is for the time being approved in this behalf by the prescribed authority:]

Provided that the prescribed authority shall not grant such approval for more than three years at a time.'.

In the above sub-section (2), the portion put within the parentheses marked‡ was, earlier, substituted by the Finance Act, 1979 (21 of 1979), s. 5 (w. e. f. 1-6-1979), for the following:—

"This section applies to any association or institution—

(*a*) which has as its object the undertaking of any programme of rural development; and

(*b*) which is for the time being approved in this behalf by the prescribed authority:".

8. Ins. by the Taxation Laws (Amendment) Act, 2006 (29 of 2006), s. 7 (w. r. e. f. 1-4-2006).

(2B) No certificate of the nature referred to in sub-section (2) or sub-section (2A) shall be issued by any association or institution unless such association or institution has obtained from the prescribed authority authorisation in writing to issue certificates of such nature.]

Explanation.—For the purposes of this section, "programme of rural development" shall have the meaning assigned to it in the *Explanation* to sub-section (1) of section 35CC[9].

(3) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under section 35C[10] or section 35CC[11] or section 80G or any other provision of this Act for the same or any other assessment year.]

Introduction under 1961 Act.—*The Finance Act, 1978.*—By **the Finance Act, 1978** (19 of 1978), **section 35CCA** has been **inserted** (**w. e. f. 1-6-1978**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 240, dated 17-5-1978*, as follows:—

'**11.** *Deduction in respect of payments to associations and institutions for carrying out rural development programmes—section 35CCA.*—**11.1** With a view to encouraging companies and co-operative societies to involve themselves in the work of rural welfare and uplift, the Finance (No. 2) Act, 1977 (29 of 1977), had introduced a new section 35CC in the Income-tax Act under which companies and co-operative societies are entitled to a deduction, in the computation of their taxable profits, of the expenditure incurred by them on any approved programme of rural development. The Finance Act, 1978 (19 of 1978), has introduced a new section 35CCA to provide that sums paid by a taxpayer to any association or institution to be used for carrying out any programme of rural development will be allowed as a deduction in computing the taxable profits. For the purposes of this section, the expression "programme of rural development" will have the meaning assigned to it in the *Explanation* to section 35CC(1) of the Income-tax Act.

11.2 The deduction under the new section 35CCA will not be allowed unless (*a*) the association or institution has as its object the undertaking of programmes of rural development; (*b*) the association or institution is for the time being approved in this behalf by the prescribed authority; and (*c*) the programme of rural development for which such sums are paid has been approved by the prescribed authority, to be notified by the Central Board of Direct Taxes. The prescribed authority will not grant approval to any association or institution for more than three years at a time.

11.3 Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure incurred towards payment of sums to any such association or institution as is referred to above, no deduction shall be allowed in respect of such expenditure under section 35C (Agricultural development allowance) or section 35CC (Rural development allowance) or section 80G (Deduction in respect of donations to certain funds, charitable institutions, etc.) or under any other provision of the Income-tax Act for the same or any other assessment year.

11.4 The new section 35CCA will take effect from 1-6-1978, and will, accordingly, apply in relation to the assessment year 1979-80 and subsequent years.'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1979.*—By **the Finance Act, 1979** (21 of 1979), the following **amendments** (**w. e. f. 1-6-1979**) have been made—

—**section 35CCA(1)** has been **substituted**; and

—**section 35CCA(2)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 258, dated 14-6-1979*, as follows:—

'**11.** *Deduction in respect of payments to approved associations and institutions for imparting training to persons to equip them for implementing rural development programmes—section 35CCA.*—**11.1** Under section 35CCA of the Income-tax Act, a taxpayer carrying on a business or profession is entitled to a deduction, in the computation of his taxable profits, in respect of any donations made by him to an association or institution which has as its object the undertaking of programmes of rural development to be used for carrying out such programme. The deduction under this section is admissible only in cases where the association or institution as also the programme of rural development is approved by the "prescribed authority".

---

9. Sections 35C and 35CC have been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989).

10. Sections 35C and 35CC have been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989).

11. Sections 35C and 35CC have been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988), s. 10 (w. e. f. 1-4-1989).

LexisNexis

11.2 The Finance Act, 1979 (21 of 1979), has extended the scope of this provision to provide for a deduction, in the computation of the taxable profits, in respect of donations made by a taxpayer carrying on business or profession, to any association or institution which has as its object the training of persons for implementation of any programme of rural development. It is, however, necessary that such association or institution should be approved by the "prescribed authority". The prescribed authority will not approve any such association or institution for a period exceeding three years at a time.

11.3 It may be relevant to mention that for the purposes of section 35CCA, the association or institution should have the main object of undertaking of any programme of rural development or, as the case may be, the training of persons for implementing programmes of rural development. In other words, such association or institution will not be disqualified from being approved by the "prescribed authority" under section 35CCA merely on the ground that such association or institution has other subsidiary objects so long as the main objects fall within the ambit of section 35CCA.

11.4 This provision has come into force with effect from 1-6-1979, and will, accordingly, apply in relation to the assessment year 1980-81 and subsequent years.'.

II. *The Finance Act, 1983.*—By **the Finance Act, 1983** (11 of 1983), the following **amendments** (**w. e. f. 1-4-1983**) have been made—

—**section 35CCA(1)(*b*)** has been **amended**;

—**section 35CCA(1)(*c*)** has been **inserted**; and

—**sections 35CCA(2), (2A) & (2B)** have been **substituted** for the then existing **section 35CCA(2)**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 372, dated 8-12-1983*, as follows:—

'(*xxi*) *Modification of provisions relating to expenditure by way of payment to associations and institutions for carrying out rural development programmes—Section 35CCA.*—**29.1** Under section 35CCA(1)(*a*) of the Income-tax Act, 1961 (43 of 1961), sums paid by an assessee carrying on business or profession to any association or institution, which has as its object the undertaking of programmes of rural development, are allowed as deduction in computing the profits and gains from business or profession where such sums are to be used for carrying out a programme of rural development. The deduction is allowed only if the association or institution and also the programme of rural development for which the sums are paid have been approved by the prescribed authority.

29.2 Under an amendment made by the Finance Act, 1983 (11 of 1983), the aforesaid deduction will not be allowed in respect of any sums paid to such associations or institutions unless the assessee furnishes a certificate from the association or institution to the effect that—

(*i*) the programme of rural development had been approved by the prescribed authority before 1-3-1983; and

(*ii*) where such payment is made after 28-2-1983, such programme involves work by way of construction of any building or other structure (whether for use as a dispensary, school, training or welfare centre, workshop or for any other purpose) or the laying of any road or the construction or boring of a well or tube-well or the installation of any plant or machinery, and such work has commenced before 1-3-1983.

29.3 Section 35CCA(1)(*b*) provides for a similar deduction in respect of sums paid to an approved association or institution, which has as its object the training of persons for implementing programmes of rural development. Under another amendment made to said section by the Finance Act, 1983 (11 of 1983), the deduction in respect of expenditure by way of payment of any sum to such associations or institutions will not be allowed unless the assessee furnishes a certificate from such association or institution to the effect that—

(*i*) the prescribed authority had approved the association or institution before 1-3-1983; and

(*ii*) the training of persons for implementing any programme of rural development had been started by the association or institution before 1-3-1983.

The certificate referred to in this and the preceding paragraph will not be issued by any association or institution unless it has obtained from the prescribed authority an authorisation in writing to issue certificates of such nature.

29.4 Under another amendment made to section 35CCA by the Finance Act, 1983 (11 of 1983), payment of any sum to a rural development fund set up and notified by the Central Government in this behalf will qualify for deduction under the said section.

29.5 These amendments take effect from 1-4-1983, and will, accordingly, apply in relation to the assessment year 1983-84 and subsequent years. [*Section 16 of the Finance Act, 1983 (11 of 1983)*]'.

LexisNexis

III. *The Finance Act, 1995*.—By **the Finance Act, 1995** (22 of 1995), the following **amendments** (**w. e. f. 1-4-1996**) have been made:—

—**section 35CCA(1)(*c*)** has been **amended**; and

—**section 35CCA(1)(*d*)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 717, dated 14-8-1995*, as follows:—

'**25.** *Deduction for payments to National Urban Poverty Eradication Fund*.—**25.1** The Government is setting up a fund called the "National Urban Poverty Eradication Fund" (NUPEF), on the lines similar to those on which the National Fund for Rural Development (NFRD) has been set up. This Fund will be notified on its being set up.

25.2 Under the existing provisions of section 35CCA of the Income-tax Act, sums paid by an assessee to any association or institution for carrying out rural development programmes or to a rural development fund set up and notified by the Central Government are allowed as a deduction in computing profits and gains of business or profession. Section 35CCA has been amended to allow the benefit of deduction under this section in respect of payments made to NUPEF also.

25.3 Towards the same end section 80GGA has also been amended. This section provides, *inter alia*, for 100 per cent. deduction in respect of donations made to an approved association or institution for carrying out the programmes approved under section 35CCA and is available to all taxpayers other than those deriving income from business or profession. The amended section 80GGA provides that donations made to NUPEF will also be allowed as a deduction in the hands of such taxpayers.

25.4 The amendment will take effect from 1-4-1996, and will, accordingly, apply in relation to the assessment year 1996-97 and subsequent years. [*Sections 9 and 17*]'.

IV. *The Taxation Laws (Amendment) Act, 2006*.—By **the Taxation Laws (Amendment) Act, 2006** (29 of 2006), ***Explanation* to section 35CCA(2A)** has been **inserted** (**w. e. f. 1-4-2006**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 1/2007, dated 27-4-2007*, as follows:—

'**12.** *Deduction in the case of an assessee* (*i.e., the donor*) *not to be denied if approval is withdrawn in the case of the donee*.—**12.1** The Act has amended section 35CCA of the Income-tax Act, 1961 (43 of 1961), by insertion of an *Explanation* after sub-section (2A) of the said section. The *Explanation* so inserted clarifies that the deduction to which an assessee is entitled on account of payment of any sum by him to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to the programme of rural development or, as the case may be, to the association or institution has been withdrawn.

12.2 *Applicability*: Assessment year 2006-07 onwards. [*Section 7*]'.

Deduction on account of payment to certain persons carrying out rural development programmes.— The provisions of **section 35CCA** of the 1961 Act, which has been **inserted** (**w. e. f. 1-6-1978**) by **the Finance Act, 1978** (19 of 1978), apply to any assessee who incurs certain expenditure for carrying out rural development programmes to certain persons.

In *CIT v. D.H. Joshi*, (1995) 216 ITR 482, 483 (AP), the Tribunal was held right in law in taking the view that a partner of a firm is an 'assessee' within the meaning of section 2(7) of the 1961 Act and he is entitled to deduction under section 35CCA of the 1961 Act in respect of payments made from income derived out of share income from the firm.

Such assessee shall be allowed 100% deduction under **section 35CCA(1)** of the 1961 Act of the amount of expenditure by way of payment of any sum incurred during the previous year to any of the following:—

(*a*) (**w. e. f. 1-6-1978**) An association or institution, which has as its object the undertaking of any programme of rural development, to be used for carrying out any programme of rural development approved by the prescribed authority.

(*b*) (**w. e. f. 1-6-1979**) An association or institution, which has as its object the training of persons for implementing programmes of rural development.

(*c*) (**w. e. f. 1-4-1983**) A rural development fund set up and notified by the Central Government in this behalf. In this regard, the National Fund for Rural Development set up under the resolution of the Government of India in the Cabinet Secretariat No. 82/1/4/83-Cab., dated 10-2-1984 has been notified *vide Notification No. GSR 84(E), dated 28-2-1984*: (1984) 147 ITR (St.) 23.

(*d*) (**w. e. f. 1-4-1996**) The National Urban Poverty Eradication Fund set up and notified by the Central Government in this behalf.

LexisNexis

Deduction under clause (*a*) above, **with effect from 1-4-1983**, shall not be allowed as per **section 35CCA(2)** of the 1961 Act unless the assessee furnishes a certificate from such association or institution to the effect that the rural development programme had been approved by the prescribed authority up to 28-2-1983. In case, such payment is made on or after 1-3-1983, such programme involves work by way of construction of any building or other structure (whether for use as a dispensary, school, training or welfare centre, workshop or for any other purpose) or the laying of any road or the construction of boring of a well or tube-well or the installation of any plant or machinery, and such work has commenced up to 28-2-1983. Similarly, deduction under clause (*b*) above, **with effect from 1-4-1983**, shall not be allowed as per **section 35CCA(2A)** of the 1961 Act unless the assessee furnishes a certificate from such association or institution to the effect that the prescribed authority had approved the association or institution up to 28-2-1983 and the training of persons for implementing any rural development programme had been started by such association or institution up to 28-2-1983.

Further, no certificate of the above nature shall be issued as per **section 35CCA(2B)** of the 1961 Act unless such association or institution has obtained from the prescribed authority authorization in writing to issue certificates of such nature.

The scheme of section 35CCA of the 1961 Act, as amended by the Finance Act, 1983 (11 of 1983), is that an assessee will be entitled to deduction of expenses incurred on account of donation made to any institution or association for the purposes of approved rural development programme or for the training of persons for implementing programmes of rural development or to a rural development fund set up and notified by the Central Government. However, the deduction is not absolute but conditional depending upon the requisite certificate to be produced by an assessee. In so far as the deduction claimed for an expenditure by way of payment of any sum to any institution or association for the purpose of utilising it for the implementation of approved rural development programme is concerned, the certificate must be to the effect that the rural development programme was already approved before 1-3-1983, and if the payment is made after 28-2-1983, it must be for the purposes of the capital cost of construction of any building or structure or laying of a road or boring of a well or tube-well or installation of any plant or machinery, the work in respect of which must have commenced before 1-3-1983. Such a certificate is to be obtained from the institution or association which has as its object the undertaking of any programme of rural development. But before the institution or association concerned can issue such a certificate, it must have been authorised in that behalf by the prescribed authority [*Kaka Ba and Kala Budh Public Charitable Trust v. CIT,* (1984) 146 ITR 9, 13-14 (Guj)].

The requirement of the approval to the institution or programme as envisaged in section 35CCA of the 1961 Act (operative up to 31-3-1983) and the authorisation which is to be accorded to the institution for the purpose of issuing a certificate under section 35CCA of the 1961 Act (operative from 1-4-1983) operate in different fields altogether. The approval which was envisaged to the programme as well as to the institution under old section 35CCA of the 1961 Act was for the purpose of enabling the assessee to claim deduction on account of any expenses made by way of payment to such an institution or association. The authorisation which has now been envisaged under section 35CCA of the 1961 Act is to empower the institution or the association to issue certificate so as to enable the assessee concerned to claim deduction on account of such expenses. Although it cannot be said that every and any institution or association which has as its object the rural development programme is entitled to the authorisation under section 35CCA(2B) of the 1961 Act, the prescribed authority is duty bound to give authorisation only to those institutions or associations which are approved and which have undertaken and are implementing approved rural development programme after 1-3-1983 [*Kaka Ba and Kala Budh Public Charitable Trust v. CIT,* (1984) 146 ITR 9, 14-15, 15 (Guj)].

In *Pressman Advertising & Marketing Pvt. Ltd. v. CIT*, (1994) 208 ITR 768 (Cal), it has been held that the deduction allowed under section 35CCA of the 1961 Act cannot be withdrawn on the ground that the money donated by the assessee to the institution concerned was not in fact utilised by the institution-donee for the purposes for which the money was given in donation. Where the assessee has fulfilled all the conditions laid down in section 35CCA of the 1961 Act read with rule 6AAA of the 1962 Rules for deduction of amount donated to the approved society, which had not come back to the assessee soon after or later on in some form or the other, there is no justification for denying deduction to the assessee under section 35CCA of the 1961 Act. Further, the entitlement of the assessee for claiming deduction of the amount donated to the approved society does not depend upon the utilisation of such fund by the approved society in the approved programme before the date specified in section 35CCA of the 1961 Act [*Chotatingarai Tea Estate Pvt. Ltd. v. CIT,* (1999) 236 ITR 644, 645, 647-48 (Gauh), **affirmed in** *CIT v. Chotatingrai Tea,* (2002) 258 ITR 529 (SC)].

Under section 35CCA of the 1961 Act, an assessee is made entitled to the claim of deduction only on his establishing that he made the payment to institutions which had been approved for the purpose mentioned in section 35CCA of the 1961 Act and the approval has been granted by the prescribed authority. The deduction under section 35CCA of the 1961 Act cannot be denied on the ground that either the two institutions were not traceable after notices were issued to them under section 131 of the 1961 Act or that the two institutions were actually not carrying out the rural development work as envisaged under section 35CCA of the 1961 Act and for

which approval had been granted by the prescribed authority to the two institutions under that section. It was no part of the assessee's obligation to either keep track of the movement of the institutions or to find out as to whether the rural development work was actually being carried out or not [*CIT v. Bhartia Cutter Hammer Co.,* (1998) 232 ITR 785, 787, 786-87 (Cal), **impliedly approved in** *CIT v. Chotatingrai Tea,* (2002) 258 ITR 529, 533 (SC)].

Prescribed authority.—As per **Rule 6AAA(*i*) of the 1962 Rules**, the prescribed authority to approve the programme of rural development shall be the Committee consisting of the following, namely:—

(*a*) The Chief CIT or CIT who exercises jurisdiction over the State or, as the case may be, the Union territory in which the programme of rural development is to be carried out—Chairman; and

(*b*) An officer not below the rank of a Secretary to the Government of the State or, as the case may be, the Union territory in which the programme of rural development is to be carried out—Member.

As per **Rule 6AAA(*ii*) of the 1962 Rules**, the prescribed authority to approve an association or institution referred to in section 35CCA of the 1961 Act shall be the Committee consisting of the following, namely:—

(*a*) The Chief CIT or CIT who exercises jurisdiction over the State or, as the case may be, the Union territory in which the principal office of the association or institution is situated—Chairman; and

(*b*) An officer not below the rank of a Secretary to the Government of the State or, as the case may be, the Union territory in which the principal office of the association or institution is situated—Member.

If, in a case, two or more Commissioners exercise jurisdiction over the State or, as the case may be, the Union territory, the CBDT may, by notification in the Official Gazette, empower the Chief CIT or CIT specified in this behalf to be the Chairman of the Committee. In this regard, the following *Notification No. SO 195(E), dated 11-2-2005* is relevant:—

'In exercise of the powers conferred by **section 35CCA** of the Income-tax Act, 1961, read with rule 6AAA of the Income-tax Rules, 1962, the Central Board of Direct Taxes empowers the income-tax authorities specified in column number (2) of the Schedule hereto annexed to be the chairman of the committee for the purposes of section 35CCA for the States/Union Territories specified in column number (3) of the said Schedule.

SCHEDULE

Sl. No.	*Income-tax authorities*	*State/Union Territory*
(1)	*(2)*	*(3)*
1.	Chief Commissioner of Income-tax, Kolkata-I	West Bengal
2.	Chief Commissioner of Income-tax, Delhi-I	Delhi
3.	Chief Commissioner of Income-tax, Chandigarh	Punjab
4.	Chief Commissioner of Income-tax, Jaipur	Rajasthan
5.	Chief Commissioner of Income-tax, Ahmedabad-I	Gujarat
6.	Chief Commissioner of Income-tax, Mumbai-I	Maharashtra
7.	Chief Commissioner of Income-tax, Bangalore-I	Karnataka
8.	Chief Commissioner of Income-tax, Thiruvananthapuram	Kerala
9.	Chief Commissioner of Income-tax, Hyderabad-I	Andhra Pradesh
10.	Chief Commissioner of Income-tax, Chennai-I	Tamil Nadu
11.	Chief Commissioner of Income-tax, Bhopal	Madhya Pradesh
12.	Chief Commissioner of Income-tax, Lucknow-I	Uttar Pradesh
13.	Chief Commissioner of Income-tax, Guwahati	Assam'

LexisNexis

Guidelines for approval to associations or institutions under section 35CCA of 1961 Act.—Keeping in view the objective underlying incentive under section 35CCA of the 1961 Act and the requirements of the statutory provisions, the prescribed authority would consider (at the time of) according approval under section 35CCA of the 1961 Act to associations/institutions which satisfy the following requirements as prescribed in *Circular No. 244, dated 13-7-1978*:

(*i*) The association/institution should have as its object the undertaking of any programme of rural development.

(*ii*) The association/institution is—

(*a*) constituted as a public charitable trust, or

(*b*) registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India, or

(*c*) registered under section 25 of the Companies Act, 1956, or

(*d*) a corporation established by or under a Central, State or Provincial Act.

(*iii*) The activities of the association/ institution are open to citizens of India without distinction of religion, caste, creed, race, lingual group, etc., and are not expressed to be for the benefit of any particular individual or community.

(*iv*) The association or institution maintains regular accounts of its receipts and expenditure.

(*v*) The instrument under which the association or institution is constituted does not, or the rules governing the association or institution do not, contain any provision for the transfer or application at any time of the whole or any part of the income or assets of the association or institution for any purpose other than a charitable purpose.

(*vi*) The association/institution has the necessary expertise and personnel for the efficient implementation of the programme of rural development.

(*vii*) The association/institution maintains a bank account.

Further, the prescribed authority has evolved the following illustrative list of categories of projects of rural development which would be considered by it for approval for the purposes of section 35CCA of the 1961 Act:—

1. Assistance in the setting up of rural industries in selected areas by the rural weak to provide them self-employment.

2. (*a*) Establishment, and (*b*) running of dispensaries, maternity and child welfare centres and family welfare centres.

3. Nutrition programmes for school children.

4. (*a*) Establishment, and (*b*) running of educational and vocational training centres.

5. (*a*) Construction, and (*b*) maintenance of rural link roads, village streets, pavements and drainage.

6. (*a*) Construction, and (*b*) maintenance of drinking water projects, such as wells, tubewells, etc., and cleaning of wells and ponds.

7. Rural electrification, *i.e.*, provision of street lighting in villages and electrification of Harijan/tribal homes.

8. Assistance to the weaker sections in constructing houses on sites provided in rural areas by Government, village panchayats, etc.

9. Minor irrigation schemes, including boring of tubewells and installation of pumping sets for the benefit of groups of small/marginal farmers.

10. Supply of improved varieties of seeds and provision of facilities for seed testing to groups of small/marginal farmers and assistance to such farmers for establishing seed farms.

11. Supply of fertilisers and insecticides to groups of small/marginal farmers and giving guidance and training to such farmers in the use of fertilisers, insecticides, etc.

12. Supply of plant protection equipment, sprayers, farm machinery, implements, etc., to the village panchayat for the use of groups of small/marginal farmers.

13. Animal husbandry—assisting the farmers in cattle improvement through establishment of veterinary dispensaries, artificial insemination centres, etc., dairy products processing and marketing.

14. Assistance to groups of small/marginal farmers, landless labourers, etc., in poultry farming, horticulture, pisciculture, etc.

15. Establishment of workshops for servicing and repair of farm machinery and training of artisans, mechanics, etc.

It may be pointed out that the above list is merely illustrative and not exhaustive and the items mentioned therein may be modified or supplemented in due course in the light of the different types of cases which come up for approval.

Some of the more important points which the applicants should keep in view while formulating schemes for rural development for approval under section 35CCA of the 1961 Act are as follows:—

(*i*) The benefit of the programme of rural development should flow to the public in general (as against individuals) in the rural area and not to the donor/association/institution.

(*ii*) The projects or schemes which the applicants may like to execute in the rural areas should be formulated keeping in view the local needs, resources of the community and the plans and programmes of the State Government for that area.

LexisNexis

(*iii*) Ordinarily, the approval of the association/institution and/or the programme to be executed will be for an initial period of one accounting year. In case the programme extends beyond one accounting year, it may in principle be approved for the successive two years but a formal approval order will, however, be passed for each year separately if the prescribed authority is satisfied that the programme has been implemented properly. For this purpose, the prescribed authority may monitor the implementation of the programme. In no case approval will be granted for more than three years at a time.

(*iv*) The application for approval of the programme of rural development should contain complete details of the programme and indicate the rural area where the programme is to be executed. The application should, in particular, provide information in respect of the following:

(*a*) Particulars of the "rural area" (where programme is to be carried out) indicating the names of the villages, tehsil, district and State and evidence to show that it qualifies as "rural area" within the meaning of the expression as defined in clause (*b*) of the *Explanation* to sub-section (1) of section 35CC of the 1961 Act.

(*b*) The total period during which the programme is expected to be completed and the total monetary outlay involved. Year-wise break-up of capital as well as revenue expenditure and the sources from which funds will be raised for the programme.

(*c*) If the programme is to be executed in different phases, the monetary outlay of each phase and its coverage.

(*d*) If the whole or part of the programme is to be executed on behalf of the applicant by any agent or contractor appointed by it, the name/address of such agent or contractor may be furnished indicating the nature of work to be executed by them and the remuneration to be paid to them.

(*e*) If the expenditure results in the acquisition or the creation of a capital asset, whether and, if so, at what stage and in what manner the applicant proposes to divest itself of the ownership of such assets? Whether proper arrangements have been made for the continued maintenance of such assets?

(*f*) In regard to programmes which have to be executed on a long-term basis, like establishment of school or dispensary, what arrangements are proposed to be made for ensuring their continued maintenance? In case, it is proposed to hand over the said establishments to the Central Government, State Government or any other agency, then a letter from the said Government/agency confirming that it would take over the programme should be furnished along with the application.

(*g*) Where the programme involves co-ordination and/or assistance by the State Government or any other agency, a letter from the State Government or the agency to this effect should accompany the application.

(*h*) If a programme involves more than one activity, for instance, the programme of health services include running of dispensaries and child nutrition programmes, details of each such activity, mode of its execution and the budgetary provisions should be furnished separately.

(*i*) Where approval is sought for more than one programme, then the application should clearly bring out this fact and also indicate the full particulars of each of the programmes and the "rural areas" where such programmes are proposed to be implemented.

(*v*) The approval of the prescribed authority for implementing the approved programme of rural development would be governed, *inter alia*, by the following conditions:

(*a*) The funds will be utilised for the purpose approved by the prescribed authority and that these would not be diverted for any other purpose.

(*b*) The representative of the prescribed authority has the right to visit the places where the approved programme is being carried out.

(*c*) The association/institution should maintain proper accounts of the receipts and payments, income and expenditure and the balance-sheet. These accounts should be audited by a Chartered Accountant.

(*d*) The association/institution shall maintain proper records of all the assets created for the project and that these shall not be transferred or disposed of or mortgaged or utilised for purposes other than those for which these are purchased.

(*e*) The association/institution shall maintain a bank account.

LexisNexis

The prescribed authority would consider for approval applications of the associations or institutions and their programme of rural development either separately or simultaneously. Therefore, two separate forms[12] of application have been devised. First Form is to be used for seeking approval of the association/institution and Second Form for seeking approval of the specific programme of rural development.

It would facilitate prompt disposal of applications for approval under section 35CCA of the 1961 Act if 3 copies of the application duly signed and certified to be correct by a person authorised to sign the return of income of the applicant, are furnished together with three copies of a note setting out details of the programme of rural development for approval by the prescribed authority.

Applications for approval under section 35CCA of the 1961 Act along with relevant enclosures as stated above may be addressed to the Secretary, Central Board of Direct Taxes, Room No. 52, North Block, New Delhi-110001. One copy of the application along with the relevant enclosures should also be forwarded to the Chief Secretary of the concerned State or the Officer nominated by him in this behalf.

"Programme of rural development", defined.—As per ***Explanation* below section 35CCA(2B)** read with **omitted *Explanation (a)* to section 35CC(1)** of the 1961 Act, "programme of rural development" includes any programme for promoting the social and economic welfare of, or the uplift of, the public in any *rural area* [as defined].

The term "rural area" **means** (*a*) an area which is not comprised within the jurisdiction of a municipality, etc., or a cantonment board and which has a population of less than 10,000; and (*b*) an area which is not within such distance (up to a maximum of 15 kilometres) from the local limits of such municipality or cantonment board as the Central Government may specify in that behalf by a notification in the Official Gazette. In this regard, the following *Notification No. 691(E), dated 29-9-1977* is relevant:—

"In pursuance of sub-clause (*ii*) of clause (*b*) of the *Explanation* to sub-section (1) of section 35CC of the Income-tax Act, 1961 (43 of 1961), the Central Government, having regard to the stage of development (including the extent of, and scope for, urbanisation) of the areas concerned and other relevant considerations, hereby specifies the areas shown in column (3) of the Schedule hereto annexed and falling outside the local limits of the municipality or cantonment board, as the case may be, shown in the corresponding entry in column (2) thereof, for the purposes of the above mentioned provisions of the Income-tax Act, 1961 (43 of 1961).

LexisNexis

SCHEDULE

Serial No.	Name of the municipality or cantonment board	Details of the area
1	2	3
1.	Bombay, Calcutta, Delhi, Hyderabad, Madras and New Delhi.	Areas up to a distance of 15 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
2.	Ahmedabad, Bangalore, Kanpur, Lucknow, Nagpur and Pune.	Areas up to a distance of 12 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
3.	Agra, Allahabad, Amritsar, Bhopal, Cochin, Coimbatore, Dhanbad, Gwalior, Indore, Jabalpur, Jaipur, Jamshedpur, Ludhiana, Madurai, Patna, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Varanasi (Banaras) and Vadodara (Baroda).	Aras up to a distance of 10 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits.
4.	Any other municipality or cantonment board.	Areas up to 8 kilometres in all directions from the municipal limits or, as the case may be, cantonment limits."

Effect of subsequent withdrawal of approval granted to associations or institutions.—Under the provisions of section 21 of the General Clauses Act, 1897 (10 of 1897), the power to grant approval necessarily implies the power to withdraw approval. The power of withdrawal inheres in the power to give approval [*CIT v. Bankam Investment Ltd.,* (1994) 208 ITR 208, 216 (Cal)]. This decision insofar as it rules that approval once grated can be withdrawn retrospectively **does not lay down the law correctly on the point** as is evident from a

12. Not reproduced here.

contrary decision in *B.P. Agarwalla & Sons Ltd. v. CIT*, (1994) 208 ITR 863 (Cal), a case relating to deduction under section 35 of the 1961 Act.

Withdrawal of approval granted to an association or institution under section 35CCA of the 1961 Act can only be prospective and the same cannot be given retrospective effect. Interfering with the existing rights is contrary to the well-known general principle that statutes are not to be held to act retrospectively unless a clear intention to that effect is manifested [*CIT v. Bachraj Dugar,* (1998) 232 ITR 290, 292 (Gauh)]. Also see, *CIT v. Shree Hari Industries,* C.C. No. 3550 of 1998: (1998) 232 ITR (St.) 2 (SC). Thus, once an approval has been granted to a particular institution by the prescribed authority under section 35CCA of the 1961 Act, there is no authority vested in the approving authority to pass an order of withdrawal of such approval retrospectively even in a case of fraud [*Jai Kumar Kankaria v. CIT,* (2001) 251 ITR 707, 709 (Cal)]. This is so because the assessee should not suffer for the mistake committed by the prescribing authority in wrongly giving approval to the institution even where such approval has been withdrawn retrospectively [*CIT v. Borbheta Estate Pvt. Ltd.,* (2001) 252 ITR 379, 380-81 (Cal)].

To give **statutory approval** to the above principle, ***Explanation* below section 35CCA(2A)** of the 1961 Act has been **inserted with retrospective effect from 1-4-2006** to clarify that the deduction to which the assessee is entitled in respect of any sum paid to an association or institution for carrying out the programme of rural development shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee, the approval granted to such programme of rural development has been withdrawn; or the approval to the association or institution has been withdrawn.

It is now well-settled that the assessee is entitled to rely upon the certificate granted by the prescribed authority under section 35CCA of the 1961 Act to the institution or association to which it had donated a sum of money for claiming deduction under that section 35CCA of the 1961 Act which was valid and subsisting at the time the donation was made. The retrospective withdrawal and/or cancellation of the certificate will have no effect upon the assessee who has acted upon it when it was valid and operative [*Ramdas Maneklal Gandhi v. Union of India,* (2000) 241 ITR 437, 438-39 (Bom), **applying** (1998) 109 STC 439, 441 (SC)]. Thus, where the concerned institution was in existence and recognized for the purposes of section 35CCA of the 1961 Act on the date when payment to it was made by the assessee, subsequent withdrawal of approval of the institution with retrospective effect would not affect the assessee's claim to deduction under section 35CCA of the 1961 Act [*CIT v. Ethelbari Tea Co.* (*1931*) *Ltd.,* (2002) 256 ITR 470, 471 (Cal)]. Also see, *CIT v. General Magnets Ltd.,* (2002) 256 ITR 471, 475 (Cal).

Where the notification issued by the Board approving the association under section 35CCA of the 1961 Act was not withdrawn, reassessment proceedings under section 147(*b*) of the 1961 Act for withdrawing the allowance already granted in respect of the donation made to the association has been held not valid [*Mrs. Nita Tushar Tana v. ITO,* (1991) 187 ITR 603, 604 (Bom)].

No double deduction allowable.—As per **section 35CCA(3)** of the 1961 Act, where a deduction is claimed and allowed under section 35CCA of the 1961 Act for any assessment year in respect of any expenditure referred to in section 35CCA(1) of the 1961 Act, then no deduction shall be allowed in respect of such expenditure under the then section 35C of the 1961 Act, the then section 35CC or section 80G or any other provision of the 1961 Act for the same or any other assessment year.

LexisNexis

Omitted/Phased-out provisions of section 35CCB of the 1961 Act

[1][**S. 35CCB. Expenditure by way of payment to associations and institutions for carrying out programmes of conservation of natural resources.—**[2][(1) [3][Where an assessee incurs any expenditure on or before the 31st day of March, 2002], by way of payment of any sum—

(*a*) to an association or institution, which has as its object the undertaking of any programme of conservation of natural resources or of afforestation, to be used for carrying out any programme of conservation of natural resources or afforestation approved by the prescribed authority; or

(*b*) to such fund for afforestation as may be notified by the Central Government,

the assessee shall, subject to the provisions of sub-section (2), be allowed a deduction of the amount of such expenditure incurred during the previous year.]

(2) The deduction under [4][clause (*a*) of] sub-section (1) shall not be allowed with respect to expenditure by way of payment of any sum to any association or institution, unless such association or institution is for the time being approved in this behalf by the prescribed authority:

Provided that the prescribed authority shall not grant such approval for more than three years at a time.

(3) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]

Introduction under 1961 Act.—*The Finance Act, 1982.*—By **the Finance Act, 1982** (14 of 1982), **section 35CCB** has been **inserted** (**w. e. f. 1-6-1982**).

The scope and effect of the above insertion, as also of section 80GGA(2)(*c*), have been elaborated in the following portion of the *Departmental Circular No. 346, dated 30-6-1982*, as follows:—

'(*x*) *Deduction in respect of payments to associations and institutions carrying out programmes of conservation of natural resources—Section 35CCB and Section 80GGA.*—**16.1** With a view to encouraging liberal donation to associations or institutions engaged in programmes of conservation of natural resources, the Finance Act, 1982 (14 of 1982), has inserted a new section 35CCB in the Income-tax Act, 1961 (43 of 1961), to provide that sums paid by an assessee carrying on business or profession to any association or institution which has as its object the undertaking of programmes of conservation of natural resources to be used for such programmes will be allowed as deduction in the computation of taxable profits. The deduction under this provision will not be allowed unless the association or institution, as also the programme of conservation of natural resources for which sums are paid, have been approved by the prescribed authority to be notified by the Central Board of Direct Taxes. In other words, the benefit of the deduction under this provision will be available only where at the time of incurring the expenditure, the institution, association, etc., as also the programme of conservation of natural resources have been approved by the prescribed authority. It is proposed to notify the Secretary, Department of Environment, as the prescribed authority for the purposes of this section. The prescribed authority will not approve an association or institution for this purpose for more than 3 years at a time.

16.2 Section 80GGA of the Income-tax Act, 1961 (43 of 1961), provides that in the case of assessees other than those carrying on business or profession, sums paid during the previous year to approved scientific research associations or approved associations or institutions which have as their object the undertaking of any programme of rural development to be used for the purposes of carrying out any approved programmes of rural development, etc., will qualify for deduction in the computation of the total income. The Finance Act, 1982 (14 of 1982), has inserted a new clause (*c*) in sub-section (2) of section 80GGA of the Income-tax Act to provide that sums paid to any association or institution which is approved by the prescribed authority for the purposes of section 35CCB, to be used for carrying out any programme of conservation of natural resources, approved for the purpose of that section will qualify for deduction under section 80GGA in the computation of taxable income.

LexisNexis

---

1. Section 35CCB has been inserted by the Finance Act, 1982 (14 of 1982), s. 9 (w. e. f. 1-6-1982).

2. Subs. by the Finance Act, 1990 (12 of 1990), s. 12(*i*) (w. e. f. 1-4-1991), for the following:—

'(1) Where an assessee incurs any expenditure by way of payment of any sum to an association or institution, which has as its object the undertaking of any programme of conservation of natural resources, to be used for carrying out any programme of conservation of natural resources approved by the prescribed authority, the assessee shall, subject to the provisions of sub-section (2), be allowed a deduction of the amount of such expenditure incurred during the previous year.'.

3. Subs., for "Where an assessee incurs any expenditure", by the Finance Act, 2002 (20 of 2002), s. 17 (w. e. f. 1-4-2003).

4. Ins. by Act 12 of 1990, s. 12(*ii*) (w. e. f. 1-4-1991).

16.3 These provisions take effect from 1-6-1982, and will accordingly apply in relation to the assessment year 1983-84 and subsequent years. [*Sections 9 and 17 of the Finance Act, 1982 (14 of 1982)*]'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1990.*—By **the Finance Act, 1990** (12 of 1990), the following **amendments** (**w. e. f. 1-4-1991**) have been made—

—**section 35CCB(1)** has been **substituted**; and

—**section 35CCB(2) (opening portion)** has been **amended**.

The scope and effect of the above amendments, as also of section 80GGA, have been elaborated in the following portion of the *Departmental Circular No. 572, dated 3-8-1990*, as follows:—

'*Tax concessions in respect of contribution to a fund or programme of afforestation.*—**19.** Under the existing provisions of section 35CCB, in the case of an assessee having income from business or profession, any expenditure incurred by way of payment of any sum to an approved association or institution is allowed as deduction where the object of such association or institution is undertaking of any approved programme of conservation of natural resources. Deduction for similar payments made by other assessees who are not having income from business or profession is allowed under section 80GGA of the Income-tax Act, 1961. With a view to promoting afforestation, the scope of deduction under sections 35CCB and 80GGA has been enlarged so as to cover the payments made to an association or institution which has as its object the undertaking of any programme of afforestation. For this purpose, both the association/institution and the programme of afforestation will have to be approved by the prescribed authority. Moreover, any payment made to a Fund for afforestation to be set up and notified in this behalf will also qualify for deductions under sections 35CCB and 80GGA of the Income-tax Act.

19.1 These amendments will take effect from 1st April, 1991, and will, accordingly, apply in relation to the assessment year 1991-92 and subsequent years. [*Sections 12 and 19 of the Finance Act, 1990*]'.

II. *The Finance Act, 2002.*—By **the Finance Act, 2002** (20 of 2002), **section 35CCB(1)** has been **amended** (**w. e. f. 1-4-2003**).

The scope and effect of the above amendment, as also amendments in section 80GGA, have been elaborated in the following portion of the *Departmental Circular No. 8 of 2002, dated 27-8-2002*, as follows:—

'**30.** *Expenditure by way of payment to associations and institutions for carrying out programmes of conservation of natural resources.*—**30.1** Under the existing provisions of section 35CCB, sums paid by an assessee carrying on business or profession to any association or institution which has as its object the undertaking of programmes of conservation of natural resources or of afforestation to be used for such programmes or to such fund for afforestation, as may be notified by the Central Government, are allowed as deduction in the computation of taxable profits. The deduction under this provision is not allowed unless the association or institution, and also the programme of conservation of natural resources or afforestation for which sums are paid, have been approved by the prescribed authority.

30.2 Under the existing provisions of section 80GGA, sums paid to any association or institution, which is approved by the prescribed authority for the purposes of section 35CCB, to be used for carrying out any approved programmes of conservation of natural resources or of afforestation, qualify for deduction in computation of taxable income of an assessee not carrying on business or profession. Similar deduction is also available in case the sums are paid to a fund notified by the Central Government for the purposes of afforestation.

30.3 The Finance Act, 2002 (20 of 2002), has amended the said sections to provide that no deduction under section 35CCB and under section 80GGA shall be allowed in cases where sums are paid after 31-3-2002. However, rule 11K of the Income-tax Rules, 1962 relating to guidelines for recommending projects or schemes for the purpose of section 35AC has been amended to include, within the list, programmes of conservation of natural resources and of afforestation with effect from 1-4-2002.

30.4 The amendment will take effect from 1-4-2003, and will, accordingly, apply in relation to the assessment year 2003-2004 and subsequent years. [*Sections 17 & 31*]'.

Deduction on account of payment to associations and institutions for carrying out programmes of conservation of natural resources.—The provisions of **section 35CCB** of the 1961 Act have been **inserted** (**w. e. f. 1-6-1982**) by **the Finance Act, 1982** (14 of 1982) and apply to any assessee who incurs any expenditure on or before 31-3-2002 by way of payment of any sum to any of the following:—

(*a*) An association or institution, which has as its object the undertaking of any programme of conservation of natural resources or of afforestation, to be used for carrying out any programme of conservation of natural resources or afforestation approved by the *prescribed authority* [*i.e.*, the Secretary, Department of Environment, Government of India as prescribed under **Rule 6AAC of the 1962 Rules**].

(*b*) Such fund for afforestation as may be notified by the Central Government.

Deduction shall be allowed under **section 35CCB(1)** of the 1961 Act to the assessee of the amount of such expenditure (*i.e.*, 100%) incurred during the previous year.

Deduction under clause (*a*) above, **with effect from 1-4-1991**, shall not be allowed as per **section 35CCB(2)** of the 1961 Act unless such association or institution is for the time being approved in this behalf by the Secretary, Department of Environment, Government of India. Such approval shall not be granted for more than 3 years at a time.

The provisions of section 35CCB of the 1961 Act are no longer available for and from assessment year 2003-04 since the deduction available under this section has been incorporated under Rule 11K of the 1962 Rules, which is relevant for the purposes of section 35AC of the 1961 Act.

No double deduction allowable.—As per **section 35CCB(3)** of the 1961 Act, where a deduction is claimed and allowed under section 35CCB of the 1961 Act for any assessment year in respect of any expenditure referred to in section 35CCB(1) of the 1961 Act, then no deduction shall be allowed in respect of such expenditure under any other provision of the 1961 Act for the same or any other assessment year.

LexisNexis

Omitted/Phased-out provisions of section 36 of the 1961 Act

WEIGHTED DEDUCTION TO EMPLOYERS EMPLOYING BLIND OR PHYSICALLY HANDICAPPED PERSONS [Omitted s. 36(1)(*iia*) of 1961 Act]

Introduction under 1961 Act.—*The Finance (No. 2) Act, 1980.*—By **the Finance (No. 2) Act, 1980** (44 of 1980), **section 36(1)(*iia*)** has been **inserted** (**w. e. f. 1-4-1981**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 281, dated 22-9-1980*, as follows:—

'**12.** *Grant of weighted deduction to employers employing blind or physically handicapped persons—Section 36.*—**12.1** In order to encourage employers to employ persons who are totally blind or physically handicapped, the Finance (No. 2) Act, 1980 (44 of 1980), has inserted a new clause (*iia*) in section 36(1) to provide for a weighted deduction in an amount equal to one and one-third times the salary paid to such persons. The weighted deduction will be admissible only in respect of employees whose income chargeable under the head "Salaries" does not exceed ₹ 20,000 during the relevant previous year. For the purpose of this tax concession, "salary" will include the allowances, bonus or commission, whether payable monthly or otherwise. In order to qualify for this concession, the employer will have to produce before the Income-tax Officer, in respect of the first assessment year for which deduction is claimed under the new provision, a certificate as to the total blindness of the employee from a registered oculist and in the case of an employee who is suffering from a permanent physical disability a certificate from a registered medical practitioner, to the effect that the employee suffers from a permanent physical disability (other than blindness) which has the effect of reducing substantially his capacity to engage in a gainful employment or occupation. These provisions are similar to the provisions contained in section 80U of the Income-tax Act.

12.2 This amendment will take effect from 1-4-1981, and will accordingly apply in relation to the assessment year 1981-82 and subsequent years.'.

Legislative amendment under 1961 Act.—I. *The Finance Act, 1984.*—By **the Finance Act, 1984** (21 of 1984), **section 36(1)(*iia*)** has been **amended** (**w. e. f. 1-4-1984**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 387, dated 6-7-1984*, as follows:—

'(*vii*) *Withdrawal of weighted deduction in respect of salary paid to a physically handicapped employee.*—**13.1** Under section 36(1)(*iia*) of the Income-tax Act, 1961, in computing the taxable profits, a taxpayer is allowed a weighted deduction equal to one and one-third times the amount of the expenditure incurred on payment of any salary to an employee who is totally blind or suffers from a permanent physical disability which has the effect of reducing substantially his capacity to engage in a gainful employment or occupation. The deduction is allowed only if the income of the employee concerned chargeable under the head "Salaries" does not exceed ₹ 20,000 and the taxpayer produces before the Income-tax Officer in respect of the first assessment year for which the deduction is claimed, in relation to such employee, a certificate as to his total blindness from a registered medical practitioner being an oculist or, as the case may be, a certificate as to the permanent physical disability from a registered medical practitioner.

13.2 On the consideration that expenditure-linked concessions for weighted deduction are liable to misuse and with a view to simplifying the tax law, the Finance Act, 1984 (21 of 1984), has discontinued the tax concession contained in section 36(1)(*iia*) of the Income-tax Act in relation to any salary paid for any period of employment after 29-2-1984.

13.3 The amendment takes effect from 1-4-1984, and will, accordingly, apply in relation to the assessment year 1984-85 and subsequent years.'.

Calculation of weighted deduction.—For the purpose of calculation of weighed deduction, income of employees chargeable under head "Salaries" was to be taken as amount after allowance of standard deduction under section 16 [*Pieco Electronics & Electricals Ltd. v. CIT*, (2019) 111 taxmann.com 57 (Cal)].

Omission of section 36(1)(*iia*) of 1961 Act.—*The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 36(1)(*iia*)** has been **omitted** (**w. e. f. 1-4-2000**).

The scope and effect of the above omission have been elaborated in the following portion of the *Departmental Circular No. 779, dated 14-9-1999*, as follows:—

'**55.** (*x*)[1] Section 36 of the Income-tax Act relates to certain deductions made in computing the income under the head "Profits and gains of business or profession". Under the existing provisions contained in clause (*iia*) of sub-section (1) of section 36, a weighted deduction is allowed in respect of the expenditure incurred by the assessee on payment of salary to an employee who is totally blind or suffers from a

1. Ought to have been (*vii*).

permanent physical disability for any period of employment before 1-3-1984. As these provisions are not applicable on or after the 1-3-1984, they are omitted.

This amendment will take effect from the 1-4-2000. [*Section 22*]'.

SPECIAL RESERVE CREATED BY NON-FOREIGN SCHEDULED BANKS [Omitted s. 36(1)(*viiia*) of 1961 Act]

Introduction under 1961 Act.—*The Finance Act, 1982.*—By **the Finance Act, 1982** (14 of 1982), **section 36(1)(*viiia*) of the 1961 Act** has been **inserted** (**w. e. f. 1-4-1983**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 346, dated 30-6-1982*, as follows:—

'**18.** *Deduction in respect of profits transferred to special reserves in the case of scheduled banks having operations abroad.*—**18.1** Under section 36(1)(*viii*) of the Income-tax Act, approved financial corporations engaged in providing long-term finance for industrial or agricultural development in India and approved public housing finance companies are entitled to deduction, in the computation of the taxable profits, in respect of the amount transferred by them out of such profits to a special reserve account, up to 40 per cent of their taxable income. In view of the important role being played by scheduled commercial banks in expanding banking operations outside India, the Finance Act, 1982, has inserted a new clause (*viiia*) in sub-section (1) of section 36 to provide for a similar tax concession to scheduled banks, other than foreign banks, which are engaged in banking operations outside India. Under this provision, such scheduled banks will be entitled to a deduction, in the computation of the taxable profits, up to 40 per cent of the total income computed before making any deduction under Chapter VI-A carried by them to a special reserve account. However, this concession will be available only where such scheduled bank is approved by the Central Government for the purposes of this clause, taking into account the capital structure, the extent of its operations outside India, its need for resources for operations outside India and other relevant factors. For this purpose, the expression "scheduled bank" will have the same meaning as in the *Explanation* at the end of clause (*b*) of sub-section (2) of section 11. Accordingly, the expression "scheduled bank" means the State Bank of India, the subsidiary banks of the State Bank of India, the nationalised banks or any other bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

18.2 These provisions will take effect from 1st April, 1983, and will accordingly apply in relation to the assessment year 1983-84 and subsequent years. [*Section 10(a) and (b) of the Finance Act, 1982*]'.

Legislative amendment under 1961 Act.—I. *The Finance Act, 1985.*—By **the Finance Act, 1985** (32 of 1985), **section 36(1)(*viiia*)** has been **amended** (**w. e. f. 1-4-1985**).

For the scope and effect of the above amendment, reference may be made to paras. 18 to 18.3 of the *Departmental Circular No. 421, dated 12-6-1985*.

Approved scheduled banks.—In view of *Notification No. SO 726(E), dated 19-9-1984*, the following scheduled banks had been approved for the purposes of section 36(1)(*viiia*) of the 1961 Act:—

(*i*) State Bank of India;
(*ii*) Bank of Baroda;
(*iii*) Indian Overseas Bank;
(*iv*) United Commercial Bank;
(*v*) Punjab National Bank;
(*vi*) Central Bank of India;
(*vii*) Bank of India.

Omission of section 36(1)(*viiia*) of 1961 Act.—*The Finance Act, 1994.*—By **the Finance Act, 1994** (32 of 1994), **section 36(1)(*viiia*)** has been **omitted** (**w. e. f. 1-4-1995**).

For the scope and effect of the above omission, reference may be made to paras. 30 to 30.3 of the *Departmental Circular No. 684, dated 10-6-1994*.

CONTRIBUTION TOWARDS A SPECIFIED EXCHANGE RISK ADMINISTRATION FUND BY A PUBLIC FINANCIAL INSTITUTION [Omitted s. 36(1)(*x*) of 1961 Act]

Introduction under 1961 Act.—*The Finance Act, 1989.*—By **the Finance Act, 1989** (13 of 1989), **section 36(1)(*x*)** has been **inserted** (**w. e. f. 1-4-1989**).

For the scope and effect of the above insertion, reference may be made to paras. 11 to 11.8 of the *Departmental Circular No. 550, dated 1-1-1990*.

Legislative amendment under 1961 Act.—I. *The Finance Act, 2003.*—By **the Finance Act, 2003** (32 of 2003), **section 36(1)(*x*)** has been **amended** (**w. e. f. 1-4-2003**).

LexisNexis

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 7 of 2003, dated 5-9-2003*, as follows:—

'**30.** *Clarification regarding deduction available under section 36(1)(x).*—**30.1** Under the existing provision contained in clause (*x*) of sub-section (1) of section 36, a deduction is allowed in respect of any sum paid by a public financial institution by way of contribution towards any fund specified under clause (23E) of section 10 for computing the business income.

30.2 The Finance Act, 2003 (32 of 2003), has amended the said clause (*x*) so as to provide that the deduction shall be allowable in respect of any sum paid by a public financial institution by way of contribution towards any Exchange Risk Administration Fund set up by public financial institutions, either jointly or separately. The amendment is consequential to the omission of clause (23E) of section 10 by the Finance Act, 2002 (20 of 2002).

30.3 This amendment will take effect retrospectively from 1-4-2003, and will, accordingly, apply in relation to the assessment year 2003-04 and subsequent years. [*Section 18(c)*]'.

Omission of section 36(1)(*x*) of 1961 Act.—*The Finance Act, 2007.*—By **the Finance Act, 2007** (22 of 2007), **section 36(1)(*x*)** has been **omitted** (**w. e. f. 1-4-2008**).

The scope and effect of the above omission have been elaborated in the following portion of the *Departmental Circular No. 3/2008, dated 12-3-2008*, as follows:—

'**22.** *Withdrawal of deduction under section 36(1)(x) in respect of contribution by public financial institutions towards Exchange Risk Administration Fund [ERAF].*—**22.1** Under the existing provisions of clause (*x*) of sub-section (1) of section 36, any sum paid by a public financial institution by way of contribution towards any Exchange Risk Administration Fund (ERAF) set up by public financial institutions, either jointly or separately, was allowed as deduction in the computation of income of the payer institution.

22.2 ERAFs were set up under a scheme known as Exchange Risk Administration Scheme (ERAS). The benefit of coverage of exchange risk under the Scheme was available to borrowers of foreign currency loans provided by institutions out of their external commercial borrowings.

22.3 An exemption under clause (23E) of section 10 in respect of any income of a notified ERAF set up by public financial institutions was earlier provided by the Finance Act, 1989 (13 of 1989). By virtue of clause (14A) of section 10, income in the nature of Exchange Risk Premium received by public financial institutions from the borrower and thereafter credited to the ERAF was also exempted from tax. The exemption of ERAFs under section 10(23E) was withdrawn by the Finance Act, 2002 (20 of 2002), from the assessment year 2003-04 on the ground that the operations of these funds were on a commercial line whereby they were collecting an exchange risk premium from borrowers of foreign currency to meet the actual losses on account of exchange fluctuation. ERAFs had been in existence for a considerable time since 1989 and it was felt that tax exemption to them had outlived the utility. Exemption under clause (14A) of section 10 was also withdrawn simultaneously.

22.4 The foreign exchange scenario in India has undergone a sea change since the launching of ERAS. There are several options available in the market for borrowers to hedge their foreign exchange risk. Responding to changed market dynamics ERAFs have been discontinued by the Industrial and Development Bank of India (IDBI), Power Finance Corporation (PFC) and Indian Renewable Energy Development Agency (IREDA). The clause (*x*) of sub-section (1) of section 36 had, therefore, outlived its utility.

22.5 The Finance Act, 2007 (22 of 2007), accordingly, has omitted clause (*x*) from the said sub-section.

22.6 *Applicability.*—This amendment will take effect from 1-4-2008, and will accordingly apply in relation to the assessment year 2008-09 and subsequent assessment years. [*Section 13*]'.

EXPENDITURE IN RESPECT OF A NON-Y2K COMPLIANT COMPUTER SYSTEM [S. 36(1)(*xi*) of 1961 Act]

Introduction under 1961 Act.—*The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 36(1)(*xi*)** has been **inserted** (**w. e. f. 1-4-2000**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 779, dated 14-9-1999*, as follows:—

'**22.** *Deduction of Y2K expenditure.*—**22.1** The change in the millennium is expected to create a major software problem in respect of the computer systems which are not Y2K compliant, that is, which are not programmed to correctly reckon dates within and between the 20th and 21st centuries. In order to ensure that the business entities run their businesses smoothly without hindrance and to avoid possible disruption in the economic activities of the country as a whole at the time of entering the new millennium, it is essential that the existing computer systems being used by the business entities are made Y2K compliant.

22.2 With a view to encourage the business entities to make their existing computer systems Y2K compliant at the earliest, the Finance Act, 1999 (27 of 1999), inserts a new clause (*xi*) in sub-section (1) of

section 36 of the Income-tax Act to provide for allowability of 100% deduction, in computing the profits and gains of business or profession, of any expenditure, whether capital or revenue, incurred in respect of existing non-Y2K compliant computer system so as to make it a Y2K compliant computer system. In order to avail of the deduction under the new provision, the following conditions need to be satisfied:—

(*i*) there should be an existing computer system which is owned by the assessee and used for the purposes of his business or profession;

(*ii*) such existing computer system should be a non-Y2K compliant computer system;

(*iii*) the assessee should incur the expenditure wholly and exclusively in respect of such non-Y2K compliant computer system so as to make such computer system a Y2K compliant computer system;

(*iv*) the expenditure should have been incurred during the period 1-4-1999 to 31-3-2000;

(*v*) the assessee should furnish along with the return of income the report of an accountant in the prescribed form certifying that the deduction has been correctly claimed in accordance with the provisions of this section. The prescribed form and rule in this regard have already been notified by the Central Board of Direct Taxes *vide* SO No. 479(E), dated 23-6-1999.

22.3 The deduction is allowable in respect of any expenditure incurred on an existing computer system so as to make it a Y2K compliant computer system and such existing computer system should continue to remain in existence after having made it a Y2K compliant computer system. The deduction will not be allowable under this section in respect of an expenditure which results in discarding the existing computer system and acquisition of a new computer system. The expenditure incurred on acquisition of new Y2K compliant computer system will be eligible for depreciation at the prescribed rates.

22.4 This amendment will take effect from the 1-4-2000, and will, accordingly, apply in relation to the assessment year 2000-2001 only. [*Section 22*]'.

BANKING CASH TRANSACTION TAX [S. 36(1)(*xiii*) of 1961 Act]

Introduction under 1961 Act.—*The Finance Act, 2005.*—By **the Finance Act, 2005** (18 of 2005), **section 36(1)(*xiii*)** has been **inserted** (**w. e. f. 1-4-2006**).

Deduction on account of payment of BCTT.—Any amount of banking cash transaction tax (BCTT) paid by the assessee during the previous year on the taxable banking transactions entered into by him was admissible as deduction.

LexisNexis

As per **section 94(3)** of **the Finance Act, 2005** (18 of 2005), "banking cash transaction tax" **meant** tax leviable on the taxable banking transactions under the provisions of Chapter VII of the Finance Act, 2005.

As per **section 94(8)** of **the Finance Act, 2005** (18 of 2005), "taxable banking transaction" **meant**:—

(*a*) Withdrawal of cash (by whatever mode) on any single day from an account (other than a savings bank account) maintained with any scheduled bank—

—exceeding ₹ 25,000, if such withdrawal was from the account maintained by any individual or an HUF; and

—exceeding ₹ 1,00,000, if such withdrawal was from the account maintained by a person (other than any individual or an HUF); or

(*b*) Receipt of cash from any scheduled bank on any single day on encashment of one or more term deposits, whether on maturity or otherwise, from that bank—

—exceeding ₹ 25,000, if such term deposit(s) were in the name of any individual or an HUF; and

—exceeding ₹ 1,00,000, if such term deposit(s) were by any person (other than any individual or an HUF).

In respect of every taxable banking transaction entered into between 1-6-2005 and 31-3-2009, BCTT was charged @ 0.1% of the value of every such taxable banking transaction.

Omitted/Phased-out provisions of sections 37(2) to (5) [excluding section 37(2B)] of the 1961 Act

[*Page 5792 of Volume 4 of Chaturvedi & Pithisaria's Income Tax Law, 9th Edition*]

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1962.*—By **the Finance (No. 2) Act, 1962** (20 of 1962), **section 37(2)** has been **amended** (**w. e. f. 1-4-1962**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 22, dated 1-8-1962*, as follows:—

'*Entertainment expenses.*—**24.** Section 4 of the Finance (No. 2) Act, 1962, has made certain amendments in section 37(2) of the Income-tax Act, 1961, which have the effect of reducing the amount of entertainment expenses which are admissible as a deduction in the case of a company. The graduated rates applicable to various slabs of income for this purpose have been reduced from 3/4% and ½% to ½% and 1/4% respectively with the result that the maximum amount admissible has been reduced from Rupees one lakh to ₹ 60,000.'.

II. *The Finance Act, 1964.*—By **the Finance Act, 1964** (5 of 1964), **section 37(3)** has been **inserted** (**w. e. f. 1-4-1964**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 20, dated 7-7-1964*, as follows:—

'*Restrictions over expenditure incurred after 31st March, 1964, on advertisement, maintenance of residential accommodation, travelling, etc.*—**46.** The Minister of Finance has observed as follows in his Budget speech in the Lok Sabha on 29th February, 1964:

"I find that the provisions of the Income-tax Act allowing as deductible expenditure amounts spend wholly and exclusively for the purpose of business are being abused in respect of certain types of expenditure. Unduly large amounts are spent on daily allowance, on unnecessary bookings in planes and trains, on advertisement and on the maintenance of guest houses and suites or rooms in hotels outside the specific places of business, on providing conveyances and in paying high rents for accommodation for their officers and directors and in many other ways. I am afraid, this tendency amongst companies is responsible in no small measure for the present high costs and the time has come to put a check at least on some of these expenses. It is not practicable to spell out all the restrictions in detail in the Act itself as some room will always be left for those inclined to evade these provisions to find ways of doing so. I feel it is necessary to have the power to make rules in this behalf where a specific provision is not practicable.".

47. A provision, having this object in view, has been made by section 9 of the Finance Act, 1964, in a new sub-section (3) introduced in section 37 of the Income-tax Act. This sub-section provides that notwithstanding anything contained in sub-section (1) of section 37 (admissibility of any expenditure, other than that covered by sections 30 to 36 of the Income-tax Act, and capital expenditure and personal expenses, laid out or expended wholly or exclusively for the purpose of business or profession), any expenditure incurred by an assessee after 31st March, 1964, on advertisement, maintenance of residential accommodation (including a guest house) or in connection with travelling by an employee or any other person (including hotel expenses and allowances) shall be allowed as a deduction in computing the income from business or profession only to the extend and subject to such conditions, if any, as may be prescribed in the Income-tax Rules. This provision is applicable to non-company assessees also, and covers the computation of the assessable income from profession, besides income from business. As it applies only to expenditure incurred after 31st March, 1964, assessments for the assessment year 1964-65 where the relevant previous year ends on or before 31st March, 1964, will not be affected by it. Rules under this provision are being formulated and will be notified shortly.'.

III. *The Finance Act, 1965.*—By **the Finance Act, 1965** (10 of 1965), **section 37(2)(*i*)** has been **amended** (**w. e. f. 1-4-1965**).

IV. *The Taxation Laws (Amendment) Act, 1967.*—By **the Taxation Laws (Amendment) Act, 1967** (27 of 1967), **section 37(2A)** has been **inserted** (**w. e. f. 1-10-1967**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Press Note, dated 14-9-1967*, as follows:—

'*Restrictions on deduction of entertainment expenditure in business and profession: Changes made by the Taxation Laws (Amendment) Ordinance, 1967.*—.... At present, entertainment expenditure is deductible in computing the taxable income from business or profession, if it is wholly and exclusively incurred for the purpose of the business or profession. However, in the case of companies, the Income-tax Act lays down a limit over the amount of entertainment expenditure which can be allowed as deduction. The limit is: 1 per cent of the

LexisNexis

first ₹ 10 lakhs of the profits and gains of the business or ₹ 5,000, whichever is higher; ½ per cent of the next ₹ 40 lakhs of the profits; ½ per cent of the next ₹ 120 lakhs of profits; and *'nil'* in respect of the balance of the profits. Thus, the maximum amount of deduction allowable at present is ₹ 60,000, which is reached where the profits of a company amount to or exceed ₹ 170 lakhs.

Under the Ordinance, deduction in respect of entertainment expenditure incurred after September 30, 1967, by any taxpayer, whether corporate or non-corporate, will be restricted to one-half of the percentage limit at present applicable to companies. This new limit is: ½ per cent of the first ₹ 10 lakhs of the profits of the business or profession, or ₹ 5,000, whichever is higher; ¼ per cent of the next ₹ 40 lakhs of the profits; ⅛ per cent of the next ₹ 120 lakhs of the profits; and *'nil'* in respect of the balance. The maximum deduction admissible will, thus, be ₹ 30,000, which will be reached where the profits and gains of the business or profession amount to, or exceed, ₹ 170 lakhs. Where the profits amount to ₹ 10 lakhs or less, or where there are no profits, and the taxpayer has incurred entertainment expenditure, deduction for it will be limited to ₹ 5,000.

The Ordinance has made transitional provisions for tax-payers whose accounting year falls partly before and partly after September 30, 1967. In such a case, where the tax-payer is a company, the deduction for entertainment expenditure incurred before October 1, 1967, will be limited to a proportion of the amount calculated in accordance with the present limits. This proportion will be the proportion which the number of days from the commencement of the accounting year up to September 30, 1967, bears to the total number of days in the accounting year. The deduction for entertainment expenditure incurred by the company after September 30, 1967, will be limited to the proportion of the amount calculated in accordance with the limits laid down by the Ordinance which the number of days in the accounting year from October 1, 1967, to the end of the accounting year bears to the total number of days in the accounting year. Where the tax-payer is not a company, no monetary limit will be applicable in respect of entertainment expenditure incurred up to September 30, 1967, but the deduction in respect of entertainment expenditure incurred after September 30, 1967, will be limited in the same manner as in the case of companies.'.

V. *The Finance Act, 1968.*—By **the Finance Act, 1968** (19 of 1968), ***Explanation* to section 37(2A)** has been **inserted** (**w. e. f. 1-4-1968**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 6P, dated 6-7-1968*, as follows:—

'*Entertainment expenditure incurred through employees in businesses and professions.*—**67.** Under section 37(2A) of the Income-tax Act [introduced by the Taxation Laws (Amendment) Act, 1967], the deduction in respect of entertainment expenditure incurred in businesses and professions is limited to certain percentages of the profit of the business or profession. The maximum amount of entertainment expenditure deductible under this provision is ₹ 30,000 in a case where the profits and gains of the business or profession amount to ₹ 1.70 crores or more during the year. These limits are, in practice, circumvented by the grant of entertainment allowances to employees or by reimbursement to them of entertainment expenditure incurred by them for the purpose of the business. In order to make the limitation over the deductible amount of the entertainment expenditure really effective in curbing wasteful or lavish entertainment, the Finance Act, 1968, has inserted an *Explanation* to section 37(2A). Under this *Explanation*, entertainment expenditure incurred in a business or profession, through the grant of entertainment allowance to employees or other persons or through 'expense accounts' operated by them, will be included in the 'entertainment expenditure' of the tax-payer for the purpose of applying the limits specified in this behalf in section 37(2A). Even though this provision takes effect from 1st April, 1968, it applies only to entertainment allowances paid to employees or other persons or entertainment expenditure incurred by an employee or any other person for the purpose of the business or profession of the tax-payer, after 29th February, 1968.'.

VI. *The Finance Act, 1970.*—By **the Finance Act, 1970** (19 of 1970), the following **amendments** (**w. e. f. 1-4-1970**) have been made—

—***Explanation* to section 37(2A)** has been **amended**;

—**section 37(2B)** has been **inserted**; and

—**section 37(4)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 45, dated 2-9-1970*, as follows:—

'*Entertainment expenditure incurred in businesses and professions.*—**33.** Under section 37 of the Income-tax Act, prior to its amendment by the Finance Act, 1970, entertainment expenses incurred in businesses and professions, including expenditure incurred through grant of entertainment allowances to directors or employees or through "expense accounts" operated by them, have been allowable as a deduction in computing the profits and gains of the business and profession, subject to certain limits specified in the law

for this purpose. The maximum deduction available in any case is ₹ 30,000 and this limit is reached when the profits of the business or profession amount to ₹ 1,70,00,000.

34. With a view to curbing the tendency for ostentatious entertainment by business houses, the Finance Act, 1970, has amended section 37 of the Income-tax Act by inserting a new sub-section (2B) in that section under which entertainment expenditure incurred in India after 28th February, 1970, will be disallowed altogether in computing the profits and gains of business or profession. Entertainment expenditure incurred outside India will continue to be admissible as a deduction subject to the limits already provided in the law in this behalf. This provision takes effect from 1st April, 1970, and applies to assessments for and from the assessment year 1970-71. [*Section 37(2A) of the Income-tax Act as amended by section 10(a) of the Finance Act, 1970, and section 37(2B) of the Income-tax Act inserted by section 10(b) of the Finance Act, 1970*]

Guest houses maintained in businesses and professions.—**35.** Under the Income-tax Act, prior to its amendment by the Finance Act, 1970, expenditure incurred by an assessee on the maintenance of guest houses for the purposes of his business or profession has been allowable as a deduction in computing the profits and gains of the business or profession, subject to certain limits and conditions specified in the Income-tax Rules. These Rules cover expenditure on guest houses maintained at the principal place of the business or profession in India, any place where the assessee has an establishment for processing of raw materials, manufacture, processing or production of any article or thing, or any other industrial establishment employing not less than 50 whole-time employees throughout the relevant year, and, in the case of a business or profession having not less than 100 whole-time employees on its rolls, also "holiday homes" for the use of such employees while on leave. The rules also cover guest houses at Delhi and at two other places in India which may be either the capital of a State Government or any other place which is of direct importance to the business or profession. Banking companies are allowed to maintain guest houses at Bombay to facilitate liaison with the Reserve Bank of India. Accommodation hired or reserved in a hotel for a period of more than six months during the year is treated as a guest house for the purposes of the rules.

36. These provisions have been found to be of little effect in curbing proliferation of guest houses. In order to place an effective check on lavish expenditure on maintenance of guest houses, the Finance Act, 1970, has inserted a new sub-section (4) in section 37 of the Income-tax Act, under which expenditure incurred after 28th February, 1970, on the maintenance of guest houses, other than "holiday homes", will be disallowed altogether in computing the profits and gains of business or profession. This provision will cover not only the establishment and other charges for running the guest house but also depreciation on the building where this is owned by the assessee, and rent paid for the accommodation where this is taken on hire or lease. Depreciation on assets, such as air-conditioners, refrigerators, cooking ranges, furniture and fittings, etc., in the guest house will also be disallowed under the new provision. Where any charges are recovered from persons using the guest house, these will be deducted from the expenditure on maintenance and the depreciation, and only the balance will be disallowed in computing the profits of the business or profession. The provision, as inserted, will not, however, apply to "holiday homes" maintained by an assessee employing in his business or profession not less than 100 whole-time employees throughout the relevant year, where the "holiday home" is intended for the exclusive use of such employees while on leave.

37. The provision in sub-section (4) of section 37 takes effect from 1st April, 1970, and will be applicable for and from the assessment year 1970-71. However, the provision for disallowance of depreciation on the building in which the guest house is located and on the assets in the guest house, in clause (*ii*) of the said sub-section (4), will apply only from the assessment year 1971-72. [*Section 37(4) of the Income-tax Act inserted by section 10(c) of the Finance Act, 1970*]'.

VII. *The Finance Act, 1976.*—By **the Finance Act, 1976** (66 of 1976), the following **amendments** have been made—

—**section 37(2A)(*i*)** has been **amended** (**w. e. f. 1-4-1976**);

—***Explanation* to section 37(2A)** has been **amended** (**w. e. f. 1-4-1977**); and

—**section 37(2B)** has been **omitted** (**w. e. f. 1-4-1977**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 202, dated 5-7-1976*, as follows:—

'*Deduction in respect of entertainment expenditure.*—**24.1** Hitherto, no deduction in respect of any entertainment expenditure incurred within India was admissible in computing the taxable profits from a business or profession. Such expenditure incurred outside India was, however, allowed as deduction, subject to the following limits:—

(*i*) On the first ₹ 10,00,000 of the profits and gains of the business or profession (computed before making any allowance for development rebate or development	1/2 per cent or ₹ 5,000, whichever is higher.

allowance or in respect of entertainment expenditure).

(*ii*)	On the next ₹ 40,00,000 of such profits and gains	1/4 per cent
(*iii*)	On the next ₹ 1,20,00,000..	1/8 per cent
(*iv*)	On the balance of such profits and gains ..	*Nil*

24.2 The Finance Act, 1976, has amended section 37 of the Income-tax Act in order to provide for deduction in respect of entertainment expenditure whether within or outside India within the existing ceiling limits applicable in respect of entertainment expenditure incurred outside India. The percentage limits will, however, be calculated with reference to the quantum of profits and gains of the business or profession as reduced by not only development rebate, development allowance and entertainment expenditure but also by investment allowance admissible under the new section 32A.

24.3 This amendment will take effect from the 1st April, 1977, and will accordingly be applicable in relation to the assessment year 1977-78 and subsequent years.'.

VIII. *The Finance Act, 1978.*—By **the Finance Act, 1978** (19 of 1978), **sections 37(3A) to (3D)** have been **inserted** (**w. e. f. 1-4-1979**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 240, dated 17-5-1978*, as follows:—

'*Disallowance of a part of expenditure on advertisement, publicity and sales promotion.*—**12.1** In order to place a curb on extravagant and socially wasteful expenditure on advertisement, publicity and sales promotion at the cost of the Exchequer, the Finance Act, 1978, has inserted new sub-section (3A) in section 37 of the Income-tax Act for the disallowance of a part of such expenditure in the computation of taxable profits. The main features of the new sub-section (3A) read with related sub-sections (3B), (3C) and (3D) inserted in section 37 are as follows:—

(*a*) The provision for the disallowance of a specified portion of such expenditure will apply only in relation to expenditure on advertisement, publicity and sales promotion in India.

(*b*) Although this provision will apply to all categories of taxpayers carrying on any business or profession, no disallowance will be made in cases where the aggregate amount of such expenditure does not exceed ₹ 40,000.

(*c*) Where a taxpayer has set up an industrial undertaking for the manufacture or production of any articles, no disallowance will be made under this provision in respect of expenditure on advertisement, publicity or sales promotion incurred by the taxpayer for the purposes of the business of such undertaking for three previous years, namely, the previous year in which such undertaking begins to manufacture or produce such articles and the two previous years immediately following that year.

12.2 The amount to be disallowed under this provision will be calculated as under:—

(*i*)	Where the aggregate expenditure on advertisement, publicity and sales promotion in India does not exceed ¼ per cent of the turnover or, as the case may be, gross receipts of the business or profession	10 per cent of the "adjusted expenditure".
(*ii*)	Where such aggregate expenditure exceeds ¼ per cent but does not exceed ½ per cent of the turnover or, as the case may be, gross receipts of the business or profession	12½ per cent of the "adjusted expenditure".
(*iii*)	Where such aggregate expenditure exceeds ½ per cent of the turnover or, as the case may be, gross receipts of the business or profession	15 per cent of the "adjusted expenditure".

The expression "adjusted expenditure" has been defined to mean the aggregate expenditure incurred by a taxpayer on advertisement, publicity and sales promotion in India, as reduced by so much of such expenditure as is not allowed under section 37(1) and as further reduced by so much of such expenditure as is not allowed under section 37(3) of the Income-tax Act. The expressions "turnover" and "gross receipts" mean the turnover or gross receipts, as the case may be, as reduced by any discount or rebate allowed by the taxpayer.

12.3 The provisions of new sub-section (3A) will not apply in relation to any expenditure incurred by the taxpayer on the following, namely:—

(*i*) advertisement in any small newspaper;

LexisNexis

(*ii*) advertisement in any newspaper for recruitment of personnel;

(*iii*) the publication in any newspaper of any notice required to be published by or under any law;

(*iv*) the maintenance of any office for the purposes of advertisement, publicity or sales promotion;

(*v*) the payment of salary [as defined in clause (1) of section 17] to any employee engaged in advertisement, publicity or sales promotion;

(*vi*) the holding of, or the participation in, any press conference, sales conference, trade convention, trade fair or exhibition;

(*vii*) publication and distribution of journals, catalogues or price lists;

(*viii*) such other items as may be prescribed by rules framed by the Central Board of Direct Taxes.

For the purposes of this provision, a newspaper will be deemed to be a "small newspaper" if the average circulation of the newspaper in the calendar year in which such advertisement has been published is certified by the prescribed authority as not exceeding 15,000 copies. "Average circulation", in relation to any newspaper, will be taken to be the number arrived at by dividing the aggregate of the number of copies of such newspaper circulated during the calendar year by the total number of days on which such newspaper was published in that year. The term "newspaper" is not confined to a "daily" newspaper, but would also cover periodicals and journals.

12.4 As the terms "publicity" and "sales promotion" have a wide amplitude, expenditure incurred by taxpayers on fashion shows, beauty contests, consumer contests, consumer gift offers, and free samples or gifts will fall within the ambit of new sub-section (3A) of section 37 of the Income-tax Act.

12.5 For the removal of doubts, it has been clarified that nothing contained in new sub-section (3A) shall apply in relation to expenditure in the nature of entertainment expenditure incurred by a taxpayer in connection with advertisement, publicity or sales promotion and such expenditure shall be governed by sub-section (2A) of section 37 which lays down certain ceiling limits for the allowance of such expenditure.

12.6 These provisions will take effect from 1st April, 1979, and will, accordingly, apply in relation to the assessment year 1979-80 and subsequent years. [*Section 8 of the Finance Act, 1978*]'.

IX. *The Taxation Laws (Amendment) Act, 1978.*—By **the Taxation Laws (Amendment) Act, 1978** (29 of 1978), the following **amendments** (**w. e. f. 1-4-1979**) have been made—

—**section 37(3A)** has been **amended**; and

—***Explanation (a)* to section 37(3A)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 245, dated 11-8-1978*, as follows:—

'**7.** The Amending Act has also made certain consequential amendments in new sub-section (3A) directed to be inserted in section 37 of the Income-tax Act by the Finance Act, 1978. Section 37(3A) provides for the disallowance of a specified percentage of the "adjusted expenditure" incurred by an assessee on advertisement, publicity and sales promotion in India. Under the provision as enacted by the Finance Act, 1978, the term "adjusted expenditure" has been defined as the aggregate expenditure incurred by a taxpayer on advertisement, publicity and sales promotion in India *as reduced* by so much of such expenditure as is not allowed under section 37(1) or section 37(3) of the Income-tax Act. In consequence of the insertion of new sub-section (2B) relating to the disallowance of expenditure on advertisement in souvenirs, etc., published by political parties, the definition of the term "adjusted expenditure" has been amended to secure that the amount disallowed under new sub-section (2B) will also be deducted from the aggregate expenditure on advertisement, publicity and sales promotion in India for the purposes of computing the "adjusted expenditure".

8. The other amendment made in sub-section (3A) of section 37 is intended to clarify that the disallowance under that sub-section shall be without prejudice to the provisions of new sub-section (2B). [*Section 2(b) of the Amending Act*]'.

X. *The Finance Act, 1979.*—By **the Finance Act, 1979** (21 of 1979), ***Explanation 1* below section 37(3B)** has been **amended** (**w. e. f. 1-4-1979**).

The scope and effect of the above amendment have been elaborated in the following portion of the *Departmental Circular No. 258, dated 14-6-1979*, as follows:—

'**15.** *Omission of the requirement for certification of circulation figures of newspapers by the prescribed authority.*—**15.1** Section 37(3A) of the Income-tax Act provides for a disallowance, in the computation of taxable profits, of a specified percentage of expenditure incurred on advertisement, publicity and sales promotion where the aggregate expenditure exceeds ₹ 40,000. Sub-section (3B) of section 37 lays down that the provisions of sub-section (3A) will not apply in relation to any expenditure incurred by a taxpayer under specified categories which, *inter alia*, include any expenditure on an advertisement in a small newspaper. For

the purposes of this provision, a newspaper is deemed to be a small "newspaper" if the average circulation of the newspaper in the calendar year in which such advertisement has been published is certified by the "prescribed authority" as not exceeding 15,000 copies. For this purpose, "average circulation", in relation to a newspaper, is to be taken to be the number arrived at by dividing the aggregate of the number of copies of such newspaper circulated during the calendar year by the total number of days on which such newspaper was published in that year.

15.2 Since it is difficult for any single authority to certify the circulation of all newspapers, the Finance Act, 1979, has modified the provisions of *Explanation 1* below section 37(3B) so as to exclude the requirement of certification of the circulation of the newspapers by the prescribed authority. The effect of this modification will be that the burden of proving that the average circulation of the newspaper during the calendar year did not exceed 15,000 copies would hereafter be on the taxpayer.

15.3 In this connection it may be relevant to mention that under the Press and Registration of Books Act, 1867, every newspaper is required to furnish an annual return to the Registrar of Newspapers functioning under the Ministry of Information and Broadcasting. Government of India. Where the average circulation of the newspaper exceeds 2,000 copies, the publisher of the newspaper has to obtain a certificate from a chartered accountant certifying the circulation figures of the newspaper. A taxpayer who claims to exclude the expenditure on advertisement in a small newspaper under section 37(3B)(*i*) would be able to obtain an extract of the information regarding the average circulation given by the newspaper in its annual return. However, if a taxpayer produces a certificate from a chartered accountant regarding the average circulation of the newspaper before an Income-tax authority in support of his claim in this behalf, it should be regarded as relevant evidence.

15.4 This provision takes effect from 1st April, 1980, and will accordingly apply in relation to the assessment year 1980-81 and subsequent years. [*Section 7 of the Finance Act, 1979*]'.

XI. *The Finance (No. 2) Act, 1980.*—By **the Finance (No. 2) Act, 1980** (44 of 1980), **sections 37(3A) to (3D)** have been **omitted** (**w. e. f. 1-4-1981**).

The scope and effect of the above omission have been elaborated in the following portion of the *Departmental Circular No. 281, dated 22-9-1980*, as follows:—

'**13.** *Discontinuance of provisions relating to the disallowance of a part of expenditure on advertisement, publicity and sales promotion.*—**13.1** Under sub-section (3A) of section 37 of the Income-tax Act, a part of the expenditure incurred in India on advertisement, publicity and sales promotion is disallowed in cases where the aggregate of such expenditure exceeds ₹ 40,000. Sub-sections (3B), (3C) and (3D) also contain some related provisions. The Finance (No. 2) Act, 1980, has repealed the aforesaid sub-sections (3A), (3B), (3C) and (3D) of section 37 and accordingly the expenditure on advertisement, publicity and sales promotion will now be admissible as deduction in computing the profits and gains of business or profession subject, however, to the fulfilment of requirements of sub-sections (1) and (3) of section 37 of the Income-tax Act read with rule 6B of the Income-tax Rules.

13.2 This amendment will take effect from 1st April, 1981, and will accordingly apply in relation to the assessment year 1981-82 and subsequent years. [*Section 10 of the Finance (No. 2) Act, 1980*]'.

XII. *The Finance Act, 1983.*—By **the Finance Act, 1983** (11 of 1983), the following **amendments** have been made—

—**section 37(2A)(*iii*)** has been **substituted** (**w. e. f. 1-4-1984**) for the then existing sections 37(2A)(*iii*) and (*iv*);

—***Explanation* to section 37(2A)** has been **numbered** (**w. r. e. f. 1-4-1976**) as ***Explanation 1* thereof**;

—***Explanation 2* to section 37(2A)** has been **inserted** (**w. r. e. f. 1-4-1976**);

—**sections 37(3A) to (3D)** have been **inserted** (**w. e. f. 1-4-1984**); and

—**section 37(5)** has been **inserted** (**w. r. e. f. 1-4-1979**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 372, dated 8-12-1983*, as follows:—

'*Provision for curbing avoidable or ostentatious expenditure in business or profession.*—**30.** Section 37 of the Income-tax Act provides for deduction in the computation of taxable profits of any expenditure, other than expenditure of the nature described in sections 30 to 36 and section 80VV‡, or expenditure in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession carried on by the taxpayer. With a view to curbing certain categories of avoidable or ostentatious expenditure by assessees carrying on business or profession, the

‡ Section 80VV has been omitted by the Finance Act, 1985, w.e.f 1-4-1986.

LexisNexis

Finance Act, 1983, has made certain amendments to section 37 of the Income-tax Act. The substance of these amendments is explained in paragraphs 31 to 34 hereunder.

Entertainment expenditure.—**31.1** For the removal of doubts regarding the scope of the expression "entertainment expenditure", the Finance Act, 1983, has inserted a new *Explanation* for the purpose of sub-section (2A) of section 37 and also sub-section (2B) of that section as that sub-section stood before 1st April, 1977. The *Explanation* clarifies that "entertainment expenditure" includes expenditure on provision of hospitality of every kind by the assessee to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom, usage or trade. However, expenditure incurred in providing food or beverages by an employer to his employees in office, factory or other place of their work will not be regarded as entertainment expenditure.

31.2 This amendment takes effect retrospectively from 1st April, 1976, and will, accordingly, apply in relation to the assessment year 1976-77 and subsequent years.

32.1 Under the existing provisions of section 37(2A) of the Income-tax Act, deduction in respect of expenditure on entertainment is subject to certain limits calculated with reference to the quantum of profits as follows:

(*i*) On the first ₹ 10 lakhs of the profits and gains of business or profession (as computed before making any deduction in respect of investment allowance, development rebate or development allowance or in respect of entertainment expenditure), at the rate of ½ per cent of the profits or ₹ 5,000, whichever is higher;

(*ii*) On the next ₹ 40 lakhs of the profits and gains as so computed at the rate of ¼ per cent of such profits;

(*iii*) On the next ₹ 1,20,00,000 of such profits and gains at the rate of per cent of such profits;

(*iv*) On the balance of such profits and gains, *nil*.

The maximum deductible amount computed under the aforesaid table works out to ₹ 30,000 only.

32.2 The Finance Act, 1983, has modified the provision relating to expenditure qualifying for deduction. While the deduction in respect of the first two slabs of the above table remains unchanged, on profits in excess of ₹ 50 lakhs, deduction will be allowed at the rate of ⅛ per cent of such profits. It has, however, been provided that the maximum deduction shall in no case exceed ₹ 50,000 as against ₹ 30,000 available under the existing table of rates.

LexisNexis

32.3 This amendment takes effect from 1st April, 1984, and will, accordingly, apply in relation to the assessment year 1984-85 and subsequent years. [*Section 17(a) of the Finance Act, 1983*]'.

Partial disallowance of certain expenses.—**33.1** The Finance Act, 1983, has inserted four new sub-sections (3A), (3B), (3C) and (3D) in section 37 of the Income-tax Act. Sub-section (3A) provides that where the aggregate expenditure incurred by any assessee on any one or more of the specified items of expenditure exceeds ₹ 1 lakh, twenty per cent of such excess shall not be allowed as deduction in computing the taxable profits.

33.2 New sub-section (3B) specifies the following items of expenditure for the purposes of this disallowance:—

(*a*) Advertisement, publicity and sales promotion.

(*b*) Running and maintenance of aircraft and motor cars.

(*c*) Payments made to hotels.

The *Explanation* to the aforesaid sub-section clarifies that—

(*a*) Expenditure incurred by the assessee under the specified heads will be reduced by so much of such expenditure as is not allowed under any other provision of the Income-tax Act and the disallowance under the new provision will be made only with reference to the balance.

(*b*) Expenditure on advertisement, publicity and sales promotion shall *not* include remuneration to the employees of the assessee engaged in the said activities. Hence, such remuneration will not be taken into account for the purposes of the disallowance under this provision.

(*c*) Expenditure on chartering aircraft of the hire charges for engaging cars plied for hire or expenditure on payment of conveyance allowance to employees or directors will be taken into account for the purposes of this disallowance.

33.3 New sub-section (3C) provides that the provision in sub-section (3A) relating to disallowance of expenditure will not apply in relation to expenditure incurred wholly and exclusively by domestic companies and resident non-corporate taxpayers (*a*) on advertisement, publicity and sales promotion outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business; or (*b*) on running and maintenance of motor cars in any branch, office or agency maintained outside India for the promotion of the sale outside India of such goods, services or facilities.

33.4 New sub-section (3D) provides that no disallowance under sub-section (3A) shall be made in the case of an assessee engaged in the business of operation of aircraft, in respect of expenditure incurred on the running and maintenance of aircraft. Similarly, expenditure incurred on maintenance and running of motor cars for hire will not be taken into account for the purposes of this disallowance in the case of persons engaged in the business of running motor cars on hire.

33.5 These amendments take effect from 1st April, 1984, and will, accordingly, apply in relation to the assessment year 1984-85 and subsequent years. [*Section 17(b) of the Finance Act, 1983*]'.

Expenditure on maintenance of guest houses.—**34.1** A new sub-section (5) has been inserted in section 37 by way of a clarificatory amendment to provide that for the purposes of the existing provisions contained in sub-section (4) of the said section relating to disallowance of expenditure on maintenance of guest houses, any accommodation maintained, hired or reserved or otherwise arranged by the assessee for providing lodging, or boarding and lodging, to any person (including any employee or, where the assessee is a company, also any director of, or the holders of any other office, in the company) on tour or visit to the place at which such accommodation is situated, will be regarded as accommodation in the nature of a guest house.

34.2 This amendment takes effect retrospectively from 1st April, 1979, and will accordingly apply in relation to the assessment year 1979-80, and subsequent years. [*Section 17(c) of the Finance Act, 1983*]'.

XIII. *The Finance Act, 1985.*—By **the Finance Act, 1985** (32 of 1985), **sections 37(3A) to (3D)** have been **omitted** (**w. e. f. 1-4-1986**).

The scope and effect of the above omission have been elaborated in the following portion of the *Departmental Circular No. 421, dated 12-6-1985*, as follows:—

'**19.** *Withdrawal of provision for partial disallowance of certain items of business expenditure.*—**19.1** Section 37(3A) of the Income-tax Act, 1961, provides that where the aggregate expenditure incurred by a taxpayer on any one or more of specified items of expenditure exceeds ₹ 1 lakh, twenty per cent of such excess shall not be allowed as deduction in computing the taxable profits. The following items of expenditure have been specified for the purpose of this disallowance:

(*a*) Advertisement, publicity and sales promotion.

(*b*) Running and maintenance of aircraft and motor cars.

(*c*) Payments made to hotels.

19.2 On a review of these provisions, it has been decided to discontinue this disallowance. The Finance Act, 1985, has accordingly amended section 37 to achieve this objective.

19.3 This amendment takes effect from 1st April, 1986, and will, accordingly, apply in relation to the assessment year 1986-87 and subsequent years. [*Section 11 of the Finance Act, 1985*]'.

XIV. *The Finance Act, 1992.*—By **the Finance Act, 1992** (18 of 1992), **section 37(2)** has been **substituted** (**w. e. f. 1-4-1993**) for the then existing sections 37(2) and (2A).

The scope and effect of the above substitution have been elaborated in the following portion of the *Departmental Circular No. 636, dated 31-8-1992*, as follows:—

'*Increasing the limit of allowable business expenses.*—**30.** Under section 37 of the Income-tax Act, there were restrictions on the quantum of expenses allowable as entertainment expenditure. Similarly, there were restrictions under sub-section (12) of section 40A of the Income-tax Act on the admissible expenditure for services in connection with any proceeding under the Income-tax Act.

30.1 The Finance Act, 1992, has liberalised the allowable deductions as under:—

(*a*) In respect of entertainment expenditure, actual expenditure upto ₹ 10,000 and 50% of the balance. This has been done by substitution of a new sub-section (2) for sub-sections (2) and (2A) in section 37 of the Income-tax Act;

(*b*) In respect for expenditure for services in connection with any proceeding under the Income-tax Act, the actual expenses. This has been achieved by omission of sub-section (12) of section 40A.

Further, in cases of articles of gifts, the Income-tax Rules have been amended by the Income-tax (Tenth Amendment) Rules, 1992, to provide that in respect of each article of gift 100% of the actual expenses upto ₹ 1,000 will be allowed and if the cost is more than ₹ 1,000 then 50% of the balance. Similarly, in case of hotel expenses the Income-tax Rules have also been amended and it has been provided that actual expenses

upto ₹ 1,500 per day will be allowed and if the expenditure exceeds ₹ 1,500, 75% of the balance will be allowed.

30.2 The operation of these provisions will take effect from 1st April, 1993, and will, accordingly, apply for the assessment year 1993-94 and onwards. [*Sections 15 & 17*]'.

XV. *The Finance Act, 1994.*—By **the Finance Act, 1994** (32 of 1994), **section 37(2)** has been **amended** (**w. r. e. f. 1-4-1993**).

XVI. *The Finance Act, 1997.*—By **the Finance Act, 1997** (26 of 1997), **sections 37(2), (3), (4) and (5)** have been **omitted** (**w. e. f. 1-4-1998**).

The scope and effect of the above omissions have been elaborated in the following portion of the *Departmental Circular No. 763, dated 18-2-1998*, as follows:—

'**22.** *Amendment of section 37 of the Income-tax Act.*—**22.1** Sub-section (1) of section 37 is a residuary section, which allows any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession as a deduction in computing the income under the head "Profits and gains of business or profession". Sub-sections (2), (2B), (3), (4) and (5) provide exceptions to the aforesaid general rule of allowance.

22.2 Sub-section (2) deals with expenditure in the nature of entertainment expenditure.

22.3 Sub-section (2B) disallows any expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

22.4 Sub-section (3) read with sub-sections (4) and (5) deals with any expenditure incurred by an assessee on advertisement, or on maintenance of any residential accommodation including any accommodation in the nature of a guest house or in connection with travelling by an employee or by any other person.

22.5 Rule 6B of the Income-tax Rules, 1962, lays down the amount deductible in respect of articles intended for presentation.

22.6 Rule 6D lays down the limits on deduction of expenditure incurred on hotel or allowance during the course of travel.

22.7 The restrictive provisions as contained in sub-sections (2), (3) and (4) were introduced with a view to discourage ostentatious expenditure. There has been frequent litigation in interpretation of these provisions. In order to simplify the Act and to bring the concept of income nearer to the concept of "profit", these provisions have been deleted. However, the provisions of sub-section (2B) regarding disallowance of expenditure on advertisement in any souvenir, etc., published by a political party will continue to be in force.

22.8 This amendment will take effect from the 1st April, 1998, and will, accordingly, apply in relation to the assessment year 1998-99 and subsequent years. [*Section 8*]'.

LexisNexis

ENTERTAINMENT EXPENDITURE
[Omitted ss. 37(2) & 37(2A) of 1961 Act]

Provisions.—Before 1-4-1961, entertainment expenses were to be judged on their merits under the provisions of section 10(2)(*xv*) of the 1922 Act, without any statutory limit as to their extent and quantum. The Finance Act, 1961, inserted a proviso to section 10(2)(*xv*), thereby fixing, in the case of company assessees, a ceiling on the extent of allowance of entertainment expenses, related to or dependent on the amount of profits and gains earned. These provisions were reflected in **section 37(2)** of the 1961 Act, although the extent was reduced on higher slabs as follows:—

Income	*Rate before 1-4-1962*	*Rate between 1-4-1962 and 30-9-1967*
(*i*) On the first Rs. 10,00,000 of the profits and gains of the business computed before making any allowance under section 33[1] or section 33A[2] or in respect of entertainment expenditure	@ 1% of the profits or Rs. 5,000, whichever is higher;	@ 1% of the profits or Rs. 5,000, whichever is higher;
(*ii*) On the next Rs. 40,00,000 of the profits and gains of the business (computed in the manner aforesaid)	@ ¾ % of the profits;	@ ½ % of the profits;
(*iii*) On the next Rs. 1,20,00,000 of profits and gains of the	@ ½ % of the profits;	@ ¼ % of the profits;

1. In the 1922 Act, the words were under clause (*vib*) of section 10(2). In the 1961 Act, the words were under section 33; the words or section 33A were inserted by the Finance Act, 1965 (10 of 1965), with effect from 1-4-1965.
2. In the 1922 Act, the words were under clause (*vib*) of section 10(2). In the 1961 Act, the words were under section 33; the words or section 33A were inserted by the Finance Act, 1965 (10 of 1965), with effect from 1-4-1965.

Income	*Rate before 1-4-1962*	*Rate between 1-4-1962 and 30-9-1967*
business (computed in the manner aforesaid)		
(*iv*) On the balance of the profits and gains	*Nil*	*Nil*

The words "the business" used in section 37(2) of the 1961 Act are not only restricted to the "assessee's own business", but are comprehensive enough to include partnership business wherein the assessee is a partner. Thus, for ascertaining the quantum of allowable entertainment expenditure on percentage basis, the base is supplied by the profits and gains of the assessee's own business as well as share income from the partnership firm wherein the assessee is a partner. However, dividends, interest on securities and capital gains are to be excluded [*Patel Engineering Co. Ltd. v. CIT,* (1982) 135 ITR 49 (Bom), **followed in** *Patel Engineering Co. Ltd. v. CIT,* (1984) Taxation 75(1)-18 (Bom)].

On the point of allowability of entertainment expenses under section 37(2) of the 1961 Act, reference may also be made to *CIT v. Advance Insurance Co. Ltd.*, (1979) 119 ITR 660, 663-4 (Bom).

In spite of the fact that the provisions of section 37(2) of the 1961 Act have been overridden by the newly inserted (w. e. f. 1-10-1967) **section 37(2A)** of the 1961 Act by the Taxation Laws (Amendment) Act, 1967 (27 of 1967), the Rajasthan High Court, in *Sunil Synchem Ltd. v. CIT*, (1994) 205 ITR 298, 302-03 (Raj) has **proceeded on the wrong assumption** that section 37(2) of the 1961 Act is a specific provision in relation to a company-assessee even in respect of the assessment year 1977-78 and has held that expenses incurred on inaugural function have to be allowed subject to the restrictions imposed by section 37(2) of the 1961 Act. Truly and legally speaking the provisions of section 37(2) of the 1961 Act have been overridden in case of a company-assessee in relation to 'any previous year which expires after the 30th of September, 1967' by the provisions of section 37(2A) of the 1961 Act, as it stood prior to its substitution by the Finance Act, 1992 (18 of 1992) (w. e. f. 1-4-1993). In that view of the matter, the Rajasthan High Court ought to have decided that case with reference to the provisions of section 37(2A) of the 1961 Act. It is pertinent to note that as the provisions of section 37(2) of the 1961 Act were not operative, the inclusive definition of 'entertainment expenditure' in the newly inserted *Explanation 2* to section 37(2A) of the 1961 Act by the Finance Act, 1983 (11 of 1983), with retrospective effect from 1-4-1976, has not made any reference to section 37(2) of the 1961 Act.

Also, the decision in *CIT v. Swadeshi Cotton Mills Co. Ltd.* [(1998) 232 ITR 618, 621-22 (All)] has **proceeded on the wrong assumption** that the provisions of section 37(2) of the 1961 Act are applicable to the assessee-company for the assessment year 1970-71. In that case, it has been held that the computation of the admissible entertainment expenses under section 37(2) of the 1961 Act has to be made with reference to the business income of the assessee-company as a whole and not with reference to each unit of the business of the assessee-company. This is so because section 37(2) of the 1961 Act refers to a company and not to its units.

The Assessing Officer allowed a deduction of 50% of Rs. 2 lakhs under section 37(2) of the 1961 Act. The expenditure incurred was for business purposes otherwise the entire amount would have been disallowed by the Assessing Officer. Even though there was no specific finding that the payment was made by the assessee for improving its business, there was an implicit acknowledgement that the expenses incurred by the assessee were for business purposes and the assessee was held eligible for deduction [*CIT v. Nestle India Ltd*., (2008) 296 ITR 682, 684 (Del)].

Under the 1922 Act or the 1961 Act as it stood before October 1, 1967, there was no limit to the extent of allowable entertainment expenses in the case of non-company assessees. Section 37(2A) of the 1961 Act, fixing such limits in case of all assessees (company as well as non-company), was first inserted by section 4 of the Taxation Laws (Amendment) Act, 1967 (27 of 1967), with effect from October 1, 1967.

Entertainment allowances given to employees.—Section 37(2) of the 1961 Act did not contain any definition of "entertainment expenditure". Then it was held that entertainment allowances given to employees did not form part of "entertainment expenditure" as contemplated by section 37(2) of the 1961 Act [*CIT v. Devkaran Nanjee Insurance Co. Ltd.,* (1977) 110 ITR 815 (Bom); *CIT v. British Paints* (*India*) *Ltd.,* (1972) Tax LR 892 (Cal). Also see, *CIT v. Allied Motors Pr. Ltd.,* (1982) 136 ITR 835 (Del) [holding that upto 31-3-1968 the entertainment allowances paid to the employees did not form part of 'entertainment expenditure' as contemplated by section 37(2) of the 1961 Act].

In *CIT v. Govindram Bros. Pr. Ltd.* [(1983) 141 ITR 777 (Bom)] and *CIT v. Govindram Bros. Pr. Ltd.*, (1983) 141 ITR 626 (Bom), the entertainment allowance paid to a director was held allowable under the provisions of the 1922 Act.

LexisNexis

In *Jet Lite* (*India*) *Ltd. v. CIT*, (2015) 379 ITR 185, 218 (Del) = (2016) 282 CTR (Del) 113 expenses claimed as conveyance expenses were in the nature of entertainment expenses as defined by section 37(2)(*iii*) of the 1961 Act.

However, earlier, the Board had issued **instructions** as follows:—

"*Entertainment allowance paid by companies to their employees—Whether to be treated as entertainment expenditure for the purpose of section 37(2)—Instructions regarding.*—Section 37(2) of the Income-tax Act, 1961 provides that expenditure in the nature of entertainment expenditure should be limited in the case of a company, to the amounts mentioned in that sub-section. A question has been raised whether the entertainment allowances granted by a company to its employees will constitute expenditure in the nature of entertainment expenditure incurred by the company within the meaning of section 37(2) for the purpose of applying the limits specified therein.

2. The Board have carefully examined the matter and it has been decided that where a company pays an amount to its employees for the purpose of entertainment, it is an expenditure in the nature of entertainment expenditure incurred by the company itself for the purpose of its business. In such cases, therefore, the entertainment allowance paid to the employees should be aggregated with the entertainment expenditure otherwise incurred by the company and the limits provided in section 37(2) should be applied to the aggregate of such amounts." [*Circular No. 12-D (LVIII-35) of 1967, dated 19-7-1967*]

Section 37(2A) of the 1961 Act, brought in with effect from 1st October, 1967, was, with effect from 1-4-1968, supplemented with an *Explanation* coining an inclusive definition of "entertainment expenditure" so as, also, to include—

(*i*) the amount of any allowance in the nature of entertainment allowance paid by the assessee to any employee or other person after 29-2-1968;

(*ii*) the amount of any expenditure in the nature of entertainment expenditure [not being expenditure incurred out of the allowance of the nature referred to (*ii*) in (*i*) above] incurred after 29-2-1968, for the purposes of the assessee's business by any employee or other person.

In *Jeewanlal* (*1929*) *Ltd. v. CIT* [(1991) 187 ITR 709, 713 (Cal)], it has been held that the amount paid by the assessee to its directors for attending on and entertaining business associates was in the nature of entertainment expenditure within the meaning of the above clause (*i*) of the *Explanation* to the said section 37(2A) of the 1961 Act.

Expenditure incurred by the assessees in providing ordinary meals to the outstation customers according to the established business practice was a permissible deduction in spite of section 37(2A) of the 1961 Act [*Cebon India Ltd. v. CIT*, (2016) 387 ITR 502, 509 (Punj)].

LexisNexis

Thus, entertainment expenses incurred in business and profession (including expenditure incurred through grant of entertainment allowances to directors or employees or through "expense accounts" operated by them) were, till 28-2-1970, allowed as a deduction in computing the profits of business or profession, subject to certain limits specified in **section 37(2A)** of the 1961 Act calculated with reference to profits of the business or profession. The maximum deduction available in any case was Rs. 30,000, and this limit reached when the profits of the business or profession amounted to Rs. 1,70,00,000.

With a view to curbing lavish expenditure on entertainment, **section 37(2B)** of the 1961 Act was inserted by the Finance Act, 1970 (19 of 1970), with effect from 1-4-1970, providing for the disallowance of entertainment expenditure incurred in India after 28-2-1970, altogether in computing the profits and gains of business or profession. Entertainment expenditure incurred outside India continued to be admissible as a deduction subject to the limits prescribed in section 37(2A) of the 1961 Act. In other words, even after the insertion of section 37(2B) of the 1961 Act, which remained operative for assessment years 1970-71 to 1976-77, the entertainment expenditure *incurred outside India* was to be allowed subject to the limits prescribed in section 37(2A) of the 1961 Act [*Phaltan Sugar Works Ltd. v. CIT,* (1995) 215 ITR 582, 585 (Bom)].

In *CIT v. K.P.V. Shaik Mohammed Rowther & Co.* (*P.*) *Ltd., (*1997) Tax LR 117, 119 (Mad), it has been held that the subscription paid, to clubs where the entertainment was given to the crew members of the vessels, etc., for becoming members of the said clubs, cannot be treated as entertainment expenditure coming under section 37(2B) of the 1961 Act, in relation to assessment years 1973-74 and 1974-75.

The Finance Act, 1976 (66 of 1976), has omitted, with effect from 1-4-1977, the said section 37(2B) of the 1961 Act. Thus, the said section 37(2B) of the 1961 Act remained in operation for assessment years 1970-71 to 1976-77 [*Phool Chand Gajanand v. CIT,* (1989) 177 ITR 265, 270 (All—FB)]. In that view of the matter, no deduction was held allowable, for assessment year 1976-77, in respect of expenditure incurred on customers in India by virtue of the provisions of section 37(2B) of the 1961 Act [*Poonam Chand Prem Raj v. CIT,* (1994) 207 ITR 895, 898 (Raj)]. Similarly, expenditure incurred, in connection with Race Ball Day, towards dinner and

other expenses for the members in the restaurant has been held entertainment expenditure not allowable under section 37(2B) of the 1961 Act [*Madras Race Club v. CIT,* (1994) 210 ITR 680, 682 (Mad)].

In *Avon Cycles Private Ltd. v. CIT*, (1999) 238 ITR 85, 87, 89 (Punj), the assessee was held not entitled to deduction in respect of the expenditure incurred on hotel bill for dealers, amount paid to diners club and the amount spent on dinner to Tanzanian dealers, for the assessment year 1975-76, in view of the banning provisions contained in the then section 37(2B) of the 1961 Act [even though the judgment has referred to section 37(2A) of the 1961 Act].

In *CIT v. Hira Lal & Sons*, (2000) 242 ITR 407, 409, 410-11 (Del), the Tribunal was held correct in law in allowing deduction, for assessment year 1975-76, of the expenditure of Rs. 31,864 incurred by the assessee on the living expenses of the foreign customers in spite of the express provisions contained in section 37(2B) of the 1961 Act because such expenditure could not be treated as 'entertainment expenditure', as interpreted by the Supreme Court in *CIT v. Patel Brothers & Co. Ltd.*, (1995) 215 ITR 165, 172-73 (SC).

In *CIT v. W.S Insulators of India Ltd.*, (2000) 243 ITR 348, 355 (Mad), without noticing the fact that the then section 37(2B) of the 1961 Act was omitted (w. e. f. 1-4-1977) by the Finance Act, 1976 (66 of 1976), it has been held that expenditure on entertainment could not be claimed as a deduction for assessment year 1977-78 in view of insertion (w. e. f. 1-4-1976) of the *Explanation* to section 37(2B) of the 1961 Act [which ought to have been *Explanation 2* to section 37(2A) of the 1961 Act]. It is pertinent to note that the then section 37(2B) of the 1961 Act banned deduction in respect of 'entertainment expenditure' as defined in that *Explanation 2* only for assessment year 1976-77.

Where the Tribunal has found that the expenditure was incurred, for the assessment years 1972-73, 1973-74 and 1974-75, in providing tea and coffee to the customers and the same could not be regarded as 'entertainment expenditure' as per the law as it stood prior to the insertion (w. e. f. 1-4-1976) of *Explanation 2* to section 37(2A) of the 1961 Act, even though section 37(2B) of the 1961 Act was operative for those three assessment years [*CIT v. Prasad Process* (*P.*) *Ltd.*, (2000) 243 ITR 830, 832 (Mad)].

In *CIT v. Indian Overseas Bank*: *Bharat Overseas Bank*, (2000) 244 ITR 120, 126 (Mad), the question regarding the disallowance of 'entertainment expenditure' under the then section 37(2B) of the 1961 Act was answered against the assessee and in favour of the Revenue.

In *CIT v. Nitco Roadways Ltd*., (2001) 161 Taxation 86, 87, 89 (J&K), the Tribunal was held right in law in holding that the expenditure incurred by the assessee in providing tea to its customers was not in the nature of entertainment expenditure as contemplated by section 37(2B) of the 1961 Act for the assessment year 1973-74. The enlarged definition of the expression 'entertainment expenditure' as contained in *Explanation 2* to section 37(2A) of the 1961 Act was operative for and from assessment year 1976-77 and was not applicable in relation to assessment year 1973-74.

In *CIT v. Modern Bakeries India Ltd*., (2004) 190 CTR (Del) 551, 552 = (2005) 273 ITR 237 (Del), it has been held that question relating to disallowance does not arise for reference since Tribunal arrived to the conclusion that section 37(2B) of the 1961 Act is not applicable to the facts of the instant case.

The assessee had provided free room and meal to one representative, a tourist agent. The provisions of section 37(2B) of the 1961 Act would not be attracted as the assessee had not incurred any expenditure in providing a hotel industry and no expenditure on this ground had been claimed by it as a deduction [*CIT v. U.P. Hotels Ltd*., (2005) 279 ITR 449, 450-51 (All)].

In *Saurashtra Cement & Chemical Industries Ltd. v. CIT*, (1995) 213 ITR 523, 530 (Guj), expenses of lavish nature were held not deductible as falling within the meaning of entertainment expenditure under section 37(2B) of the 1961 Act. As a result of this omission, the entertainment expenditure, even incurred in India, is eligible for deduction, for and from assessment year 1977-78, subject to the limits prescribed in section 37(2A) of the 1961 Act, which are as follows:—

Income	*Rate*
(*i*) on the first Rs. 10,00,000	@ ½% or Rs. 5,000, whichever is higher;
(*ii*) on the next Rs. 40,00,000	@ ¼%;
(*iii*) on the next Rs. 1,20,00,000	@ ⅛%;
(*iv*) on the balance	*Nil.*

The maximum deductible amount computed as per the above limits worked out to Rs. 30,000. That ceiling was applicable for assessment years 1977-78 to 1983-84.

As a result of the amendment of **section 37(2A)** of the 1961 Act by the Finance Act, 1983 (11 of 1983), with effect from 1-4-1984, the entertainment expenditure, even incurred in India, is eligible for deduction, for and

from assessment year 1984-85, subject to the limits prescribed in the amended section 37(2A) of the 1961 Act, which are as follows:—

(*i*)	on the first Rs. 10,00,000 of profits, etc.	@ ½% or Rs. 5,000[3], whichever is higher;
(*ii*)	on the next Rs. 40,00,000 of the profits, etc.	@ ¼% of such profits;
(*iii*)	on the balance	@ ⅛%.

It has, however, been provided that the maximum deduction shall in no case exceed Rs. 50,000[4].

The limit of permissible deduction of entertainment expenditure under the then section 37(2A) of the 1961 Act had to be applied only with reference to the income computed under section 28 of the 1961 Act under the head 'Profits and gains of business or profession'. The income computed under the then head 'Interest on securities' could not be taken into account [*CIT v. Vysya Bank Ltd.,* (1991) 190 ITR 77, 81 (Karn)].

For the purposes of allowing the entertainment expenditure under section 37(2A) of the 1961 Act, the profits and gains of the business should be taken to be the income without setting off the brought forward losses and unabsorbed depreciation of earlier years [*CIT v. Mangalore Chemicals & Fertilizers Ltd.,* (1991) 191 ITR 156, 164 (Karn)].

The above state of law remained operative up to assessment year 1992-93.

As a result of the **substitution** (w. e. f. 1-4-1993) of **section 37(2)** of the 1961 Act for the then existing sections 37(2) and 37(2A) of the 1961 Act by the Finance Act, 1992 (18 of 1992), and subsequently amended (w. r. e. f. 1-4-1993) by the Finance Act, 1994 (32 of 1994), any expenditure in the nature of entertainment expenditure incurred by any assessee during any previous year commencing on or after 1-4-1992, shall be allowed as follows:—

(*a*) where the amount of such expenditure does not exceed Rs. 10,000, the whole of such amount;

(*b*) in any other case, Rs. 10,000 as increased by a sum equal to 50 per cent. of such expenditure in excess of Rs. 10,000.

LexisNexis

This state of law remained operative **up to and including assessment year 1997-98** as a result of omission of section 37(2) of the 1961 Act by the Finance Act, 1997 (26 of 1997), with effect from 1-4-1998.

Inclusive definition of 'entertainment expenditure' coined with retrospective effect from 1-4-1976.—Prior to the insertion of an inclusive definition of the expression 'entertainment expenditure' in the newly inserted *Explanation 2* to section 37(2A) of the 1961 Act by the Finance Act, 1983 (11 of 1983), with retrospective effect from 1-4-1976, there was a cleavage of judicial opinion as to the implication of the expression 'entertainment expenditure' as is evidenced from the discussion under the paragraphs titled *'Entertainment expenditure—what it means and includes?'* under section 37(2), *post.*

For the import of this new definition of the expression 'entertainment expenditure', reference may be made to paragraphs 31.1 and 31.2 of the departmental circular No. 372, dated 8th December, 1983. Under that new definition, the expression "entertainment expenditure", for and from assessment year 1976-77,—

—**includes** expenditure on provision of hospitality of every kind by the assessee to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade,

—**but does not include** expenditure on food or beverages provided by the assessee to his employees in office, factory or other place of their work.

Further, it may be noted that the aforesaid definition has been coined not only for the purposes of section 37(2A) of the 1961 Act for and from assessment year 1976-77 but also for the purposes of section 37(2B) of the 1961 Act as it stood for the assessment year 1976-77 [see, *Karnataka State Financial Corporation v. CIT,* (1988) 174 ITR 212, 214 (Karn)].

Explanation 2 to section 37(2A) of the 1961 Act clearly postulates that benefits given to the workmen would not be included as entertainment expenditure [*CIT v. Ashok Kumar Manibhai Patel & Co*., (2009) 317 ITR 386, 390 (MP)].

---

3. Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, these monetary limits are to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

4. Where the transitional previous year in relation to assessment year 1989-90 exceeds 12 months, these monetary limits are to be increased proportionately as per the provisions of rule 3 of the Tenth Schedule to the 1961 Act read with the Table appended to that rule 3.

In view of *Explanation 2* to section 37(2A) of the 1961 Act, for assessment years 1978-79 and 1979-80, 20% of expenditure held admissible [*Jay Engg. Works Ltd. v. CIT*, (2008) 166 Taxman 55, 56 (Del)].

In *Indian Smelting & Refining Co. Ltd. v. Union of India*, (1994) Tax LR 347, 350-51, 352 (Bom), it has been held that Parliament was competent to enact *Explanation 2* to section 37(2A) of the 1961 Act as the same clearly falls under entry 82 of the Central List under the caption 'Taxes on income other than agricultural income'. Further, as the said *Explanation 2* is of the clarificatory nature and it is not brought with a view to introduce a new burden on the assessee, the retrospective effect given to that *Explanation 2* is valid having regard to the proposition of law laid down by the Supreme Court in *Escorts Ltd. v. Union of India*, (1993) 199 ITR 43 (SC).

From the legislative history and the introduction of the said *Explanation 2*, the Himachal Pradesh High Court was of the opinion that the Legislature always intended that entertainment expenditure included expenditure on provision of hospitality of every kind by the assessee. It was in order to resolve the ambiguity that *Explanation 2* was added [*CIT v. Mohan Meakin Breweries Ltd.,* (1991) 192 ITR 134, 143 (HP)].

In *CIT v. Grandlay Electricals* (*India*), (1992) 198 ITR 591, 593 (Del), a case relating to assessment year 1967-68, expenditure incurred in providing tea and cold drinks has been held to be regarded as 'entertainment expenditure' in view of the said *Explanation 2*, without noticing that the said *Explanation* was inserted retrospectively for and from assessment year 1976-77. However, in *CIT v. Central Distillery & Breweries Ltd.*, (1993) 202 ITR 45, 47 (Del), which is a case relating to assessment years 1976-77 and 1977-78, it has rightly been held that, in view of the said *Explanation 2*, expenditure incurred in providing meals, coffee, tea, etc., in the assessee's factory premises to its customers is to be regarded as 'entertainment expenditure'.

The widened meaning to the expression 'entertainment expenditure' given in the said *Explanation 2* cannot be extended to any assessment relating to assessment year 1975-76 or earlier year [*CIT v. Rajasthan Mercantile Co. Ltd.,* (1995) 211 ITR 400, 410, 416 (Del), **approved in** *CIT v. Patel Brothers & Co. Ltd.,* (1995) 215 ITR 165, 175-76 (SC). Also see, *CIT v. Bhagwandass Manhar Lal,* (1998) 145 CTR (Del) 319, 320].

The customary *Dewali gift*, *Dewali Bohni* or *Dewali Baksis* given during *Dewali* cannot be brought even within the ambit of the said *Explanation 2* [*CIT v. Shalimar Industries* (*P.*) *Ltd.,* (1995) 78 Taxman 521, 525 (Cal)].

In *English Electric Co. of India Ltd. v. CIT,* (1996) 218 ITR 478, 481, 482 (Mad), the amounts spent on provision of tea and coffee to the customers of the assessee-company were held allowable, for assessment year 1978-79, to the extent provided in section 37(2A) of the 1961 Act as such expenditure fell within the definition of *Explanation 2*. The High Court did not consider the contention that the tea and coffee had also been supplied to the employees and such part of the expenditure should not be disallowed by invoking section 37(2A) of the 1961 Act because such contention was neither raised before or considered by the Tribunal.

LexisNexis

In *CIT v. Green Roadways,* (1985) 154 ITR 639 (Raj), expenditure incurred in providing tea, coffee, soft drinks, etc., to customers has been held to be 'entertainment expenditure' within the meaning of *Explanation 2* to section 37(2A) of the 1961 Act. Also see, *CIT v. Yadav Transport Service,* (1987) 167 ITR 474 (Raj). Similarly, expenses incurred for presenting curios to the foreign buyers and for providing facilities to them have been held to be 'entertainment expenditure' within the meaning of that *Explanation 2* [*CIT v. Alleppey Co. Ltd.,* (1994) 207 ITR 598, 607 (Ker)]. Similar is the case with the expenditure on mess of foreign customers incurred in the accounting year relevant to assessment year 1976-77 [*CIT v. Polisetty Somasundaram Pvt. Ltd.,* (1997) 225 ITR 123, 124, 128 (AP), **distinguishing** *CIT v. Andhra Sugars Ltd.,* (1997) 225 ITR 118 (AP)]. Also see, *HMM Ltd. v. CIT,* (1998) 231 ITR 726, 733 (Punj).

In *CIT v. Sundaram Clayton Ltd.*, (1997) 226 ITR 81, 87-88 (Mad), expenses on guest house, mess account and cigarettes for customers have been held to fall under the category of entertainment expenditure. However, incidental expenditure like tips to the waiters in the hotels where the assessee's sales executives stayed and expenditure for photographs taken when the foreign dignitaries visited the assessee-company were held not to amount as entertainment expenditure in relation to assessment year 1979-80.

In *CIT v. South India Viscose Ltd.,* (1998) 229 ITR 203, 206 (Mad), mess expenses has been held deductible for assessment year 1974-75 but not for assessment years 1976-77 and 1977-78 as the said *Explanation 2* is operative for and from assessment year 1976-77.

In *CIT v. Broach Textile Mills,* CC Nos. 8535-36 of 1997: (1998) 229 ITR (St.) 74 (SC), their Lordships of the Supreme Court have, by an order dated 24-11-1997, dismissed on the ground of delay the special leave petition filed by the Department against the judgment dated 10-2-1993 and 12-7-1996, of the Gujarat High Court in ITR No. 390 of 1980 and M.C.A. No. 26 of 1996, whereby the High Court answered the reference in favour of the assessee on the question whether the Tribunal was right in law in holding that the amount of Rs. 15,955 being kitchen expenses and Rs. 500 in respect of tea expenses were not disallowable as entertainment expenditure under section 37(2B) of the 1961 Act.

In *CIT v. Jeevandas Laljee & Sons,* (1996) Tax LR 945, 946 (Mad), expenditure incurred on provision of tea, coffee, etc., to the customers and clients has been held to be regarded as entertainment expenditure as per *Explanation 2* to section 37(2A) of the 1961 Act.

In *CIT v. Tamilnadu Mercantile Bank Ltd.,* (1998) 232 ITR 454, 456 (Mad), in view of the retrospective amendment from 1-4-1976 of section 37(2A) of the 1961 Act by introducing a new *Explanation 2* by the Finance Act, 1983 (11 of 1983), the Tribunal was held not correct in coming to the conclusion that the expenditure incurred towards the supply of soft drinks to the customers could not be treated as entertainment expenditure and disallowed under section 37(2A) of the 1961 Act for the assessment year 1979-80.

In *CIT v. Eskaps* (*I.*) *Pvt. Ltd.,* (1991) 191 ITR 675, 676 (Cal), a case relating to assessment year 1976-77 and decided with reference to section 37(2B) of the 1961 Act, expenditure was incurred on a dinner party at Grand Hotel, Calcutta, wherein foreign representatives acting on behalf of foreign buyers of jute and jute goods and experts from jute mills were invited. It has been held that the expenditure was not in the nature of 'entertainment expenditure' within the meaning of section 37(2B) of the 1961 Act on the ground that the dinner party in the instant case was for promotion of business and not for social hospitality. It is pertinent to note that this case has been decided without noticing the definition of the 'entertainment expenditure', even for the purposes of section 37(2B) of the 1961 Act as it stood for the assessment year 1976-77, as contained in the newly inserted *Explanation 2* by the Finance Act, 1983 (11 of 1983) (w. r. e. f. 1-4-1976).

But, under that *Explanation 2*, messing expenses incurred for employees are not 'entertainment expenditure' [*CIT v. Central India Builders,* (1985) 156 ITR 453 (Guj)]. Also see, *CIT v. Ashok Kumar Manibhai Patel & Co.,* (2009) 317 ITR 386, 388 (MP). Similarly, expenditure for providing tea and coffee to the factory workers in the factory is outside the purview of the said *Explanation 2* [*CIT v. Anjani Kumar & Co. Pvt. Ltd.,* (1997) 227 ITR 786, 789-90 (Raj)]. Shareholders of a company cannot be treated as 'employees' within the meaning of that *Explanation 2* [see, *CIT v. Mysore Minerals Ltd.,* (1986) 162 ITR 562 (Karn)].

The provisions of *Explanation 2* to section 37 of the 1961 Act, specifically excludes expenditure on food or beverages provided by the assessee to the employees, *inter alia*, at an office, factory or other place of work. The phrase 'other place of work' would include any place where an employee of the assessee is asked to perform his work in connection with the business of the employer [*CIT v. Indian Rayon & Industries Ltd.*, (2011) 336 ITR 479 (Bom)].

When the employees are having their food along with the assessee-company's customers in a hotel, in discharge of their official duties, the employees are taking food while at work because it is their work and duty to entertain the customers of the company. Therefore, wherever any expenditure is incurred on the food and beverages of the employees at the time when they are working, would obviously be excluded from the purview of section 37(2A) of the 1961 Act [*CIT v. Expo Machinery Ltd.,* (1991) 190 ITR 576, 577 (Del)].

Where the expenditure is incurred on food or beverages provided by the assessee to his employees in office, factory or other places of their work as well as to the customers, such an expenditure does not fall within the enlarged meaning of 'entertainment expenditure' in the said *Explanation 2* [*CIT v. Andhra Sugars Ltd.,* (1997) 225 ITR 118, 122 (AP)].

Entertainment expenditure covered by section 37(2A) of the 1961 Act is allowable subject to the ceiling limits prescribed by that section [see, *Amritsar Transport Co. Pr. Ltd. v. CIT,* (1986) 161 ITR 18 (Punj); *Amritsar Transport Co.* (*P.*) *Ltd. v. CIT,* (1988) 174 ITR 377 (Punj); *Amritsar Transport Co.* (*P.*) *Ltd. v. CIT,* (1989) 178 ITR 574 (Punj)].

Applying the Supreme Court decision in *CIT v. Patel Brothers & Co. Ltd.,* (1995) 215 ITR 165 (SC), the Gauhati High Court has, in *CIT v. Assam Asbestos Ltd.,* (1999) 240 ITR 297, 299, 306-07 (Gauh), it has been held that the expenses on foreign tours of the dealers of the assessee amounting to Rs. 3,41,043 was allowable as business expenditure, for the assessment year 1987-88, as the same was incurred on account of sales promotion incentive scheme and such expenses were not in the nature of 'entertainment expenditure' whose allowability was restricted as per the provisions of the then section 37(2A) of the 1961 Act. On achieving the given target, a dealer became entitled for the reward promised, which in the present case was in the shape of foreign trip, and it became the duty or liability of the assessee to fulfil it. It was reward or something earned by the dealer on making extra efforts for the purpose. It was in return for the extra effort made. Therefore, it was neither hospitality nor entertainment provided by the assessee so as to attract the restrictive provisions of section 37(2A) of the 1961 Act.

In view of the insertion, for and from assessment year 1976-77, of *Explanation 2* to section 37(2A) of the 1961 Act, the Tribunal was held not justified in holding that the assessee was entitled to deduction of the expenditure of Rs. 54,305 incurred by the assessee in extending customary hospitality to the customers by

LexisNexis

offering meals, etc., under section 37(1) of the 1961 Act, because such expenditure was to be treated as 'entertainment expenditure' within the meaning of that *Explanation 2* so as to attract the restrictive provisions contained in section 37(2A) of the 1961 Act for the assessment year 1977-78 [*CIT v. Indian Plastics Ltd.*, (1999) 240 ITR 528, 530 (Bom)].

As held by the Supreme Court in *CIT v. Patel Brothers & Co. Ltd.,* (1995) 215 ITR 165 (SC), *Explanation 2* to section 37(2A) of the 1961 Act, which is also applicable to section 37(2B) of the 1961 Act, is not clarificatory and is operative only prospectively for and from assessment year 1976-77. That *Explanation* cannot be applied in relation to assessment year 1973-74. In that view of the matter, the Tribunal was held correct in holding that the amount claimed by the assessee as entertainment expenditure in a sum of Rs. 25,062 was allowable as a deduction [*CIT v. National Engineering Co.* (*Madras*) *Pvt. Ltd.*, (2001) 251 ITR 764, 767 (Mad)].

In *Modern Threads* (*India*) *Ltd. v. CIT,* (2002) 258 ITR 511, 512, 513 (Raj), it has been held that on a proper interpretation of the provisions of section 37(2A) of the 1961 Act read with *Explanation 2* thereto, the Tribunal was justified in disallowing Rs. 19,918 being cost of gift articles by treating the same as entertainment expenses for the assessment year 1984-85. This Rajasthan view has been **followed in** *CIT v. Instrumentation Ltd.,* (2002) 258 ITR 513, 515 (Raj). Also see, *Duncans Tea Ltd. v. CIT*, (2012) 344 ITR 442 (Cal).

In *Rane* (*Madras*) *Ltd. v. CIT,* (2003) 259 ITR 307, 309-10 (Mad), the Tribunal was held right in holding that the sum of Rs. 42,345 out of the expenses incurred on the dealers' conference, annual general meeting, providing food to the visitors was 'entertainment expenditure' within the meaning of *Explanation 2* to section 37(2A) of the 1961 Act for the assessment year 1984-85.

In *Ennore Foundries Ltd. v. CIT,* (2003) 259 ITR 414, 416 (Mad), it has been held that part of the entertainment expenditure attributable to the staff of the assessee was to be excluded from the disallowance under section 37(2A) of the 1961 Act for the assessment year 1985-86 in view of the provisions contained in *Explanation 2* to section 37(2A) of the 1961 Act to the effect that the expenditure incurred on food and beverages provided by the assessee to its employees in office, factory or other places of work was not to be regarded as entertainment expenditure for the purpose of section 37(2A) of the 1961 Act.

As observed by the Supreme Court in *CIT v. Patel Brothers & Co. Ltd.,* (1995) 215 ITR 165 (SC), the insertion of *Explanation 2* to section 37(2A) of the 1961 Act takes effect retrospectively from 1-4-1976 and will, accordingly, apply in relation to the assessment year 1976-77. In that view of the mater, the expenses incurred by the assessee on the boarding and lodging facilities given to auditors and other Government and semi-Government servants visiting the assessee's factory have been held to form part of the 'entertainment expenditure' within the meaning of section 37(2B) of the 1961 Act to which that *Explanation* also applied for the assessment year 1976-77. [*CIT v. Bazpur Co-operative Sugar Factory*, (2003) 262 ITR 45, 47 (All)].

It is pertinent to note that the food and drinks supplied to the employees is excepted from the wider meaning of entertainment clarified by *Explanation 2* to section 37(2A) of the 1961 Act to the extent it is spent at other place of their work unless it is spent in the office or the factory of the assessee. In that view of the matter, expenses to the extent these are incurred for the purpose of providing food and drinks to the employees in the seminar are not to be regarded as 'entertainment expenditure' within the meaning of that *Explanation 2* for the assessment year 1990-91. However, amount spent on food and drinks for persons other than the employees is to be regarded as 'entertainment expenditure' [*CIT v. Chemcrown* (*India*) *Ltd.*, (2003) 262 ITR 177, 181, 184 (Cal)]. Also see, *Ravi Marketing P. Ltd. v. CIT,* (2006) 280 ITR 519 (Cal).

In *G.A. Vasant v. CIT,* (2004) 265 ITR 481, 483 (Mad), the Tribunal was held absolutely correct in holding that the expenditure made on the trips to Tirupathi, Mahabalipuram, etc., and the expenditure made for some parties by making payments to various hotels, could be treated only as entertainment expenditure, which would be well covered within section 37(2A), for the assessment years 1979-80, 1981-82 and 1982-83.

In *CIT v. Registhan* (*P.*) *Ltd.,* (2003) 180 CTR (Raj) 380, 381, the Tribunal was held not justified in holding that the sum of Rs. 8,025 spent on boarding and lodging of foreign buyers was not 'entertainment expenditure' within the meaning of section 37(2A). In that judgment, clause (*iii*) of the *Explanation* to section 37(2) of the 1961 Act [which was operative for assessment years 1993-94 to 1997-98] has been extracted and not the relevant provisions of *Explanation 2* to section 37(2A) of the 1961 Act.

In *CIT v. Mangalam Cement Ltd.,* (2004) 266 ITR 385, 387-88 (Raj), the Tribunal was held not justified in deleting the addition of Rs. 1,94,775 by holding that giving gifts and presents did not amount to hospitality and could not be considered for disallowance as entertainment expenditure for the assessment year 1989-90 in view of the provisions contained in *Explanation 2* to section 37(2A) of the 1961 Act. This view has been **followed in** *CIT v. Mangalam Cement Ltd.,* (2003) 180 CTR (Raj) 485, 486.

In *CIT v. Associated Stone Industries,* (2002) 168 Taxation 463, 464 (Raj), the Tribunal was held justified in holding that expenditure of Rs. 32,727 was not in the nature of entertainment and in deleting the same. Also see, *Associated Stone Industries* (*Kotah*) *Ltd. v. CIT*, (2002) 123 Taxman 643, 644 (Raj).

LexisNexis

The question whether the Tribunal was justified in restricting the disallowance under the head 'Sales promotion expenses' from Rs. 1,04,857 to Rs. 20,970 particularly in view of the *Explanation 2* inserted in section 37(2A) of the 1961 Act by the Finance Act, 1983 (11 of 1983), is one of law [*CIT v. Dalmia Cement Ltd.,* (1988) 173 ITR 87 (Del)].

Expenditure subjected to disallowance under the then section 37(3A) of 1961 Act could not again be subjected to disallowance under section 37(2A) of 1961 Act.—Once a particular expenditure has been subjected to the disallowance as per the provisions of the then section 37(3A) of the 1961 Act for the assessment year 1985-86, the same expenditure could not again be subjected to the disallowance as per the provisions of the then section 37(2A) of the 1961 Act [*CIT v. Dabur* (*Dr. S.K. Burman*) *P. Ltd.*, (2001) 250 ITR 301, 304 (Cal)].

Section 37(2A) of 1961 Act cannot be attracted in relation to an expenditure held eligible for weighted deduction under section 35B of 1961 Act.—It is clear that section 37(2A) of the 1961 Act can have application in relation to an expenditure covered under section 37(1) of the 1961 Act. Where weighted deduction has been allowed in respect of entertainment expenditure under section 35B of the 1961 Act, such expenditure cannot be subjected to disallowance as per the provisions of section 37(2A) of the 1961 Act. In that view of the matter, the Tribunal was held right in ordering deletion of Rs. 29,983 under section 37(2A) of the 1961 Act on account of entertainment expenditure incurred by the assessee, in respect of which the assessee was held entitled to weighted deduction under section 35B of the 1961 Act for the assessment year 1978-79 [*CIT v. Walchandnagar Industries Ltd.*, (2003) 262 ITR 212, 221 (Bom)].

An inclusive definition of 'entertainment expenditure' also coined for assessment years 1993-94 to 1997-98.—By amalgamating (omitting unnecessary portion) the provisions of the then existing *Explanation 1* and *Explanation 2* to section 37(2A) of the 1961 Act, the ***Explanation*** **to the newly substituted** (w. e. f. 1-4-1993) **section 37(2)** of the 1961 Act by **the Finance Act, 1992** (18 of 1992), coins a definition, for the purposes of section 37(2) of the 1961 Act, of the expression 'entertainment expenditure' so as to include—

(*i*) the amount of any allowance in the nature of entertainment allowance paid by the assessee to any employee or other person;

(*ii*) the amount of any expenditure in the nature of entertainment expenditure [not being expenditure incurred out of an allowance of the nature referred to in clause (*i*)] incurred for the purposes of the business or profession of the assessee by any employee or other person;

(*iii*) expenditure on provision of hospitality of every kind by the assessee to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade, but does not include expenditure on food or beverages provided by the assessee to his employees in office, factory or other place of their work.

LexisNexis

The following **departmental circulars** are relevant to section 37(2) of the 1961 Act:—

I. *'Expenditure on food or beverages provided to the employees by an employer—Section 37(2) of the Income-tax Act, 1961—Clarification.*—Section 37(2) of the Income-tax Act, 1961, as it is substituted with effect from April 1, 1993, places restrictions on the quantum of deduction permissible on account of entertainment expenditure. The expression "entertainment expenditure" has been defined to include, *inter alia*, expenditure on provision of hospitality of every kind by the assessee to any person whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade, but "entertainment expenditure" does not include expenditure on food or beverages provided by the assessee to his employees in office, factory or other place of their work.

2. The Board has received a number of representations from various trade associations that the restriction that food or beverages to the employees should be provided in office, factory or other place of their work, has adversely affected small and medium sized establishments which are unable to provide canteen services within their own premises for want of space and infrastructure, but provide such facility under contract with nearby eating places.

3. The issue whether the provision of food or beverages in places other than the place of work in respect of the low-paid employees can be treated as expenditure on provision of hospitality has been considered by the Board.

4. It can be argued that food or beverages provided to low-paid employees are more on account of their low salary than as a measure of hospitality. Hence, the Board has decided that the expenditure on provision of food or beverages by an employer to such employees as are not hit by the provisions of section 17(2)(*iii*) need not be treated as entertainment expenditure within the meaning of the *Explanation* under section 37(2) substituted with effect April 1, 1993, if such food or beverages are provided during working hours even in places other than the place of work, provided the expenditure is genuine and reasonable. Accordingly, such expenditure on the following classes of employees will get the benefit of this circular:

"employees whose income under the head 'Salaries' (whether due from or paid or allowed by one or more employers), exclusive of the value of all benefits or amenities not provided for by way of monetary payment does not exceed Rs. 24,000; provided that, in the case of such employees of a company, they should be neither directors nor persons having substantial interest in the company.".

In respect of other high-paid employees, *i.e.*, those mentioned in section 17(2)(*iii*), however, such expenditure will continue to be treated as entertainment expenditure.

5. You are requested to bring the contents of this circular to the notice of all the officers working under your region.

6. This circular will be applicable for assessment year 1993-94 and onwards.' [*Circular No. 644, dated 15th March, 1993*].

II. *Expenditure on food or beverages provided to the employees by employers—Extent to be treated as entertainment—Section 37(2) of the Income-tax Act, 1961—Instructions regarding.*—'Reference is invited to the Board's Circular No. 644, dated 15th March, 1993 (F. No. 204/10/93-ITA.II)[5] wherein it was clarified that the expenditure on provision of food or beverages by an employer to the low-paid employees will not be treated as entertainment expenditure within the meaning of the *Explanation* under section 37(2) of the Income-tax Act, 1961, even if the facility is provided in places other than the place of work, provided the same is provided during the working hours and the expenditure is genuine and reasonable. Representations have since been received for extending the benefit of the circular to all the employees irrespective of salary limits, subject to monetary limits on the expenditure.

2. The Board has since considered the matter and has decided that expenditure up to Rs. 35 per day per employee shall not be treated as in the nature of entertainment if the same is incurred on food or beverages even outside the place of work, but during working hours subject to proof of genuineness of the expenditure. In case the expenditure exceeds the above limit, only the excess over Rs. 35 per day per employee shall be treated as entertainment in nature within the meaning of the *Explanation* under section 37(2) of the Act. In the hands of the employees, however, the amount shall be treated[6] as income subject to the provisions of section 17 of the Act.

3. This circular shall apply with reference to the expenditure incurred during the financial year 1995-96 relevant to the assessment year 1996-97 and subsequent years.

4. This may be brought to the notice of all the Assessing Officers in your region.' [*Circular No. 708, dated 18th July, 1995*].

III. *Expenditure on food or beverages provided to the employees by employers—Extent to be treated as entertainment—Section 37(2) of the Income-tax Act, 1961—Instructions regarding.*—'Reference is invited to the Board's Circular No. 708, dated July 18, 1995 (F. No. 225/27/95-ITA.II)[7], on the above referred subject.

2. In partial modification of the circular, the following sentence appearing at the end of para 2:—

"In the hands of the employees, however, the amount shall be treated as income subject to the provisions of section 17 of the Act"

may be substituted by the following:—

"In the hands of the employee, the amount up to Rs. 35 per day will not be treated as income, provided the amount is paid by the employer directly to the caterer, restaurant, eating place, canteen, etc.".

3. This may be brought to the notice of the Assessing Officers of your region.' [*Circular No. 727, dated 27th October, 1995*].

A resume about the provisions concerning allowability of 'entertainment expenditure'.—As the provisions about allowability of 'entertainment expenditure' have frequently been changed, a resume of these provisions is given hereunder:—

(1) **For assessment years 1993-94 to 1997-98,** in case of company-assessees as well as non-company-assessees, the allowability of the 'entertainment expenditure' [as defined in the *Explanation* to section 37(2) of the 1961 Act], whether incurred within India or outside India, has to be determined as per the provisions of section 37(2) of the 1961 Act as substituted by the Finance Act, 1992 (18 of 1992) (w. e. f. 1-4-1993), and subsequently amended by the Finance Act, 1994 (32 of 1994) (w. r. e. f. 1-4-1993). Such section 37(2) of the 1961 Act overrode the provisions of section 37(1) of the 1961 Act.

(2) **For assessment years 1977-78 to 1992-93,** in case of company-assessees as well as non-company-assessees, the allowability of the 'entertainment expenditure' [as defined in *Explanation 1* and also in *Explanation 2*, newly inserted (w. r. e. f. 1-4-1976) by the Finance Act, 1983 (11 of 1983), to section

5. See, serial No. I u/s. 37(2), *ante*.
6. For modification, see, serial No. III, *post*.
7. See, serial No. II u/s. 37(2), *ante*.

LexisNexis

37(2A) of the 1961 Act], whether incurred within India or outside India, has to be determined as per the provisions of the then section 37(2A) of the 1961 Act, which has overridden the provisions of sections 37(1) and 37(2) of the 1961 Act.

(3) **For assessment years 1970-71 to 1976-77,** in case of company-assessees as well as non-company-assessees, the allowability of—

— the entertainment expenditure' [as defined in the *Explanation/Explanation 1* and also for assessment year 1976-77 in *Explanation 2* to section 37(2A) of the 1961 Act] incurred within India after 28-2-1970, has to be determined as per the provisions of the then section 37(2B) of the 1961 Act, which placed a total ban on the allowability of such expenditure, overriding the provisions of the entire section 37 of the 1961 Act;

— the 'entertainment expenditure' [as defined in the *Explanation/Explanation 1* and also for assessment year 1976-77 in *Explanation 2* to section 37(2A) of the 1961 Act] incurred outside India, has to be determined as per the provisions of the then section 37(2A) of the 1961 Act, which has overridden the provisions of sections 37(1) and 37(2) of the 1961 Act.

It may also be noted that the allowability of the 'entertainment expenditure', **for assessment year 1970-71**, in respect of such expenditure incurred within India upto 28-2-1970 has also to be determined as per the provisions of the abovesaid section 37(2A) of the 1961 Act.

(4) **For assessment years 1968-69 and 1969-70,** in case of company-assessees as well as non-company-assessees, the allowability of the 'entertainment expenditure' [as defined in the *Explanation* to section 37(2A) of the 1961 Act], whether incurred within India or outside India has to be determined as per the provisions of the then section 37(2A) of the 1961 Act [where such expenditure was incurred by the assessee during any previous year which expired after 30-9-1967], which has overridden the provisions of sections 37(1) and 37(2) of the 1961 Act.

It may be noted that, **for assessment year 1968-69**, in case of a company-assessee, the allowability of the 'entertainment expenditure' [having no definition thereof] incurred by such assessee during the relevant previous year which expired before 30-9-1967, has to be determined as per the provisions of the then section 37(2) of the 1961 Act, which has overridden the provisions of section 37(1) of the 1961 Act.

(5) **For assessment years 1962-63 to 1967-68,** only in case of company-assessees and not in case of non-company-assessees, the allowability of the 'entertainment expenditure' [having no definition thereof] has to be determined as per the provisions of the then section 37(2) of the 1961 Act, which has overridden the provisions of section 37(1) of the 1961 Act. It may be noted that the restrictive provisions of the then section 37(2) of the 1961 Act were not attracted in the case of non-company-assessees.

LexisNexis

Entertainment expenditure—what it means and includes?—The word "entertainment" has different meanings for purposes of different Acts. For the purposes of Refreshment Houses Act, 1860, it is defined to mean "not diversion or amusement, but the provision of food, drink and whatever else might be reasonably required for the personal comfort of guests, for example, cigars, coffee, ginger beer or lemonade .... (*Stroud's Judicial Dictionary,* 3rd Edition Vol. 2, p. 96). Within the meaning of the C.P. and Berar Entertainment Duty Act, 1936, it implies some exhibition, performance, amusement, game or sport for affording some sort of amusement and gratification [*Calico Mills Ltd. v. State of M.P.,* AIR 1961 MP 257].

Although the *Explanation* (with effect from 1-4-1976, *Explanation 1*) to section 37(2A) of the 1961 Act gives an inclusive definition of the expression "entertainment expenditure", the word "entertainment" has not been defined in the Act. There was a **sharp difference in judicial opinion on** the point as to what does, and what does not, amount to entertainment expenditure within the meaning of these provisions. **One view** was, that entertainment expenditure includes all expenditure incurred in connection with business on the entertainment of customers and/or constituents. The entertainment may consist of providing refreshment or other sorts of entertainment [see, *Brij Raman Dass & Sons v. CIT,* (1976) 104 ITR 541 (All)]. In that case, the expenditure incurred in providing refreshments to customers was held to be entertainment expenditure. In so holding the Allahabad High Court relied on *Bentleys Stokes and Lowless v. Beeson,* (1952) 33 TC 491 (CA), where expenses, incurred by a firm of solicitors, in entertaining its clients by providing lunch to them were held to be wholly and exclusively for the purposes of the business of the firm. Cases holding similar view to the effect that the expenditure did amount to "entertainment expenditure", are:—

1. *A.C.C.-Vickers Babcock Ltd. v. CIT,* (1976) 103 ITR 321 (Bom) [paying hotel bills for guests and catering charges].

2. *CIT v. Veeriah Reddiar,* (1977) 106 ITR 610 (Ker—FB) [supplying cigarettes, coffee, meals, etc., to customers]. Also see, *CIT v. C.P.A. Yoosuf,* (1978) 113 ITR 225 (Ker).
3. *CIT v. Gheru Lal Bal Chand,* (1978) 111 ITR 134 (Punj) [maintaining kitchen for serving meals to constituents].
4. *CIT v. Manoo Ram Ram Karan Dass,* (*1979*) 116 ITR 606 (All) [*arhatdar* meeting messing expenses of mofussil constituents]. Also see, *CIT v. Bagraj & Co.,* (1979) 117 ITR 694 (All).
5. *CIT v. Kunji Lal Dhanpat Rai,* (1979) 116 ITR 608 (All) [serving tea, paan, etc., to outside customers].
6. *CIT v. Modi Spng. & Mfg. Co. Ltd.,* (1980) 125 ITR 361 (All) [payment made for tea, etc., to local restaurant].
7. *CIT v. Khem Chand Bahadur Chand,* (1981) 131 ITR 336 (Punj—FB), **overruling**, *CIT v. Nadh Shah Kapur & Sons,* (1980) 122 ITR 972 (Punj) [running a regular kitchen to furnish wholesome food and drink to customers]. Also see, *CIT v. Khem Chand Bahadur Chand,* (1982) 134 ITR 65 (Punj); *Atlas Cycle Industries Ltd. v. CIT,* (1990) 181 ITR 18 (Punj); *Khetu Ram Bishamber Dass v. CIT,* (1989) 180 ITR 240 (Punj).
8. *Brijraman Das & Sons v. CIT,* (1983) 142 ITR 509 (All) [amount spent in providing refreshments to constituents and in purchasing articles for serving refreshments]. Also see, *Laxmi Narain Chunni Lal v. CIT,* (1983) 140 ITR 837 (All); *CIT v. U.P. Hotels,* (1987) 163 ITR 805 (All).
9. *Chandmull Rajgarhia v. CIT,* (1987) 167 ITR 433 (Pat) [expenditure incurred by the assessee in entertaining foreign guests and visitors].
10. *Phool Chand Gajanand v. CIT,* (1989) 177 ITR 265 (All—FB) [expenditure incurred by the assessee for the messing of its customers]. Also see, *Phoolchand Gajanand v. CIT,* (1989) 178 ITR 535 (All); *CIT v. Umrao Singh Mithai Lal,* (1991) 188 ITR 504, 505 (All); *CIT v. Kesho Dass Shri Gopal,* (1991) 189 ITR 40 (All); *CIT v. Madho Lal Sua Lal,* (1991) 189 ITR 418, 419 (All); *CIT v. Madho Lal Sua Lal,* (1991) 190 ITR 142, 143 (All); *CIT v. Ram Narain Shivji Ram,* (1991) 192 ITR 195 (All); *L.H. Sugar Factories Ltd. v. CIT,* (1993) 200 ITR 410 (All); *Marketing Services Agency* (*P.*) *Ltd. v. CIT,* (1991) 55 Taxman 305, 306 (All).
11. *CIT v. Haryana Financial Corporation Ltd.,* (1989) 180 ITR 18 (Punj) [expenses incurred for providing lunch and other refreshments to the assessee's directors and other persons during meetings]. Also see, *Saraswati Industrial Syndicate Ltd. v. CIT,* (1990) 183 ITR 120, 126 (Punj).
12. *CIT v. Mohan Meakin Breweries Ltd.,* (1991) 192 ITR 134, 142 (HP) [expenditure incurred on hotel bills, travelling and taxi expenses, etc., for assessee's guests and customers, etc.].
13. *CIT v. State Bank of Bikaner & Jaipur*, (2007) 294 ITR 499, 501 (Raj) [sum of Rs. 1,71,791 incurred by the assessee bank on entertainment of customers or other visitors at 400 branches in the entire State could not be treated as lavish expenditure in any manner and the same to be treated as entertainment one towards business development].
14. *Electra India Ltd. v. CIT*, (2008) 303 ITR 242, 244-45 (All) [the expenditure incurred on tickets purchased by the applicant and dry fruits and sweets for Diwali and expenses incurred on lunches and dinners to officers and engineers of different State Electricity Boards are covered under the term 'entertainment expenditure' and the limit provided under section 37(2A) of the 1961 Act would be attracted].

Some of the above cases have proceeded on the footing that the Legislature in enacting these provisions has not used the word "entertainment" simpliciter, but it has employed a much wider and a compendious expression "in the nature of entertainment expenditure" [see, *CIT v. Khem Chand Bahadur Chand,* (1981) 131 ITR 336 (Punj—FB); *CIT v. Veeriah Reddiar,* (1977) 106 ITR 610, 616-17 (Ker—FB)].

On the other side of the fence lies the more liberal view. The Gujarat High Court, in *CIT v. Patel Bros. & Co. Ltd.* [(1977) 106 ITR 424, 441-42 (Guj)], laid down four broad tests to serve as a guideline. These are:

(*a*) if the provision of food, drinks or any amusement to a client, constituent or customer is on lavish and extravagant scale, or is of wasteful nature, it is entertainment per se;

(*b*) if the provision of food or drinks to a client, constituent or customer is in the nature of a bare necessity, or by way of ordinary courtesy or as an express or implied term of contract or employment spelt out from long-standing practice or custom of trade or business, it will not amount to entertainment;

LexisNexis

(*c*) if the provision of food or drinks to a client, customer or constituent is in liberal and friendly way, it may amount to entertainment having regard to the place, item and cost of such provision; and

(*d*) the provision of amusement to a client, customer or constituent by way of hospitality or otherwise will always be entertainment.

In that Gujarat case, the question was whether the cost of ordinary meals supplied by the assessee-company to up-country farmers, who came to supply goods, could be termed as entertainment expenditure. The Court held that it did not. The above Gujarat decision [106 ITR 424 (Guj)] has been **followed in** *CIT v. Kaira District Co-operative Milk Producers Union Ltd.,* (1991) 192 ITR 608, 610 (Guj); *CIT v. Gujarat State Finance Corporation,* (1992) 196 ITR 822, 830 (Guj), a case relating to assessment year 1977-78, without noticing the retrospectively inserted definition of the expression 'entertainment expenditure' operative for and from assessment year 1976-77; *CIT v. Ahmedabad Mfg. & Calico Printing Co. Ltd.,* (1992) 197 ITR 538, 540-41 (Guj); *CIT v. Arvind Industries,* (1993) 201 ITR 821, 825 (Guj); *CIT v. New Bharat Engineering* (*Jam*) *P. Ltd.,* (1993) 203 ITR 678, 681 (Guj); *CIT v. Maharana Mills Ltd.,* (1994) 208 ITR 972, 974 (Guj), a case relating to assessment year 1976-77 to be governed by section 37(2B) of the 1961 Act read with the abovestated newly inserted definition of the expression 'entertainment expenditure'; *CIT v. Kaira District Co-operative Milk Producers' Union Ltd.,* (1994) 209 ITR 898, 900 (Guj); *CIT v. Narbada Valley Chemical Industries Pvt. Ltd.,* (1993) 109 CTR (Guj) 15, 17; *CIT v. Broach Textile Mills,* (1993) 114 Taxation 65, 66-67 (Guj). Other cases taking similar view and holding the expenditure not to be "entertainment expenditure" are:—

1. *CIT v. Shah Nanji Nagsi,* (1979) 116 ITR 292 (Bom) [messing to outside customers/constituents and offering tea and *paan* to them]. Also see, *CIT v. Ravalgaon Sugar Farm Ltd.,* (1982) 138 ITR 235 (Bom); *Kirloskar Oil Engines Ltd. v. CIT,* (1994) 206 ITR 13, 15 (Bom); *Century Spng. & Mfg. Co. Ltd. v. CIT,* (1990) Tax LR 1103 (Bom).
2. *CIT v. Corporation Bank Ltd.,* (1979) 117 ITR 271 (Karn) [coffee and tea served to customers].
3. *Addl. CIT v. Maddi Venkataratnam & Co. Ltd.,* (1979) 119 ITR 514 (AP) [boarding and lodging expenditure for foreign customers by an exporter]. Also see, *CIT v. Maddi Venkataratnam & Co. P. Ltd.,* SLP (Civil) No. 15048 of 1985 : (1991) 187 ITR (St.) 66 (SC); *CIT v. Akkamba Textiles Ltd,* SLP (Civil) No. 7621 of 1985 : (1992) 193 ITR (St.) 7 (SC).
4. *CIT v. Karuppuswamy Nadar & Sons,* (1979) 120 ITR 140 (Mad), **followed in**, *South India Viscose Ltd. v. CIT,* (1982) 135 ITR 206 (Mad) [supply of coffee, tea, etc., to clients].
5. *Addl. CIT v. Bangalore Turf Club Ltd.,* (1980) 126 ITR 430 (Karn) [serving refreshment, lunch, liquor, etc., at the business meetings of the managing committee or of ordinary members of the club].
6. *CIT v. Mysore Paper Mills Ltd.,* (1980) 126 ITR 437 (Karn) [catering and refreshment, etc., to shareholders and guests at the general body meeting].
7. *CIT v. Lalubhai B. Patel & Co.,* (1983) 139 ITR 832 (MP), **following,** *CIT v. Lakhmichand Muchhal,* (1982) 134 ITR 234 (MP) [providing tea, *pan*, coffee, cold drinks, etc., to customers].
8. *CIT v. Navalmal Punamchand,* (1982) 135 ITR 801 (MP) [messing expenses to provide meals to up-country customers].
9. *CIT v. Rajkumar Mills Ltd.,* (1982) 135 ITR 811 (MP) [amount spent in providing tea, etc., to customers visiting the mills of the assessee].
10. *CIT v. Mathuralal Kapoorchand & Co.,* (1983) 141 ITR 297 (MP) [expenditure incurred on providing messing facilities to trade clients]. Also see, *CIT v. Shyam Lal Ramcharan,* (1984) 147 ITR 52 (MP); *CIT v. Shree Synthetics Ltd.,* (1986) 162 ITR 819 (MP); *CIT v. Ashish Coal Coke Traders,* (1987) 163 ITR 174 (MP); *CIT v. Jadhavji Kanji & Co.,* (1983) 35 CTR (MP) 320.

    But, expenditure incurred on entertaining customers and business constituents to lunches and dinners at posh hotels has been held to constitute entertainment expenditure [*Central Paints Ltd. v. CIT,* (1984) 146 ITR 212 (MP). Also see, *Mysodet Pr. Ltd. v. CIT,* (1987) 163 ITR 848 (Karn)].
11. *CIT v. Orient Prospecting Co.,* (1983) 141 ITR 301 (Guj) [expenses incurred on messing and tea]. Also see, *CIT v. Mehta Transport Company,* (1986) 160 ITR 35 (Guj); *CIT v. Jyoti Ltd.,* (1987) 163 ITR 274 (Guj).
12. *Brijraman Das & Sons v. CIT,* (1983) 142 ITR 509 (All) [expenses incurred on transportation of customers and festival allowance paid to staff].
13. *CIT v. Maddi Venkataratnam & Co. Pr. Ltd.,* (1983) 144 ITR 373 (AP) [provision of coffee, tea and food, etc., to customers]. Also see, *CIT v. Sirpur Paper Mills,* (1983) 144 ITR 393 (AP); *CIT v.*

LexisNexis

Warner Hindustan Ltd., (1984) 145 ITR 24 (AP), **SLP dismissed**: (1990) 185 ITR (St.) 3 (SC); *CIT v. A.P. Small Scale Industrial Development Corporation,* (1989) 175 ITR 352 (AP).

14. *CIT v. Supreme Motors Pr. Ltd.,* (1984) 147 ITR 48 (Del) [provision of tea and cold drinks to customers, etc.]. Also see, *Santlal Kashmirilal v. CIT,* (1986) 157 ITR 422 (Del); *CIT v. Electric Construction & Equipment Co. Ltd.,* (1990) 185 ITR 651 (Del); *CIT v. Jay Engineering Ltd.,* (1990) 181 ITR 510 (Del); *Modi Spinning & Weaving Mills Co. Ltd. v. CIT,* (1993) 200 ITR 544, 557 (Del); *CIT v. New Bank of India Ltd.,* (1993) 201 ITR 878, 880 (Del); *Delhi Cloth & General Mills Co. Ltd. v. CIT,* (1994) 208 ITR 785, 794-95 (Del); *CIT v. Modi Spinning & Weaving Mills Co. Ltd.,* (1993) 109 CTR (Del) 319, 321; *CIT v. Chander Bhan Raj Kumar,* (1996) 221 ITR 465, 467-68 (Del).

15. *CIT v. O.M.S.S. Sankaralinga Nadar & Co.,* (1984) 147 ITR 332 (Mad) [expenditure on provision of coffee, tea and other refreshments supplied to customers]. Also see, *CIT v. Express Newspapers Ltd.,* SLP (Civil) Nos. 5850-5851 of 1980 and 5100-5101 of 1981: (1985) 155 ITR (St.) 5 (SC); *CIT v. Carborandum Universal Ltd.,* (1985) 156 ITR 1 (Mad); *CIT v. L.G. Balakrishna & Bros. Ltd.,* (1984) 38 CTR (Mad) 59; *CIT v. Sundaram Industries Ltd.,* (1987) 166 ITR 35 (Mad).

16. *Devichand Bastimal: Bhanwarlal Manakchand v. CIT,* (1985) 156 ITR 166 (Raj) [provision of food and soft drinks to customers and constituents]. Also see, *CIT v. Mewar Sugar Mills Ltd.,* (1986) 157 ITR 444 (Raj); *CIT v. Seth Abdulla Yusuf,* (1986) 159 ITR 810 (Raj); *Pratap Cotton Trading Co. v. CIT,* (1986) 159 ITR 926 (Raj); *Shree Sadul Textiles Ltd. v. CIT,* (1987) 165 ITR 154 (Raj); *CIT v. Meg Raj Sohan Lal,* (1987) 165 ITR 411 (Raj); *Metharam Lekhumal v. CIT,* (1987) 165 ITR 568 (Raj); *Pratap Trading Co. v. CIT,* (1987) 167 ITR 36 (Raj); *Green Roadways v. CIT,* (1985) 23 Taxman 16 (Raj); *Rajasthan Cotton Mills v. CIT,* (1985) 49 CTR (Raj) 49; *CIT v. Aditya Mills,* (1987) 31 Taxman 273 (Raj); *CIT v. Bhonrilal Jain,* (1987) 167 ITR 400 (Raj); *CIT v. Aditya Mills,* (1987) 168 ITR 43 (Raj); *Mangilal Vijay Kota v. CIT,* (1987) 167 ITR 37 (Raj); *Golecha Properties* (*P.*) *Ltd. v. CIT,* (1988) 171 ITR 47 (Raj); *Maharaja Shree Umaid Mills Ltd. v. CIT,* (1989) 175 ITR 70 (Raj); *Maharaja Shri Umaid Mills Ltd. v. CIT,* (1989) 175 ITR 72 (Raj); *CIT v. S. Zoraster & Co.,* (1989) 179 ITR 416 (Raj); *Metharam Lekhumal v. CIT,* (1988) 36 Taxman 207 (Raj); *Associated Stone Industries* (*Kota*) *Ltd. v. CIT,* (1992) 194 ITR 401 (Raj); *CIT v. Chandulal Taksali & Co.,* (1990) 185 ITR 604 (Raj).

17. *CIT v. Agarpara Co. Ltd.,* (1987) 167 ITR 866 (Cal) [expenditure incurred on supply of ordinary items of refreshments and other items like cigarettes, etc.]. Also see, *CIT v. KMW Johnson Ltd.,* (1987) 59 CTR (Cal) 160; *CIT v. Orient Paper Mills Ltd.,* (1988) 171 ITR 181 (Cal); *CIT v. Hindusthan Aluminium Corporation Ltd.,* (1989) 176 ITR 206 (Cal).

18. *CIT v. Motor Industries Co. Ltd.,* (1988) 173 ITR 374 (Karn) [expenditure incurred on account of tea, coffee, etc., supplied to its employees].

19. *CIT v. F. Racek & Co.* (*Pvt.*) *Ltd.,* (1989) 176 ITR 406 (Bom) [expenditure incurred by the assessee on tea, coffee, lunch, etc., for its customers].

20. *CIT v. Gaekwar Mills Ltd.,* (1992) 193 ITR 734, 738 (Guj) [expenditure which was incurred in providing messing facilities to assessee's employees where the expenditure was not lavish or extravagant].

21. *CIT v. Ram Chander Ram Kishandas,* (1993) 199 ITR 825, 826 (Del) [cost of coarse food and conveniences provided to '*veoparies*' and employees of the assessee-firm].

22. *CIT v. Mehsana District Co-operative Milk Producers Union Ltd.,* (1994) 207 ITR 140, 142 (Guj) [expenditure incurred for the purpose of providing tea, snacks and food to assessee's members and customers or visitors].

23. *CIT v. Bennete Coleman & Co. Ltd.,* (1994) 73 Taxman 64, 66 (Bom) [expenses incurred in connection with the customer courtesy, news and advertisement gathering and filmfare awards dinner].

24. *CIT v. Rajasthan Mercantile Co. Ltd.,* (1995) 211 ITR 400, 419-20 (Del) [expenditure incurred on serving tea, snacks, etc., to customers visiting hotel].

25. *CIT v. Varinder Agro Chemicals Ltd*., (2006) 205 CTR (Punj) 334, 338 = (2007) 290 ITR 147 (Punj) [expenditure on distribution of gifts on the occasion of festivals].

26. *CIT v. Avery Cycle Industries Ltd*., (2006) 206 CTR (Punj) 347, 350 = (2008) 296 ITR 393 (Punj) [expenditure incurred on distribution of gift items to dealers].

27. *CIT v. Avery Cycle Industries Ltd*., (2008) 298 ITR 239, 241 (Punj) [amount of Rs. 86, 914 spent on silverware for distribution to dealers and foreign visitors].

LexisNexis

28. *CIT v. Avery Cycle Industries Ltd*., (2008) 298 ITR 239, 243-44 (Punj) [amount of Rs. 2,10,142 been spent on distribution of watches amongst employees keeping in view their status and length of service which led to harmonious relations between the management and staff resulting in higher output and productivity].

Also see, *CIT v. Salam Hanif Taj Fruit,* SLP (Civil) No. 6199 of 1981: (1984) 147 ITR (St.) 4 (SC); *Travancore Electro-Chemical Industries Ltd. v. CIT,* SLP (Civil) No. 15449 of 1985: (1986) 159 ITR (St.) 107 (SC); *Royal Calcutta Turf Club v. CIT,* (1991) 188 ITR 352, 357 (Cal); *CIT v. Oil India Ltd.,* (1992) 198 ITR 701, 708-09 (Cal); *CIT v. Travel Agents Association of India Ltd.,* SLP (Civil) No. 6122 of 1984 : (1993) 199 ITR (St.) 88 (SC); *CIT v. Modi Spinning & Weaving Mills Co. Ltd.,* SLP (Civil) No. 4897 of 1985 : (1994) 207 ITR (St.) 12 (SC); *CIT v. Maddi Venkataratnam & Co. Ltd.,* SLP (Civil) Nos. 15470-15471 of 1985 : (1995) 212 ITR (St.) 371-72 (SC).

In *CIT v. Prasad Process* (*Pr.*) *Ltd.,* (1983) 141 ITR 9 (Mad), the distinction between entertainment and hospitality has been pointed out.

In *Nava Bharat Enterprises Pr. Ltd. v. CIT,* (1983) 143 ITR 804 (AP), **SLP granted:** (1991) 191 ITR (St.) 76 (SC)], the general principles about allowability or otherwise of entertainment expenditure were discussed. Also see, *CIT v. K.P.V. Shaik Mohamed Rowther & Co.,* (1984) 145 ITR 37 (Mad), **SLP dismissed:** (1991) 191 ITR (St.) 75 (SC); *CIT v. Navabharat Enterprises* (*P.*) *Ltd.,* (1988) 170 ITR 332 (AP).

The expression "entertainment" as used in section 2(3) of the Uttar Pradesh Entertainment and Betting Tax Act, 1937, has been interpreted by the Supreme Court in *Geeta Enterprises v. State of U.P.,* AIR 1983 SC 1098.

Still, "food expenses" incurred by an assessee for the employees have been held to be permissible deduction even by the Allahabad High Court [*Harak Chand Flour Mills v. CIT,* (1983) 139 ITR 823 (All); *CIT v. Bagraj & Co.,* (1979) 117 ITR 694 (All)].

In *CIT v. Gujarat Carbon Ltd.*, (2005) 277 ITR 349, 353 (Guj), **applying** *CIT v. Patel Brothers & Co. Ltd*., (1995) 215 ITR 165 (SC), it has been held that sum of Rs. 35,226 relating of sales expenses would fall within the meaning of the term 'entertainment expenditure', as the said expenditure had been incurred for extending hospitality to various persons as detailed in the assessment order.

In *CIT v. ING Vysya Bank Ltd.,* (2013) 356 ITR 532 (Karn), the claim made by the assessee had rightly been disallowed regarding entertainment expenditure of Rs. 16,21,016.

Entertainment, meaning of.—The term 'entertainment' has been defined in *Websters Encyclopedic Unabridged Dictionary*, 1989 Edition, as the act of entertaining; agreeable occupation for the mind; diversion; amusement; solving the daily crossword puzzle is an entertainment for many; something affording diversion or amusement, esp., an exhibition or performance of some kind; the high light of the ball was an elaborate entertainment; hospitable provision for the wants of guests [*CIT v. Varinder Agro Chemicals Ltd*., (2006) 205 CTR (Punj) 334, 337-38].

Entertaining, connotation of.—The word 'entertaining' means affording entertainment, amusing, diverting [*CIT v. Varinder Agro Chemicals Ltd*., (2006) 205 CTR (Punj) 334, 338].

Hospitality, meaning of.—The word 'hospitality' means the friendly reception and treatment of guests or strangers; the quality or disposition of receiving and treating guests and strangers in a warm friendly and generous way [*CIT v. Varinder Agro Chemicals Ltd*., (2006) 205 CTR (Punj) 334, 338].

The term 'hospitality' as defined in *Oxford Advanced Learner's Dictionary*, 2000 Edn., means friendly and generous behaviour towards guests: thank you for your kind hospitality; food, drink or services that are provided by an organisation for guest, customers, etc. [*CIT v. Gujarat Carbon Ltd*., (2005) 277 ITR 349, 353 (Guj)].

Setting at rest the above controversy with regard to the construction of section 37(2A) of the 1961 Act, as it existed without *Explanation 2* [which was inserted retrospectively with effect from 1-4-1976 by the Finance Act, 1983 (11 of 1983)], upto assessment year 1992-93, the Supreme Court has, in *CIT v. Patel Brothers & Co. Ltd.,* (1995) 215 ITR 165, 172 (SC), **affirming** *CIT v. Patel Brothers & Co. Ltd.,* (1977) 106 ITR 424 (Guj), without affirming the wide observations and the elaborate guidelines given therein, ruled that generally, 'entertainment expenditure' is an expression of wide import. However, in the context of disallowance of 'entertainment expenditure' as a business expenditure by virtue of section 37(2A) of the 1961 Act, the word 'entertainment' must be construed strictly and not expansively. Ordinarily, 'entertainment' connotes something which may be beneficial for mental or physical well being but is not essential or indispensible for human existence. A bare necessity, like an ordinary meal, is essential or indispensible and, therefore, is not 'entertainment'. If such a bare necessity is offered by another, it is hospitality but not entertainment. Unless the definition of 'entertainment' includes hospitality, the ordinary meaning of 'entertainment' cannot include hospitality. For this reason, the expenditure incurred in extending customary hospitality by offering ordinary

LexisNexis

meals as a bare necessity, is not 'entertainment expenditure' without the aid of the enlarged meaning given to those words by the said *Explanation 2*. The definition in the said *Explanation 2* is not the ordinary meaning of the words 'entertainment expenditure', but the enlarged meaning given for the purpose of the Act with effect from 1-4-1976. This construction flows not merely from the language of the provision but also matches with the object thereof. It means that the expenditure incurred by the assessee in providing ordinary meals to outstation customers according to established business practice, was a permissible deduction in spite of section 37(2A) of the 1961 Act, to which the assessees were entitled in the computation of their total income for the purpose of payment of tax under the 1961 Act during the relevant period prior to 1-4-1976. In taking the above view, the Supreme Court has **overruled the contrary view** taken in *Brij Raman Dass & Sons v. CIT,* (1976) 104 ITR 541 (All) and other cases following such view.

The above Supreme Court view [215 ITR 165 (SC)] has been **followed in** *CIT v. Lakhpat Rai Nand Lal,* (1996) 220 ITR 318 (All) (assessment year 1975-76); *CIT v. Metallurgical Engineering Consultants* (*India*) *Ltd.,* (1996) 221 ITR 90, 98 (Pat) (assessment years 1975-76 and 1976-77); *CIT v. Indo Asian Switch-gears* (*P.*) *Ltd.,* (1996) 222 ITR 772, 783-84 (Punj) (assessment years 1975-76 and 1976-77); *CIT v. Jaipur Golden Transport,* (1997) 226 ITR 399, 400 (Del) (assessment year 1974-75); *CIT v. Electric Construction & Equipment Co. Ltd.,* (1996) 133 Taxation 411, 412 (Del) (assessment year 1972-73); *CIT v. New Horizon Sugar Mills Ltd.,* (1997) 139 CTR (Mad) 130, 133-34 = (1999) 237 ITR 102, 105-06 (Mad) (assessment year 1975-76); *CIT v. Capital Metals,* (1997) 141 CTR (Del) 31, 32; *CIT v. Ude Ram Shivdhan Mal,* (1997) 143 CTR (Del) 381, 382; *CIT v. Madho Lal Sualal,* (1998) 144 CTR (All) 420, 422 (assessment year 1974-75); *CIT v. Bhagwandass Manhar Lal,* (1998) 145 CTR (Del) 319, 320 (assessment year 1972-73); *CIT v. T.V. Sundaram Iyengar & Sons,* (1998) 148 CTR (Mad) 9, 16 = (1999) 235 ITR 491, 499-500 (Mad) (assessment year 1976-77); *Oriental Fire & General Insurance Co. Ltd. v. CIT,* (2004) 190 CTR (Del) 553 (assessment years 1974-75 and 1975-76); *Gangeshwar Ltd. v. CIT,* (2007) 165 Taxman 31 (Del); *CIT v. Indian Rayon & Industries Ltd.,* (2011) 336 ITR 479 (Bom).

The above Supreme Court ruling [215 ITR 165 (SC)] has been **followed in** *CIT v. Sundaram Industries Ltd.* : (1999) 240 ITR 335, 337-38 (Mad) [so as to hold that expenditure of Rs. 10,480 spent on the provision of coffee, tea, etc., **could not** be regarded as 'entertainment expenditure' for the assessment year 1974-75] *or* in *CIT v. Modern Bakeries India Ltd.* : (2001) 249 ITR 465, 468 (Del) [so as to hold that the expenditure of Rs. 43,403, incurred on offering tea, coffee, etc., to the officials/guests of the assessee at its various branches, **did not** constitute 'entertainment expenditure' within the meaning of the then section 37(2B) of the 1961 Act and was, therefore not liable to be disallowed for the assessment year 1973-74] *or* in *CIT v. Gem Financiers & Distributors* (*P.*) *Ltd.* : (2001) 250 ITR 786, 789 (Del) [so as to hold that expenses incurred on purchase of tea, cool drinks for visiting exhibitors, producers, film journalists and members of the trade were **allowable** as business expenditure for the assessment year 1974-75] or in *CIT v. Printers House* (*P.*) *Ltd.* : (2001) 252 ITR 352, 353-54 (Del) [so as to hold that the sum of Rs. 5,000 was **not disallowable** as entertainment expenditure within the meaning of section 37(2B) of the 1961 Act] or in *CIT v. Bharat Heavy Electricals Ltd.*: (2002) 254 ITR 447, 448 (Del) [so as to hold that the expenditure of Rs. 19,429 incurred by the assessee on serving tea, coffee and light refreshments to the representatives of the customers **was not** in the nature of entertainment and was allowable as a business expenditure for the assessment year 1974-75] or in *CIT v. Gujarat State Fertilizer Co.* : (2002) 255 ITR 294, 297-98 (Guj) [so as to hold that the expenditure of Rs. 24,375 **was not** hit by the provisions of section 37(2B) of the 1961 Act for the assessment year 1973-74] or in *CIT v. Tulsi Bhai Gordhan Bhai Patel* : (2003) 259 ITR 752, 753 (Del) [so as to hold that expenses in the nature of *rasoi* expenses in the branch office and head office of the assessee **were not** to be treated as entertainment expenditure with the meaning of section 37(2B) of the 1961 Act] or in *Modi Spinning & Weaving Mills v. CIT* : (2002) 177 CTR (Del) 114, 115, 166 [so as to hold that the expenditure incurred by the assessee-company on customers and clients in providing tea, snack, etc., at its various units **was not** in the nature of 'entertainment expenditure' for the assessment year 1975-76] or in *CIT v. Regal Theatre* : (2001) 116 Taxman 831, 832 (Del) [so as to hold that the Tribunal was correct in law in holding that the amounts of Rs. 28,474 and Rs. 2,738 aggregating Rs. 31,212 **did not** represent the 'entertainment expenditure' contemplated under section 37(2B) of the 1961 Act for the assessment year 1974-75] or in *CIT v. Harchand Rai Chandan Lal* : (2002) 124 Taxman 20 (Del) [so as to hold that the Tribunal was correct in holding that the expenditure of Rs. 8,403 claimed by the assessee as messing expenses on its constituents **was not** entertainment expenditure within the meaning of section 37(2B) of the Income-tax Act, 1961, and in allowing a deduction for the same as business expenditure for the assessment year 1973-74] or in *Sir Shadi Lal Sugar & General Mills v. CIT* : (2003) 132 Taxman 106, 107 (All) [so as to hold that the Tribunal **was not** right in holding that the provisions of section 37(2B) of the 1961 Act were applicable to the entertainment expenses of Rs. 7,959 incurred by the assessee for the assessment year 1972-73].

In *CIT v. Gujarat Carbon Ltd*., (2005) 277 ITR 349, 353 (Guj), **applying** *CIT v. Patel Brothers & Co. Ltd*., (1995) 215 ITR 165 (SC), it has been held that it could not be said that the expenditure incurred towards presentation articles would fall either within the meaning of the term 'entertainment' or 'hospitality'.

In *CIT v. Lakshmi Machine Works Ltd.,* (2000) 241 ITR 53, 57 (Mad), the assessee was held entitled to deduction in respect of the expenditure incurred by it on food and drinks provided to customers in relation to the assessment years 1972-73 and 1973-74 as *Explanation 2* to section 37(2A) of the 1961 Act [operative between 1-4-1976 and 31-3-1993] was not attracted for those assessment years.

In view of the above settled legal position, the matter has been remanded to the Tribunal to decide the same in the light of the abovesaid Supreme Court ruling [215 ITR 165 (SC)] and in accordance with law [*Saraspur Mills Ltd. v. CIT,* (1997) 226 ITR 533, 536 (Guj); *CIT v. Arvind Mills Ltd.,* (1998) 145 Taxation 202, 204 (Guj) = (1999) 237 ITR 415, 417 (Guj); *CIT v. United India Insurance Co. Ltd.,* (1998) 233 ITR 779, 782 (Mad)].

Since assessment year 1976-77, the statutory definition of the expression 'entertainment expenditure' holds the field on the above controversy.

Onus for invoking section 37(2A) of 1961 Act.—Where the allowability of a particular expenditure under section 37(1) of the 1961 Act is not disputed, it is for the department to prove its nature to be that of entertainment expenditure if the limit laid down in that section is intended to be applied [*Saraswati Industrial Syndicate Ltd. v. CIT,* (1982) 136 ITR 361, 365 (Punj)].

Entertainment expenditure incurred by a banking company.—On a reading of sections 19 and 20 of the 1961 Act (operative upto assessment year 1988-89), it is clear that, in case of non-banking company assessees, no deduction for entertainment expenditure is provided for in order to compute income under the head "Interest on securities". But, so far as banking companies are concerned, they are entitled, by virtue of the special provisions of the then section 20(1)(*i*) of the 1961 Act, to get proportionate deduction, in such computation, even in respect of entertainment expenditure subject to the provisions of section 37(2) of the 1961 Act or, as the case may be, section 37(2A) of the 1961 Act. In such a case, it is essential first to ascertain the exact quantum of the allowable amount of entertainment expenditure as per the limits in section 37(2) of the 1961 Act or, as the case may be, section 37(2A) of the 1961 Act. Out of such quantum, say Rs. X, the proportionate allowance, say Rs. Y, as per the provisions of the then section 20(1)(*i*) of the 1961 Act is to be allowed in computing the income under the head "Interest on securities" and the balance (Rs. X—Rs. Y) only is eligible for deduction under section 37(2) of the 1961 Act or, as the case may be, section 37(2A) of the 1961 Act. There is nothing in the scheme of the Income-tax Act to warrant an independent allowance of entertainment expenditure under the then section 20(1)(*i*) of the 1961 Act without having recourse to the restrictions contained in section 37(2) of the 1961 Act or, as the case may be, section 37(2A) of the 1961 Act [*Addl. CIT v. Indian Overseas Bank*, (1980) 123 ITR 790 (Mad)].

LexisNexis

Sections 37(2) and 37(2A) of 1961 Act are in the nature of provisos to section 37(1) of 1961 Act.— Under section 37(1) of the 1961 Act, an expenditure wholly and exclusively incurred for the purposes of the business including entertainment at a lavish, modest or even a frugal level, would come within the wide language thereof. Both sub-sections (2) and (2A) of section 37 of the 1961 Act begin with a *non obstante* clause, namely, "Notwithstanding anything contained in sub-section (1)". Therefore, whatever the amount of business entertainment expenses may be, they are subject to the stringent rule and limits provided in sub-sections (2) and (2A) thereof [*CIT v. Khem Chand Bahadur Chand,* (1981) 131 ITR 336, 347 (Punj—FB)]. In other words, sub-sections (2) and (2A) [also (2B) between 1-4-1970 and 31-3-1977] of section 37 do not contemplate expenditure of a different kind from that contemplated by section 37(1) of the 1961 Act. Every expenditure falling under any of the aforesaid sub-sections must necessarily be an expenditure wholly and exclusively incurred for business purposes. So construed, these sub-sections are not independent provisions but are in the nature of provisos to section 37(1) of the 1961 Act [*Brij Raman Dass & Sons v. CIT,* (1976) 104 ITR 541, 543 (All), **overruled on another point in** (1995) 215 ITR 165 (SC)]. It is also pertinent to note that the provisions of section 37(2A) of the 1961 Act not only override the provisions of section 37(1) of the 1961 Act but also override those of section 37(2) of the 1961 Act.

EXPENDITURE ON ADVERTISEMENT, ETC.
[Omitted ss. 37(3), 37(4) & 37(5) of 1961 Act]

Advertisement, guest houses, etc., or travelling expenses [s. 37(3) of 1961 Act].—Up to 31-3-1964, there was no specific provision as regards allowability or otherwise of expenditure incurred by a businessman (*i*) on advertisement (*ii*) on maintenance of any residential accommodation including a guest house, and (*iii*) in connection with travelling by an employee or any other person. The allowability of such expenditure was to be judged on the phraseology of section 10(2)(*xv*) of the 1922 Act or section 37(1) of the 1961 Act, as the case might have been. The Finance Act, 1964 (5 of 1964), inserted, with effect from 1-4-1964, section 37(3) of the 1961 Act. **Section 37(3)** of the 1961 Act covers three types of expenditure, if incurred by an assessee after the 31-3-1964. The three types of expenditure are, those incurred—

(*i*) on advertisement;

(*ii*) on maintenance of any residential accommodation, including any accommodation in the nature of a guest house; and

(*iii*) in connection with travelling by an employee or any other person, including hotel expenses or allowances paid in connection with such travelling.

The sub-section provides that notwithstanding anything contained in section 37(1) of the 1961 Act, any such expenditure shall be allowed only to the extent, and subject to such conditions (if any), as may be prescribed.

Rule 6B of the Income-tax Rules, 1962, applies to expenditure incurred on advertisement. The gift of a carpet worth Rs. 3,000 to a foreign buyer is not a case of advertisement on behalf of the assessee when, admittedly, the assessee earns a lot of income from foreign customers [*CIT v. Associated India Exports,* (1991) 188 ITR 125, 126 (Del)]. Similarly, rule 6B of the 1962 Rules was held not applicable in respect of expenses incurred in giving items like sarees, etc., to persons who visit the factory under the direction of the management [*CIT v. Modi Spinning & Weaving Mills Co. Ltd,* (1993) 202 ITR 708, 710 (Del)].

Rule 6B of the 1962 Rules deals with expenditure an advertisement. Rule 6B(1) of the said Rules provides that the allowance in respect of expenditure an advertisement shall not, *inter alia*, in respect of articles intended for presentation, exceed the limits which are set out in that rule. The articles intended for presentation must be such articles, which advertise the company's products [*CIT v. Producin P. Ltd.*, (2007) 290 ITR 598, 608 (Karn)].

Thus, where the presentation articles did not bear either the name of the assessee-company nor its logo, such articles could not be considered as meant for advertisement and, therefore, rule 6B of the 1962 Rules would not be attracted [*CIT v. Allana Sons Pvt. Ltd.,* (1995) 216 ITR 690, 691 (Bom)]. This Bombay view [216 ITR 690 (Bom)] has been **followed in** *CIT v. Sharp Industries Ltd.,* (2003) 173 Taxation 129, 131-32 (Bom). Also see, *CIT v. Producin P. Ltd.,* (2007) 290 ITR 598 (Karn); *CIT v. Lilasons Breweries P. Ltd.,* (2008) 306 ITR 314 (MP); *Shriram Pistons & Rings Ltd. v. CIT*, (2008) 307 ITR 363 (Del); *CIT v. Indian Rayon & Industries Ltd.*, (2011) 336 ITR 479 (Bom) = 236 CTR (Bom) 279.

However, where there is no finding by the Tribunal that the expenditure on purchase of articles for presentation does not advertise the assessee's products, rule 6B of the 1962 Rules is attracted [*Indian Rayon Corporation Ltd. v. CIT,* (1998) 231 ITR 26, 29-30 (Bom)].

No disallowance, by invoking rule 6B of the 1962 Rules, is possible on the mere ground that the presentation items were of value of more than the monetary limit prescribed in that rule 6B of the 1962 Rules without examining the specific contention raised by the assessee that the articles presented to his clients were meant only as a measure of business promotion and not for any advertisement of his products [*CIT v. Mysodet Pvt. Ltd.,* (1998) 233 ITR 674, 677 (Karn)].

In *CIT v. Ratan Chand Samir Mal,* (1985) 154 ITR 399 (Raj), the assessee distributed certain silver glasses amongst its customers. The cost of each glass did not exceed Rs. 50. It was held that the cost of such glasses was eligible for deduction as there was no breach of rule 6B of the 1962 Act making prescriptions about expenditure on advertisements.

In *CIT v. Indian Aluminium Cables Ltd.,* (1990) 183 ITR 611 (Del), the Tribunal gave a categorical finding, after perusing the assessment order, that none of the gifts and presents indicated therein fell in the category of 'advertisement' within the meaning of rule 6B of the 1962 Rules as they do not bear the name of the assessee nor do they have any advertisement value. Such finding does not give rise to any question of law.

When disallowance of expenditure on presents given to foreign business associates is deleted by the Tribunal, the mere fact that full details were not given cannot be a reason for coming to the conclusion that a question of law arises [*CIT v. J.K. Synthetics Ltd.,* (1990) 181 ITR 537, 541 (Del)]. Also see, *CIT v. Bharat Commerce & Industries Ltd.,* (1990) 184 ITR 90, 94 (Del); *CIT v. Bharat Commerce & Industries Ltd.,* (1990) 184 ITR 143 (Del).

In *CIT v. S.P. Textiles Co.,* (1990) 185 ITR 272 (All), the finding of the Tribunal that the amount spent on purchase of articles for distribution amongst selected purchasers was not spent on publicity or on advertisement so as to fall within the provisions of rule 6B of the 1962 Rules has been held to be finding of fact.

In *CIT v. Autofin Ltd.,* (1985) 151 ITR 741 (AP), it has been held that the ceiling prescribed by rule 6D(2) of the 1962 Rules applies to travelling expenses incurred by an 'employee' or 'any other person'. Therefore, the travelling expenses incurred by a director or managing director in excess of the ceiling prescribed in rule 6D(2) of the 1962 Rules are not eligible for deduction under section 37(3) of the 1961 Act. Similarly, a partner of the firm has also to be included within the meaning of 'any other person' [*Shama Magazine v. CIT,* (1998) 232 ITR 430, 431 (Del)].

It is evident from the Andhra decision [151 ITR 741 (AP)] that a director or a managing director of a company will come within the expression 'any other person' mentioned in rule 6D(2) of the 1962 Rules and deduction can be allowed for the travelling expenses incurred by them within the ceiling prescribed thereunder [*CIT v. K.P.V. Shaik Mohamed Rowther & Co.* (*P.*) *Ltd.*, (2000) 242 ITR 245, 249-50 (Mad)]. In that case, the Tribunal was held not justified in sustaining the deletion of the disallowance of Rs. 12,751 under rule 6D of the 1962 Rules. This view has been **followed in** *CIT v. K.P.V. Shaik Mohamed Rowther & Co.* (*P.*) *Ltd.,* (2003) 130 Taxman 494, 496 (Mad).

The expression 'any other person' in rule 6D(2) of the 1962 Rules is broad enough to take within its sweep professionals. While disallowing a sum of Rs. 2,000 out of the travelling expenses, the Tribunal had correctly interpreted rule 6D(2) of the 1962 Rules [*Industrial Cables* (*India*) *Ltd. v. CIT*, (2005) 272 ITR 314, 317 (Punj)].

The phrase 'any other person' in rule 6D(2) of the 1962 Rules would draw its colour from the preceding word, namely, 'employee'. A trustee was not an employee or not akin to an employee and the amounts paid to trustees by the trust could not be disallowed under rule 6D(2) of the 1962 Rules [*CIT v. Shivalik Drug* (*Family Trust*)., (2008) 300 ITR 339, 340, 341 (All)].

In *CIT v. Mangal Tirth Estates Ltd*., (2008) 303 ITR 366, 386 (Mad), it has been held that the assessee was entitled to have the deduction of the expenditure on advertisement in full in the year in which it was incurred.

On a plain reading of rule 6D(1)(*i*) of the 1962 Rules, the assessee was not entitled to claim the expenses incurred by K on travelling and conveyance. It may be added that K's travel was not to a place outside India but was to India. Under such circumstances the authorities below correctly declined to grant to the assessee, the benefit of the provisions of section 37(3) of the 1961 Act read with rule 6D(1)(*i*) of the 1962 Rules [*Kushwaha Exports P. Ltd. v. CIT*, (2008) 214 CTR (Del) 236, 239-40]

For determining whether the amount of expenditure admissible under rule 6D of the 1962 Rules has been exceeded or not, all the business tours undertaken by an employee during the previous year should be taken together and in view of the principle of consistency, revenue cannot be permitted to raise an issue in isolation only for 1 year and that too in the case of one assessee while accepting the findings on the same issue in the case of other assessees and also for other years in the case of the same assessee [*CIT v. Leader Valves Ltd*., (2007) 295 ITR 273, 275 (Punj)].

Relevant rules.—The extent, and the conditions, for allowance of any such expenditure were prescribed in **rules 6AC (omitted w. e. f. 19-11-1999), 6B (omitted w. e. f. 19-11-1999) and 6D of the 1962 Rules (omitted w. e. f. 19-11-1999)** of the Income-tax Rules, 1962.

LexisNexis

The matter is elaborated in a Press Note as follows:—

"*Limits for allowance of expenditure on advertisement and other items—Rules announced.*—The Central Board of Direct Taxes have published, in a Gazette of India, Extraordinary, rules prescribing limits and conditions for the allowance of expenditure incurred on advertisement, maintenance of guest houses and other residential accommodation and on travelling by employees and others for the purposes of the business. The limits and conditions will be applicable to expenditure under these heads incurred by tax-payers in their accounting years commencing (on or) after August 10, 1966. Expenditure incurred in the past accounting years and also the current accounting year will be allowed without the application of these limits and conditions, if otherwise admissible under the provisions of the Income-tax Act.

The main provisions of these rules are as follows:

[8]*Expenditure on Advertisement.*—(1) The expenditure on advertisement through articles intended for presentation will be allowed upto a limit of Rs. 50[9], on the value of each article, and the excess, if any, will be disallowed.

(2) In respect of expenditure in foreign exchange for publicity outside India, the allowance will be limited to the amount for which foreign exchange permission has been given.

(3) The Income-tax Officer will have the power to disallow that part of the expenditure on advertisement which in his opinion is excessive or unreasonable having regard to the legitimate business needs of the tax-payer and the benefit derived by him or accruing to him therefrom. Such disallowance can, however, be made only in the following cases, *viz.*:

---

8. See, rule 6B of the Income-tax Rules, 1962.

9. Raised to Rs. 200 (w. e. f. 12-4-1990). As a result of the amendment of rule 6B(1)(*a*) by the Income-tax (Eighth Amendment) Rules, 1992, effective for and from assessment year 1993-94, the limit of Rs. 200 has been raised to Rs. 1,000 where the amount of such expenditure does not exceed Rs. 1,000 on each such article; in any other case, to Rs. 1,000 on each such article as increased by a sum equal to 50% of the expenditure in excess of Rs. 1,000 on such article.

(*i*) where the payment is made to a person who has a substantial interest in the business of the tax-payer or to a relative of such person;

(*ii*) where the payment is made to a person who carries on business or profession as a publicity or advertising agent and the tax-payer has a substantial interest in that business or profession.

A person will be treated as having a substantial interest in a business if he is entitled to not less than 20% of the profits of the business or is the beneficial owner of not less than 20% of the equity capital of the company which owns the business.

Where, either the tax-payer or the person to whom the payment is made, is a company or a firm or a Hindu undivided family or an association of persons, the test of 'substantial interest' will be applied also to directors of the company, partners of the firm or members of the family or association, as the case may be, and also to any relative of such director, partner or member.

(4) Where a single payment exceeding Rs. 2,500[10] in respect of expenditure on advertisement has been made otherwise than by crossed cheque on a bank or by a crossed bank draft, the expenditure represented by such payment will be disallowed in computing the taxable income.

[11]*Expenditure on Residential Accommodation including Guest Houses*

(*i*) *Guest Houses.*—The allowance will be limited to expenditure on the maintenance of one or more guest houses at the following places only:—

(*a*) The principal place of business or profession of the tax-payer in India.

(*b*) Place where the tax-payer has an industrial establishment employing not less than 50 whole-time employees.

(*c*) The place where any operations relating to raising or processing of raw materials or manufacture, processing or production of any article or thing are carried on.

(*d*) In the case of a bank, the city of Bombay and in the case of other tax-payers, the city of Delhi (including New Delhi).

(*e*) Two other places in India, which may be the capital of the State Government or any other place of direct importance to the business of the tax-payer, as for example, the place where the administrative offices or sales or purchasing offices are situated.

Accommodation hired or reserved by the tax-payer in a hotel for a minimum period of 182 days in a year for the use of employees or other persons for the purpose of the business or profession will be deemed to be a 'guest house' maintained by the tax-payer at the place at which the hotel is situated.

(*ii*) *Holiday homes.*—In addition to expenditure on guest houses at the above-mentioned places, expenditure on one or more holiday homes maintained mainly for the use of employees drawing salary not exceeding Rs. 1,000 per month while on leave, will also qualify for allowance in the case of a tax-payer who has not less than 100 whole-time employees in his employment throughout the relevant previous year.

(*iii*) *Residential accommodation provided to individual employees.*—In the case of tax-payers other than companies, the allowance for expenditure on maintenance of residential accommodation provided for use of an individual employee with total emoluments exceeding Rs. 7,500 in the year will be limited to 20% of the salary of each such employee. In the case of companies, a similar limit is already applicable under section 40(*c*)(*iii*)[12] of the Income-tax Act.

(*iv*) *Register to be maintained.*—The tax-payer will be required to keep a register in each guest house maintained by him. No specific form is prescribed for this register, but the following information has to be recorded in any register maintained by the tax-payer for the purpose:

(1) Name and address of employee or director of the company, partner of the firm or member of the association of persons or Hindu undivided family, who stays in the guest house.

LexisNexis

10. Raised to Rs. 10,000 (w. e. f. 12-4-1990).

11. These provisions were contained in rule 6C of the Income-tax Rules, 1962. The Finance Act, 1970 (19 of 1970), inserted a new section 37(4) of the 1961 Act under which expenditure incurred after 28th February, 1970, on the maintenance of guest houses (other than 'holiday homes') and depreciation on any building used as a guest house or depreciation on any asset in such guest house are not to be allowed as a deduction in computing the taxable profits. Thus, rule 6C became inapplicable from the assessment year 1971-72 and was, therefore, omitted with effect from 1-4-1972.

12. Section 40(*c*)(*iii*) has been omitted by the Finance Act, 1968 (19 of 1968), with effect from April, 1, 1969. Provisions similar to section 40(*c*)(*iii*) were then reflected in section 40(*a*)(*v*), inserted by that Act, with effect from April 1, 1969, making such provisions applicable to all assessees. Section 40(*a*)(*v*) has been omitted by the Finance (No. 2) Act, 1971 (32 of 1971), with effect from 1-4-1972 and thereafter section 40A(5), inserted with effect from that date, contained such provisions prior to its omission with effect from 1-4-1989.

(2) Whether the stay in the guest house was for the purpose of the business or profession of the tax-payer.

(3) Date of arrival of the employee or director, partner or member at the guest house, and the date of his departure therefrom.

(4) The amount, if any, paid by him towards boarding and lodging in the guest house.

[13]*Expenditure in connection with travelling by employees and other persons*

(*i*) *Foreign Travel.*—Expenditure on travelling outside India by an employee or other person will be apportioned as relating to the business or profession of the tax-payer and for personal purposes. This apportionment will be made according to the *ratio* of the number of days mainly devoted by the employee or other person for the purposes of the business or profession of the tax-payer to the total number of days spent outside India (excluding, in either case, travelling days). Where the employee or other person has to stay in a foreign country over the week-end holidays in order to continue the business discussions in the following week, the week-end holidays will not be treated as non-business days for this purpose. The *ratio*, as stated, will be applied to the amount of the expenditure for which permission has been granted under the law relating to foreign exchange taken together with the expenditure incurred in Indian currency for which no such permission was required.

(*ii*) *Travelling in India.*—The allowance in respect of expenditure on travelling in India by an employee or other person outside his headquarters will be limited to the aggregate of the following amounts:

(*a*) Actual expenditure on journeys.

(*b*) Daily allowance for the period spent outside headquarters at the rates specified below:

(*i*) In the case of an employee whose salary is Rs. 1,000 per month or more	Rs. 100[14] per day or part thereof.
(*ii*) In the case of any other employee	Rs. 50[14] per day or part thereof.
(*iii*) In the case of any other person	The amount calculated at the rates applicable to the highest paid employee of the taxpayer.

LexisNexis

Where the stay outside headquarters is at Bombay, Calcutta or Delhi, the limits will be 1½ times[15] the amounts specified above. However, all these limits will be reduced to one-third where the employee or other person stays free of charge in a guest house maintained by the tax-payer, and to one-half where the employee or other person is allowed free lodging only in such a guest house.

Expenditure on travelling at the headquarters of the employee or other person for the purpose of the business or profession of the tax-payer will not be subject to any limits under these rules." [*Press Note, dated 10-8-1966.*]

Expenditure on advertisement.—The use of *non obstante* clause in the opening of section 37(3) of the 1961 Act clearly excludes the considerations which are contemplated by section 37(1) of the 1961 Act. It, therefore, follows that if once it is found that an expenditure incurred on or after 1-4-1964, is on advertisement, deduction in respect thereof can be claimed under the conditions of section 37(3) of the 1961 Act read with rule 6B of the 1961 Act. Thus, the question whether the expenditure is of capital nature or revenue nature does not at all arise. Deduction on account of expenditure on advertisement is *qua* advertisement and not *qua* its capital or revenue nature [*Mohan Meakin Breweries Ltd. v. CIT,* (1979) 118 ITR 101, 103-04 (HP)]. Also see, *CIT v. Raj Bros.,* (1988) 171 ITR 249, 252 (AP).

In *CIT v. Dascroi Taluka Co-operative Purchase and Sales Union Ltd.,* (1980) 126 ITR 413 (Guj), the assessee, on completing 25 years of its existence, celebrated its Silver Jubilee. It sent certain of its employees to

---

13. See, rule 6D of the Income-tax Rules, 1962.

14. The rates from time to time are:

(*i*) from 10-8-1966 Rs. 100 per day or part thereof;

(*ii*) from 1-4-1972 Rs. 80 per day or part thereof;

(*iii*) from 1-4-1976 Rs. 100 per day or part thereof; and

(*iv*) from 18-6-1980 to 31-3-1992 Rs. 150 per day or part thereof.

As a result of the substitution of rule 6D(2)(*b*) by the Income-tax (Eighth Amendment) Rules, 1992, for and from assessment year 1993-94, the rates are:—

(*i*) where the amount of such expenditure does not exceed Rs. 1,500 per day, the whole of such amount;

(*ii*) in any other case, Rs. 1,500 as increased by a sum equal to seventy-five per cent. of such expenditure in excess of Rs. 1,500 per day.

15. With effect from 18-6-1980, this has been changed to '1⅓ rd times'.

Bombay for purchasing wall clocks for presentation to other co-operative societies who were its members. It also purchased household stainless steel utensils which were distributed to its members. It claimed allowance for the amount spent on travelling and on making the purchases. It was held that the expenditures were incurred by the assessee-company for the purposes of inducing the members to keep good relations with the assessee. Such expenditure cannot be said to have been spent on advertisement. The expenditures were held allowable, **following** *CIT v. S.L.M. Maneklal Industries,* (1977) 107 ITR 133 (Guj); *Amarjothi Pictures v. CIT,* (1968) 69 ITR 755 (Mad) and *CIT v. Tata Sons P. Ltd.,* (1978) 111 ITR 290 (Bom). Also see, *CIT v. Escorts Employees Ancillaries Ltd.,* (1997) 224 ITR 28, 33 (Punj).

In *Karjan Co-operative Cotton Sales Ginning & Pressing Society v. CIT,* (1993) 199 ITR 17, 33 (Guj—FB), it has been ruled that the *ratio* of the decision of the Division Bench of the Gujarat High Court in *CIT v. Dascroi Taluka Co-operative Purchase & Sales Union Ltd.,* (1980) 126 ITR 413 (Guj) lays down good law.

A harmonious reading of section 37(3) of the 1961 Act read with rule 6B of the 1962 Rules and section 40A(3) of the 1961 Act read with rule 6DD of the 1962 Rules leads one to conclude that, in case of any expenditure on advertisement in excess of the monetary limit of section 40A(3) of the 1961 Act, the requirements of rule 6B of the 1962 Rules have to be regulated by the second proviso to section 40A(3) of the 1961 Act, which second proviso enables the assessee to take shelter under the mitigating circumstances prescribed under rule 6DD of the 1962 Rules. But that does not mean that in such a case the expenditure on advertisement should only be governed by the provisions of section 40A(3) of the 1961 Act alone and not by the prescriptions of rule 6B of the 1962 Rules made in that regard [*CIT v. Diamond Finance,* (1995) 212 ITR 472, 481 (Mad)].

So far as expenditure incurred on purchase of gift items is concerned, allowance is to be restricted upto the amount specified in rule 6B(1) of the 1962 Rules with respect to each article of presentation [see, *CIT v. Escorts Employees Ancillaries Ltd.,* (1997) 224 ITR 28, 33 (Punj)].

Where the Tribunal has arrived at a finding that the distribution of the watches amongst the existing dealers and stockists was not for the purpose of advertisement but for maintaining good relations and, therefore, expenditure towards the cost of the watches so distributed cannot be disallowed under rule 6B(3) of the 1962 Rules, such a finding cannot give rise to a question of law [*CIT v. Ayurved Sewa Ashram Ltd.,* (1997) 225 ITR 778, 780 (Raj)].

Any presentation made to the delegates, directors or shareholders who essentially are not members of the public and thus being not a potential buyer, the same would not amount to 'advertisement' [*Sarda Plywood Industries Ltd. v. CIT*, (1999) 238 ITR 354, 364 (Cal)]. In that case, the disallowance of a sum of Rs. 1,07,570 towards the price of the silver boxes given as presentation by the assessee to its dealers was held not justified.

In *T.V. Sundaram Iyengar & Sons Ltd. v. CIT,* (2000) 241 ITR 420, 422 (Mad), it has been held that as found by the Tribunal no details regarding the presentation articles in respect of which a claim for deduction had been made under section 37(3) of the 1961 Act read with rule 6B of the 1962 Rules had been furnished, the Tribunal was held justified in confirming the disallowance of Rs. 94,708 in respect of presentation articles for the assessment year 1987-88.

Where the Tribunal has found, on the facts, that the expenditure incurred by the assessee on purchase of articles for presentation was not incurred for advertising its product, it could not be disallowed as advertisement expenses [*CIT v. West Coast Paper Mills Ltd.*, (2001) 250 ITR 506, 507-08 (Bom)].

Where the Tribunal, after analysing the factual aspects has held that the amount was spent for the purpose of advertisement, such a conclusion being factual did not give rise to any question of law [*CIT v. Gem Financiers & Distributors P. Ltd.*, (2001) 250 ITR 786, 788-89 (Del)].

In *Oriental Science Apparatus Workshops v. CIT,* (2002) 254 ITR 271, 272 (Punj), it has been held that the Tribunal was wrong in taking the view that the allotment of pages in souvenirs and magazines was only to satisfy the ego of certain persons who are interested in the assessee-firm as partners or relation of partners. The expenses incurred by the assessee-firm for giving advertisement in souvenirs and magazines were held allowable under section 37(3) of the 1961 Act.

In *CIT v. Berger Paints* (*India*) *Ltd.,* (2002) 254 ITR 503, 506 (Cal), it has been held that advertisement expenses are normally to be treated as revenue expenditure since the memory of the purchasing market is short and advertisement is needed from year to year and cannot be made once for all in any single particular year.

In *CIT v. Shree Panchaganga Sahakari Sakhar Karkhana Ltd.*, (2002) 254 ITR 572, 574 (Bom), **following** *CIT v. Shree Panchaganga Sahakari Sakhar Karkhana Ltd.*, (2000) 250 ITR 772 (Bom), the disallowance of shubhechha greetings was not upheld because the same represented advertisement expenses.

In *Hemraj Nebhomal Sons v. CIT,* (2005) 278 ITR 345, 348 (MP), it has been held that expenditure incurred by the assessee towards advertisement and sales promotion for the purpose of business for assessment years

LexisNexis

1989-90 and 1990-91 were held to be allowable deductions. Also see, *Hemraj Nebhomal v. Union of India*, (2008) 306 ITR 40, 42 (MP).

In *Motor Industries Co. Ltd. v. Deputy CIT,* (2006) 285 ITR 365, 369 (Karn), it has been held that the appellant was a large company spending lakhs of rupees for advertising expenses. In the instant case, the amount involved was hardly Rs. 1,60,000 and, in the light of the nature of the articles presented, the same could not be treated as advertising expenses.

The assessee claimed deduction of advertisement charges. The assessee had changed from cash system to mercantile system. As regards advertisement it was not denied that the expenditure incurred was for the purpose of business and the possible benefit in future did not militate against the claim for expenditure. Thus, the Tribunal correctly held that the assessee was entitled to deduction sought for [*CIT v. Brilliant Tutorials P. Ltd*., (2007) 292 ITR 399, 405 (Mad)].

In *CIT v. Salora International Ltd.,* (2009) 308 ITR 199, 201 (Del), it has been held that the advertisement expenditure for launching of products having direct nexus between advertising expenditure and business of the assessee and the said expenditure being revenue in nature. Also see, *CIT v. Salora International*, (2009) 177 Taxman 456, 457 (Del); *CIT v. Spice Distribution Ltd.*, (2015) 374 ITR 30, 34 (Del).

In *Deputy CIT v. Core Healthcare Ltd*., (2009) 308 ITR 263, 270 (Guj), it has been held that the advertisement expenses incurred by the assessee to create brand image held admissible as revenue expenditure.

In *CIT v. Liberty Group Marketing Division,* (2009) 315 ITR 125, 132 (Punj), it has been held that the assessee had incurred expenditure on glow sign boards with an object to facilitate the business operation and not with an object to acquire an asset of enduring nature and, thus, such expenditure rightly held to be of revenue nature.

The expenditure incurred on production of television film for advertising purposes been rightly held admissible for deduction from profit. While treating such expenditure as of revenue nature, there was no illegality in the order of the Tribunal [*CIT v. Liberty Group Marketing Division*, (2009) 315 ITR 125, 133 (Punj)]. Also see, *CIT v. Geoffrey Manners & Co. Ltd*., (2009) 315 ITR 134, 136-37 (Bom).

In *Yum! Restaurants* (*India*) (*P.*) *Ltd. v. CIT,* (2009) 224 CTR (Del) 383, 390, it has been held that incentive paid to franchisees towards reimbursement of advertisement expenses under a scheme formulated in April, 2001, held not deductible in assessment year 2001-02.

Since the assessee-company was under no obligation whatsoever to contribute any money to the subsidiary and the assessee company has not been able to prove that the contributions were made on account of commercial expediency, the contribution made by the assessee-company towards advertisement, marketing and promotional activities undertaken by its wholly owned subsidiary company is not admissible as deduction [*Yum! Restaurants* (*India*) (*P.*) *Ltd. v. CIT*, (2009) 224 CTR (Del) 383, 391].

On account of franchise agreements, assessee had deferred advertising expenses incurred by it. It conducted business by appointing franchisees for showrooms but due to some unforeseen circumstances, agreements with franchisees got revoked and the assessee claimed deduction of entire expenditure and the same was held admissible in relevant assessment year [*CIT v. Diamond Products Ltd*., (2009) 177 Taxman 331, 334 (Del)].

Mere hiring of a space on hoardings could not be treated as expenditure for advertisement or publicity or sales promotion and, hence, not deductible [*Bakelite Hylam Ltd. v. CIT*, (2012) 349 ITR 317 (AP)].

The advertisement expenses in question held admissible as the main purpose of such expenses was to augment sales [*CIT v. Adidas India Marketing* (*P.*) *Ltd.*, (2010) 195 Taxman 256 (Del)].

In *CIT v. Bonanza Portfolio Ltd.,* (2011) 202 Taxman 545 (Del), it has been held that expenses incurred on ad films for promotion and marketing of products by way of advertisements held to be admissible deduction.

In *CIT v. Rakhra Technologies* (*P.*) *Ltd.,* (2011) 203 Taxman 154 (Punj), it has been held that for merely facilitating the assessee into trading operations, the advertisement expenses spent on purchase of sign boards were admissible one.

In *CIT v. Dey's Medical Stores Manufacturing P. Ltd.,* (2013) 355 ITR 126 (All), the payment of 8 per cent of the sales realization, to the Calcutta company, to reimburse it for expenditure incurred by it on behalf of the assessee in maintaining the sales promotion office and other infrastructure for advertising its product held as admissible one.

Advertising a product, what it involves.—Advertising a product involves an intention and several factors including the person to whom it is presented, how it is presented and when it is presented. Presentation of an article with the name of the company to a dignitary or a VIP would not by itself amount to an advertisement, unless sufficient material is forthcoming with regard to the details of advertising nature [*Motor Industries Co. Ltd. v. Deputy CIT*, (2006) 285 ITR 365, 368 (Karn)].

LexisNexis

Expenditure on advertisement in souvenirs.—Prior to insertion of section 37(3) of the 1961 Act, expenditure incurred on advertisement in souvenirs published by charitable organisations and institutions was held to be for business purposes and, therefore, deductible [see, *British Electrical and Pumps P. Ltd. v. CIT,* (1977) 106 ITR 620 (Cal)].

In *Godavari Sugar Mills Ltd. v. CIT*, (1991) 191 ITR 311, 314-15 (Bom), a case relating to assessment year 1963-64 when section 37(3) of the 1961 Act was not on the statute book, the assessee claimed deduction in respect of expenditure on advertisements in souvenirs published by charitable trusts. The entire expenditure was disallowed by the ITO but only 25% of the expenditure was disallowed by the Tribunal. On a reference, it has been held that the manner in which the expenditure had been dealt with by the appellate authorities indicated that they considered the expenditure to have been incurred for the purpose of business. That being so, the mere fact that the expenditure was also motivated by charity would not justify any disallowance. The entire expenditure was deductible. This decision has been **followed in** *Godavari Sugar Mills Ltd. v. CIT*, (1992) 193 ITR 141, 144-45 (Bom), a case relating to assessment year 1965-66, without noticing the provisions of section 37(3) of the 1961 Act which are operative for and from assessment year 1964-65.

After insertion of section 37(3) of the 1961 Act, the allowance is to be guided by the prescriptions of that section. There are three circulars on the subject of allowability or otherwise of expenditure on advertisement in souvenirs, which are as follows:—

(1) *Disallowance of expenditure on advertisements in souvenirs.*—It has been represented to the Board that expenditure incurred by businessmen on advertisements in souvenirs by trade, commerce and industry should be allowed in full in the same manner as expenditure on advertisements in newspapers since the purpose of both kinds of advertisements is identical.

2. The matter has been examined. The position, in law, is that expenditure on advertisements in souvenirs[16] by trade, commerce and industry will be admissible in full if it can be said to have been laid out wholly and exclusively for purposes of business. Rule 6B of the Income-tax Rules which lays down the extent and the conditions subject to which expenditure on advertisement is to be allowed under section 37(3) of the Income-tax Act, does not bar the allowance of expenditure on advertisements in souvenirs, etc., in full. It is only where donations are given in the garb of advertisement expenses that the expenditure is inadmissible. Even in such cases, the donations should be considered for relief under section 80G of the Income-tax Act if the conditions mentioned in that section are fulfilled [*Circular No. 19, F. No. 9/20/69-IT (A-II), dated 13-6-1969*].

(2) *Disallowance of expenditure on advertisements in souvenirs.*—Attention is invited to Board's Circular No. 19 [F. No. 9/20/69-IT (A-II)], dated the 13th June, 1969, on the above subject.

2. It has been represented to the Board that expenditure on advertisements in souvenirs[17] is expenditure incurred wholly and exclusively for the purpose of business and as such is allowable as a deduction under section 37(1) of the Income-tax Act, 1961. Disallowance of a part of expenditure on advertisement in souvenirs by the Income-tax Officer on the ground that it is in the nature of donation has caused hardship to the assessees and has caused avoidable litigation.

3. The Board has re-examined the question in the light of the representations made. It is clarified that no distinction need be drawn between expenditure on advertisements in souvenirs and other types of advertisements. Claims in respect of expenditure on advertisements in souvenirs may be allowed if the conditions laid down in rule 6B of the Income-tax Rules, 1962, are fulfilled and there is evidence that the expenditure has been incurred [*Circular No. 200, dated 28-6-1976*].

(3) *Disallowance of expenditure on advertisements in souvenirs.*—Reference is invited to Board's Circular No. 200, dated the 28th June, 1976, by which it was clarified that no distinction need be drawn between expenditure on advertisements in souvenirs and other types of advertisements.

2. A question has been raised as to whether an assessee can resort to publicity in more than one souvenir published by the same institution/organisation. Souvenirs are one of the recognised media of publicity. A businessman can advertise in more than one newspaper or magazine and also in more than one issue of the same newspaper or magazine. Expenditure on such advertisements will qualify for deduction under section 37(3) of the Income-tax Act, 1961, read with rule 6B of the Income-tax Rules, 1962. Similarly, if advertisements have been released in more than one souvenir[18] published by the same organisation, deduction in respect of such publicity will be admissible provided the aforesaid conditions are satisfied [*Circular No. 203, dated 16-7-1976*].

---

16. Now, reference may also be made to section 37(2B), for and from assessment year 1979-80.
17. Now, reference may also be made to section 37(2B), for and from assessment year 1979-80.
18. Now, reference may also be made to section 37(2B), for and from assessment year 1979-80.

In the facts of *CIT v. Sundaram Finance Pr. Ltd.*, (1985) 154 ITR 564 (Mad), it was held that *Circular No. 200, dated 28-6-1976* had application. Merely because the advertisement given by the assessee were published in the souvenirs released by a political party on the eve of election, they did not cease to be advertisements and the expenses incurred therefor could not be labelled as donations to a political party. Expenditure on such advertisements was held allowable for the assessment year 1973-74 as the conditions of rule 6B were also satisfied.

In *CIT v. Saurashtra Cement & Chemicals Industries Ltd.*, (1987) 163 ITR 258 (Guj), the assessee incurred expenditure on advertisements in souvenirs issued by charitable institution. The Tribunal did not give any finding whether the expenditure was on advertisements eligible for deduction under section 37(1) of the 1961 Act or the same was to be treated as a donation eligible for straight deduction under section 80G of the 1961 Act. In the absence of such a finding, the matter was remanded to the Tribunal.

In *Century Spinning & Manufacturing Co. Ltd. v. CIT*, (1991) 189 ITR 660, 662 (Bom), relying on the *Circular No. 200, dated 28th June, 1976*, it has been held that expenditure incurred on advertisement in souvenirs were allowable, for assessment year 1972-73, in their entirety.

In the facts of *Indian Trading Corporation v. CIT*, (1995) 216 ITR 751, 757 (Gauh), considering the commercial expediency from the businessman's stand point, expenditure on advertisements taken out in the souvenirs published by the Delhi Flying Club Ltd. and the AICC Souvenir Committee has been held allowable being incurred wholly and exclusively for the assessee's business.

In *CIT v. F.C. Sondhi & Co.* (*India*) *Pvt. Ltd.*, (1998) 230 ITR 279, 287-88 (Punj), it has been held that the payment made by the assessee for giving an advertisement in the souvenir of the political party is an expenditure on advertisement and the same cannot be treated to be a donation. Hence, it is allowable as business expenditure.

Expenditure on maintenance of residential accommodation, etc.—*Provisions.*—The second type of expenditure which falls within the sweep of section 37(3) of the 1961 Act concerns expenditure on maintenance of any residential accommodation including any accommodation in the nature of a guest house. The conditions contemplated by section 37(3) of the 1961 Act were contained in rule 6C of the 1962 Rules [see, "*Expenditure on residential accommodation including guest houses*", under section 37(3), *ante*]. As explained, *ante*, under section 37(3) of the 1961 Act, rule 6C of the 1962 Rules was omitted with effect from 1-4-1972.

Where the disallowance of expenditure on maintenance of a guest-house was held unjustified on the plea taken by the department that it was "entertainment expenditure" and the department sought, for the first time before the Supreme Court, to bring that expenditure under section 37(3) of the 1961 Act for justifying the disallowance, the Supreme Court did not permit to raise such a plea at that stage [*CIT v. Sirpur Paper Mills Ltd.,* (1978) 112 ITR 776 (SC)].

In *Modi Spinning & Weaving Mills Co. Ltd. v. CIT,* (1993) 200 ITR 544, 554-55 (Del), it has been held that amount spent towards cost of food and refreshment of the customers of the assessee-company could not be regarded as expenditure incurred on maintenance of any residential accommodation including any accommodation in the nature of a guest house so as to attract the provisions of section 37(3) of the 1961 Act. The expenses which are contemplated by section 37(3) of the 1961 Act are those which have to be incurred by an assessee irrespective of the fact whether a guest stays or not, or are those types of expenses which are necessary for the upkeep and running of the establishment. Provision for food and refreshment is something extra. Also see, *CIT v. Modi Spinning & Weaving Mills Co. Ltd.,* (1993) 109 CTR (Del) 319, 321.

In *CIT v. Gujarat State Financial Corporation,* (1994) 210 ITR 698, 699-700 (Guj), the guest house expenditure has been held allowable under section 37(1) of the 1961 Act as the same was not an entertainment expenditure as found by the Tribunal.

In *Raja Bahadur Motilal Poona Mills Ltd. v. CIT,* (1995) 212 ITR 175, 176 (Bom), the assessee has been held entitled for the expenditure incurred on the maintenance of the guest house for the assessment year 1970-71 in accordance with section 37(3) of the 1961 Act.

Guest-house—what it is?—The term "guest-house" is not defined in the Act. The dictionary meaning of "guest-house", as per the *Random House Dictionary,* is "a building, separate from a main house or establishment, for the housing of guests". In *the Shorter Oxford Dictionary,* third edition, the meaning is given as "an inn—a house or apartment for the reception of strangers or guests". In view of this, unless the guest-house is intended for use by complete strangers, it cannot be called a guest-house within the meaning of section 37(3) of the 1961 Act. A house intended for use, in the case of a company, only by its directors, or, in the case of a firm, only by its partners, etc., is a residential accommodation but not a guest-house [*CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad)].

Section 37(5) of the 1961 Act**, inserted by the Finance Act, 1983** (11 of 1983), with retrospective effect from 1-4-1979, defines what a guest-house is. For the scope and effect of the new section 37(5), reference may be made to paragraphs 34.1 and 34.2 of the departmental circular No. 372, dated 8th December, 1983.

That section 37(5) of the 1961 Act enacts clarificatory provisions and provides that any accommodation, by whatever name called, maintained, hired, reserved or otherwise arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person (including any employee or, where the assessee is a company, also any director of, or the holder of any other office in, the company), on tour or visit to the place at which such accommodation is situated, is accommodation in the nature of a guest-house within the meaning of section 37(4) of the 1961 Act. The provisions of section 37(5) of the 1961 Act are operative, retrospectively, for and from assessment year 1979-80. In other words, that section 37(5) of the 1961 Act has clarified that accommodation maintained by the assessee to provide lodging or boarding and lodging to any person including any employee or a director or the holder of any office in the assessee-company would be in the nature of a guest house within the meaning of section 37(4) of the 1961 Act [*CIT v. Ocean Carriers Pvt. Ltd.,* (1995) 211 ITR 357, 361 (Bom)]. In that case, the assessee-company acted as freight and shipping agent for non-resident shipping companies. The assessee-company owned flats and in the course of its business, the shipping crew and representatives of non-resident shipping companies which had dealings with the assessee were put in these flats. On the question of allowability of the expenditure incurred on the maintenance of these flats as also depreciation allowance on these flats in relation to assessment year 1977-78, it has been held that these flats were in the nature of guest houses and assessee was not entitled to claim deduction on the maintenance expenses and depreciation as these guest houses were not maintained exclusively as a holiday home for employees of the assessee-company. Also see, *CIT v. Modipon Ltd.,* (1995) 80 Taxman 228, 232 (Del).

In *CIT v. Cooper Engineering Co. Ltd.,* (1999) 153 Taxation 232, 233 (Bom), it has been held that the assessee-company was entitled to the claim of deduction of expenses as well as depreciation on the guest house for the assessment year 1976-77.

In *CIT v. Carborandum Universal Ltd.,* (1998) 149 CTR (Mad) 309, 313-14, **following** *CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad)] and **dissenting from** *CIT v. Ocean Carriers Pvt. Ltd.,* (1995) 211 ITR 357 (Bom), it has been held that the employees of the assessee cannot be regarded as strangers and only if the accommodation is maintained for strangers, that place and accommodation could be regarded as a 'guest house' within the meaning of section 37(4) of the 1961 Act for assessment year 1975-76. The retrospective amendment with effect from 1-4-1979 by the Finance Act, 1983 (11 of 1983), by inserting a new section 37(5) of the 1961 Act cannot be regarded as of clarificatory nature.

LexisNexis

Since the provisions of section 37(5) of the 1961 Act are operative with effect from 1-4-1979, the same are not applicable to assessment year 1978-79 and, therefore, the assessee was held entitled to deduction in respect of expenditure incurred on the maintenance of the guest house and the depreciation on the building used as a guest house, for assessment year 1978-79 [*CIT v. Chemicals & Plastics India Ltd.,* (1998) 145 CTR (Mad) 294, 296 = (1999) 239 ITR 846, 847-48 (Mad), **following** *CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad)].

In *CIT v. Neyveli Lignite Corporation Ltd.,* (2000) 244 ITR 521, 527-28 (Mad), it has been held that the accommodation maintained by the assessee for business guests who come and stay in the assessee's bungalow was a guest house attracting the provisions of section 37(4) of the 1961 Act for the assessment years 1970-71 to 1976-77. Further, for assessment year 1979-80, such as accommodation is liable to be regarded as a guest house in view of the specific provisions enacted in section 37(5) of the 1961 Act.

In *CIT v. Gujarat Industrial Development Corporation,* (2001) 170 CTR (Guj) 19, 23, it has been held that any accommodation exclusively used by the assessee for the purpose of providing accommodation to its employees during their visit on official tour cannot be considered as 'guest house' for the purpose of section 37(4) of the 1961 Act for the assessment year 1976-77, to which assessment year the provisions of section 37(5) of the 1961 Act (operative for and from assessment year 1979-80) are not applicable. In that view of the matter, the expenditure of Rs. 66, 248 incurred by the assessee on such accommodation has been held to be allowable deduction.

The then rule 6C of 1962 Rules made prescriptions for guest house only.—Section 37(3) of the 1961 Act contemplates two categories of accommodation maintained by an assessee. One is residential accommodation and the other is accommodation in the nature of a guest-house. So far as rule 6C of the 1962 Rules (omitted with effect from 1-4-1972) was concerned, it made prescriptions only in respect of the latter category, *i.e.*, a residential accommodation in the nature of a guest-house. No prescription was made in respect of the former category, *i.e.*, a residential accommodation. Thus, rule 6C of the 1962 Rules, even when it was in force, had no application to a residential accommodation which was not in the nature of a guest-house [*CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad); *CIT v. Commonwealth Trust Ltd.,* (1979) 120 ITR 491 (Ker)]. A register prescribed in rule 6C(3) of the 1962 Rules was necessary only in the case of guest-houses [*CIT v. Aruna Sugars Ltd.,* (1980) 123 ITR 619 (Mad)]. Also, the maintenance of the register prescribed in rule 6C(3) of the 1962

Rules did concern only the persons specified therein and not to others, *e.g.*, customers of the assessee [*Karnatak Exports Ltd. v. CIT,* (1980) 121 ITR 154 (Karn). Also see, *CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 124 (Bom); *CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 128 (Bom)].

In the facts of *Nava Bharat Enterprises Pr. Ltd. v. CIT,* (1983) 143 ITR 804, 807 (AP), the assessee was held not entitled to deduction in respect of expenditure on account of maintenance of guest house because it had not maintained the register as required by the then rule 6C(3) of the 1962 Rules. Also see, *Golcha Properties* (*P.*) *Ltd. v. CIT,* (1988) 169 ITR 525 (Raj).

Thus, where no register has been maintained by the assessee, expenditure incurred, till 28-2-1970, on maintenance of a guest house, even though termed as a rest house, has been held not allowable under section 37(3) of the 1961 Act read with the then rule 6C of the 1962 Rules [*CIT v. West Coast Paper Mills Ltd.,* (1992) 193 ITR 349, 353-54 (Bom)].

Gamut of expenditure incurred on a guest house.—The expenditure on maintenance of a residential accommodation in the nature of a guest house includes the expenditure also of providing food and other amenities to the guests using it [*Karnatak Exports Ltd. v. CIT,* (1980) 121 ITR 154 (Karn); *Saraswati Industrial Syndicate Ltd. v. CIT,* (1982) 136 ITR 361 (Punj)]. Also see, *CIT v. Saraswati Industrial Syndicate Ltd.,* (1982) 136 ITR 758 (Punj).

The expenditure in the nature of salary of cook-*cum*-servant, curtains, repairs of bathroom and other day to day expenditure falls to be considered under section 37(1) of the 1961 Act only and the provisions of section 37(3) of the 1961 Act are not attracted in respect of such expenditure [*CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 124 (Bom); *CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 128 (Bom)].

The expenditure on rent in respect of a guest-house has been held allowable under section 30 of the 1961 Act and the expenses on repairs and polishing of the furniture in the guest-house have been held allowable under section 31. These were held not disallowable under section 37(3) of the 1961 Act [*CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 124 (Bom); *CIT v. Chase Bright Steel Ltd.,* (1989) 177 ITR 128 (Bom)].

The question whether the Tribunal was right in holding that the expenditure incurred on the maintenance of the guest-house and the depreciation on such building should be allowed as a deduction has been held to be one of law [*CIT v. Chemical and Plastics* (*India*) *Ltd.,* (1987) 65 CTR (Mad) 332].

Expenditure in connection with travelling, etc.—Section 37(3) of the 1961 Act lays down that expenditure incurred in connection with travelling by an employee or any other person shall be allowed only to the extent, and subject to such conditions, if any, as may be prescribed. Rule 6D of the 1962 Rules makes prescriptions about such conditions. The expression 'in connection with' in section 37(3) of the 1961 Act includes matters occurring prior to as well as subsequent to or consequent upon, so long as they are related to the principal thing. In other words, whatever has nexus to the travel undertaken in connection with the work outside the headquarters resulting in the stay, such stay, whether actual work in connection with the company's affairs was carried out or not, would be relatable to the travel undertaken which was undisputably in connection with the work of the company and, therefore, the only logical inference to be drawn is that the stay also was in connection with the work as it is intimately connected with the travel undertaken [*Stumpp, Schuele & Somappa Ltd. v. CIT,* (1991) 190 ITR 152, 154-55 (Karn)]. In the facts of that case, the Tribunal was held right in holding that the expenses incurred by the assessee on account of its employees attending to its business from outside its headquarters for the days on which the employees did not actually travel would also come under the purview of section 37(3) of the 1961 Act read with rule 6D of the 1962 Rules.

Rule 6D(2) of the 1962 Rules read with section 37(3) of the 1961 Act seeks to limit the expenditure incurred on travelling to the extent of stay in hotels confining it to daily allowances referred to in rule 6D(2) of the 1962 Rules and do not extend to any other expenditure incurred provided the expenditure is wholly and exclusively laid out for the purpose of business [*CIT v. Vidyut Metallics Ltd.,* (1993) 203 ITR 779, 783 (Cal)].

Also see, *Union Carbide India Ltd v. CIT,* (1994) 72 Taxman 63, 68-69 (Cal).

The provisions of rule 6D(2) of the 1962 Rules have to be read harmoniously with the provisions of section 37(3) of the 1961 Act. As 'hotel expenses' are specifically and separately mentioned within parantheses both in section 37(3) of the 1961 Act and rule 6D(2) of the 1962 Rules, the word 'etc.' mentioned in the marginal note of rule 6D of the 1962 Rules alongwith 'Expenditure in connection with travelling' does not mean that that rule 6D of the 1962 Rules provides for expenditure on travel only. Further, in order to attract the provisions of rule 6D(2) of the 1962 Rules, it is not necessary that the assessee should incur both types of expenditure mentioned in clauses (*a*) and (*b*) of that rule. Again, it is not necessary that the headquarters of the employee or any other person should also be within India. Such headquarters can be anywhere in the world and not necessarily within India. In that view of the matter, rule 6D(2) of the 1962 Rules has been held applicable in respect of travel in

India by foreigners whose headquarters was not in India in the relevant previous year [*Inaroo Ltd. v. CIT,* (1993) 204 ITR 312, 321, 322, 323 (Bom)].

In *CIT v. Oil India Ltd.,* (1992) 198 ITR 701, 708-09 (Cal), the assessee was doing exploration and prospecting and drilling for crude oil in India. The assessee incurred travelling expenses which were found by the Tribunal to have been incurred by the assessee in the field. Therefore, the travelling expenditure was held deductible under section 37(3) of the 1961 Act. Also see, *CIT v. Industrial Engineering Projects Pvt. Ltd.,* (1993) 202 ITR 1014, 1016 (Del).

In *CIT v. Gannon Dunkerly & Co.,* (1993) 114 CTR (Bom) 56, 58, it has been held that local conveyance expenses and other actual expenses which are incurred by the employee on tour for conducting assessee's business cannot be considered as travelling expenses of the employee under rule 6D of the 1962 Rules. This Bombay decision [114 CTR (Bom) 56] has been **followed in** *CIT v. Chemet,* (1999) 240 ITR 624, 625 (Bom). Thus, conveyance expenses and telephone expenses are to be excluded while computing the disallowance under rule 6D of the 1962 Rules [*CIT v. Acme Manufacturing Co. Ltd.*, (2001) 249 ITR 460, 462-63 (Bom)].

Rule 6D of the 1962 Rules does not apply to a foreign technician who is not an employee of the assessee [*CIT v. Modipon Ltd.,* (1995) 212 ITR 420, 423-24 (Del), **following** *CIT v. Modipon Ltd.,* (1991) 189 ITR 344, 346 (All)].

Reference may also be made to *CIT v. K.P.V. Shaik Mohammed Rowther & Co.* (*P.*) *Ltd.,* (1997) Tax LR 117, 118-19 (Mad).

For the purpose of calculating expenditure in connection with travelling for a day in terms of rule 6D of the 1962 Rules, it is not correct to proceed on the basis of taking 24 hours as a day. Reading of rule 6D of the 1962 Rules shows that it does not specify a 24 hour period as comprising a day for the purpose of calculating travelling allowance. It is not as if for an employee to claim such allowance for a day he must be travelling all the 24 hours. Suppose, the employee had spent three days, then the rate permissible is (calculating at Rs. 120 per day) Rs. 360. Similarly, if the employee had spent two days and a part of the third day, even then the assessee could claim Rs. 360 [*CIT v. Southern Sea Foods Ltd.,* (1995) 215 ITR 176, 185-86 (Mad)].

Interpreting the provisions of rule 6D(2)(*b*) of the 1962 Rules, as these stood prior to their substitution (w. e. f. 1-4-1992) by the Income-tax (Eighth Amendment) Rules, 1992, it has been held that the ceiling laid down in rule 6D(2) of the 1962 Rules is on the expenditure incurred, in connection with each day of the journey and if the allowable deduction is calculated in accordance with the said rule for each day of travelling, it will make no difference whether the calculation of the allowable expenditure is made for each trip or journey or for all the journeys in the year taken together. The total allowable expenditure would be the same. There is nothing in rule 6D of the 1962 Rules to suggest the calculation of allowable expenditure by multiplying the number of days spent on journey with the per day rate without any regard to the restrictions and conditions set out therein. Rule 6D of the 1962 Rules imposes a ceiling on the aggregate expenditure in connection with the journey in respect of each employee. The aggregate amount allowable in case of travel within the country is to be calculated in the manner set out in clauses (*a*) and (*b*) of rule 6D(2) of the 1962 Rules. The allowance will be restricted to the aggregate of the actual expenditure incurred on travel and a sum not exceeding the specified amount per day calculated in the manner set out in rule 6D(2)(*b*) of the 1962 Rules [*CIT v. Aorow India Ltd.,* (1998) 229 ITR 325, 334 (Bom), **followed in** *CIT v. Alpha Laval* (*I.*) *Ltd.,* (2006) 282 ITR 445, 446 (Bom); *CIT v. Bajaj Auto Ltd.,* (2010) 322 ITR 29, 32 (Bom); *CIT v. SRF Ltd.*, (2012) 342 ITR 106 (Del)]. In that case, the matter has been remitted back to the Tribunal (p. 335) to recompute the amount allowable as a deduction under section 37(3) of the 1961 Act read with rule 6D of the 1962 Rules correctly on the lines indicated above. Also see, *CIT v. Mafatlal Dyes & Chemicals Ltd.,* (1997) 141 Taxation 549, 550 (Bom); *CIT v. Hindustan Ferodo Ltd.,* (1997) 141 Taxation 551, 553 (Bom).

In *CIT v. Hickson & Dadajee Ltd.,* (1997) 141 Taxation 395, 396 (Bom), it has been held that disallowance as per rule 6D of the 1962 Rules has to be calculated in respect of each tour of the employee concerned.

A careful reading of rule 6D(2)(*b*) of the 1962 Rules shows that while computing the expenditure under section 37(3) of the 1961 Act, subject of course to the limitations imposed therein, the amount has to be calculated with reference to each individual employee. It may be that the total expenditure incurred by the assessee throughout the year will have to be arrived at in view of the phrase 'whole of such amount' as mentioned in rule 6D(2)(*b*)(*i*) of the 1962 Rules. The actual expenditure incurred on each trip has to be ascertained with reference to the provisions of rule 6D of the 1962 Rules. The unit of expenditure for the purposes of rule 6D of the 1962 Rules is the trip and not the individual employee. Therefore, it necessarily follows that the expenditure incurred by the assessee will have to be taken into consideration with reference to each trip of an individual employee but not with reference to the totality of the trips made by an individual employee. Thus, even where an employee travels more than once in an year and spents more amount in one trip and less in another trip, the excess amount expended in one trip cannot be adjusted against the expenditure made in the next or subsequent trips [*CIT v. Coramandel Fertilizers Ltd.,* (1996) 220 ITR 298, 304 (AP)]. Here, it is

pertinent to note that although the said Andhra case [220 ITR 298 (AP)] has related to assessment year 1973-74, rule 6D(2)(*b*) of the 1962 Rules has been extracted therein as the same has been substituted (w. e. f. 1-4-1992) by the Income-tax (Eighth Amendment) Rules, 1992, which rule is operative for and from assessment year 1993-94.

The above Andhra decision [220 ITR 298 (AP)] has been **followed in** *CIT v. Coromandal Fertilizers,* (2001) 247 ITR 417, 421 (AP); *CIT v. Ashok Leyland Ltd.,* (2002) 253 ITR 425, 427-28 (Mad); *CIT v. Nutan Mills Ltd.,* (2002) 254 ITR 519, 521 (Guj). Similar view has been taken in *CIT v. Arvind Mills Ltd.,* (2002) 254 ITR 529, 533 (Guj); *Ennore Foundries Ltd. v. CIT,* (2003) 259 ITR 414, 416 (Mad); *CIT v. Bush Boake Allen* (*Indid*) *Ltd.,* (2003) 130 Taxman 410, 402 (Mad).

Dissenting from the Andhra view [220 ITR 298 (AP)] and Madras view [253 ITR 425 (Mad)], the Calcutta High Court has, in *CIT v. General Electric Co. of India Ltd.,* (2002) 255 ITR 22, 25-26 (Cal), taken the view that in rule 6D(2) of the 1962 Rules, there is nothing to indicate that an assessment year has to be further cut up within itself into different trips which are undertaken by different employees. If an employee's maximum amount on the days of travel is not spent in one particular previous year, then the amount 'saved' cannot be carried forward to the next succeeding previous year for increasing the limit allowable. Such carrying forward requires very special permission and mandate of the Income-tax Act and none such is to be found here.

But, if the employee's travel is to be sub-divided even within the same assessment year as per the number of trips undertaken by him and such sub-division goes against the interest of the assessee, then for that sub-division also some clear indication or express word must be available in the rule itself.

The words 'aggregate of the amounts' mentioned in the said **rule 6D(2) of the 1962 Rules** refers to the aggregate for the assessment year. Such aggregate is to be found out from the number of days, the maximum expense permitted per day and the number of employees involved. On the basis of actuals this aggregate amount, even if exceeded, is the ceiling limit of allowance permissible, but within such aggregate amount it little matters what one particular employee spent on one day of travel and what he (the same employee) spent on another.

If it were the intention of the rule-making authority to limit the allowable expense per day per employee, or per trip per employee, and not merely to limit the allowable expense of the assessee in the aggregate for the assessment year in question taken together, then absolutely different words should have been used by the rule-making authority in the said rule.

A combined reading of rule 6D(2) of the 1962 Rules and the provisos appearing thereunder clearly goes to show that this rule refers to an employee, and such employee at more than one place. Thus, it cannot be said that the assessee is entitled to allowance of an expenditure incurred under this head by clubbing the expenses of all the employees relating to a particular accounting year. The benefit also cannot be given to an employee by clubbing the trips undertaken by him during the entire accounting year for the purposes of granting the relief under rule 6D(2) of the 1962 Rules to the assessee. Clause (*b*) of that rule 6D(2) of the 1962 Rules and the proviso appearing thereunder clearly lead to the conclusion that an employee outside the headquarters is entitled to different rates, depending upon the situation, *i.e.*, stay in a hotel, stay at Bombay, Calcutta or Delhi or stay in a rent-free accommodation, or in a guest house maintained by the assessee. Once that is so, an employee is required to be paid that amount on account of his travelling outside the headquarters of the company keeping in view his each trip, the place and the nature of this stay. Thus, the contention of the assessee before the Tribunal was right to the extent that the expenditure of each individual employees is required to be considered under that rule 6D(2) of the 1962 Rules. However, the claim of the assessee that all the trips undertaken by an employee can be clubbed together, cannot be accepted in view of specific provisions contained in rule 6D(2)(*b*) of the 1962 Rules and the proviso appearing thereunder [*CIT v. Porritts & Spencer* (*Asia*) *Ltd.*, (2000) 241 ITR 126, 130 (Punj)]. Also see, *CIT v. Sayaji Iron & Engineering P. Ltd.,* (2006) 281 ITR 438 (Guj).

In *CIT v. Sharp Industries Ltd.,* (2003) 173 Taxation 129, 133-34 (Bom), it has been held that the disallowance under rule 6D of the 1962 Rules has to be calculated on per day basis with reference to the salary of each employee, the place of stay during the journey and the expenditure incurred by each employee during such stay.

From a con-joint reading of section 37(3) of the 1961 Act and rule 6D of the 1962 Rules, it is apparent that not only travel expenses would be covered under rule 6D of the 1962 Rules but also hotel expenses or allowances paid in connection with such travel would come under rule 6D of the 1962 Rules [*R.K. Swamy Advertising Associates Pvt. Ltd. v. CIT,* (1996) 220 ITR 507, 508 (Mad)].

Following the Madras decision [220 ITR 507 (Mad)] it has been held that the disallowance under rule 6D of the 1962 Rules would take into account all the expenses incurred by the assessee during the entire period of absence of its employees from headquarters [*South India Shipping Corporation Ltd. v. CIT*, (2001) 250 ITR 624, 626 (Mad)].

LexisNexis

There is no provision in rule 6D(2) of the 1962 Rules to break the period of tour outside headquarters into two portions, one relating only to travelling and the second relating only to actual stay at the place of destination. In fact, word 'destination' is not used in rule 6D(2) of the 1962 Rules. The headquarters of an employee do not change from place to place in accordance with the places an employee may visit during the course of a tour away from headquarters. The words 'outside the headquarters of such employee used in rule 6D(2) of the 1962 Rules, the words 'other expenditure (including hotel expenses or allowances paid) in connection with such travel' used in clause (*b*) of rule 6D(2) of the 1962 Rules, the words 'if the stay of such employee outside his headquarters' used in the first proviso to rule 6D(2) of the 1962 Rules and the words 'on any day of stay outside his headquarters' would clearly indicate that the limitation provided under rule 6D(2) of the 1962 Rules covers the entire expenditure incurred by an employee both on actual travelling as well as during the period of the stay at any particular place for the purpose of the business [*Bharat Commerce & Industries Ltd. v. CIT*, (2002) 253 ITR 671, 675 (Del)].

Subject to limits laid down in rule 6D of the 1962 Rules, travelling expenses incurred on the tour of Chairman of the assessee-company held admissible [*Porritts & Spencer* (*Asia*) *Ltd. v. CIT*, (2008) 175 Taxman 533, 549 (Punj)].

'*Travelling'—not to be construed in a narrow way.*—The word 'travelling' is no doubt capable of being construed in a narrow way as to limit it to the actual time spent on travel, *i.e.*, the time actually spent on road, rail or air while travelling from one destination to another. In rule 6D of the 1962 Rules and in section 37(3) of the 1961 Act, however, that term has been used in a wider sense to include the entire period of absence from the headquarters including the period from the time of the departure till the time of the return, and including the time spent on actual travel and the time spent staying in hotels or elsewhere during the period when the person was not actually travelling, but remained outside the headquarters and had incurred expenditure on such a stay. To put it differently, 'travelling' for the purpose of these provisions includes the entire period of absence after the travel commences. It includes the periods spent on actual travel as also the periods spent while staying away from the headquarters before completing the route which brings the person back to the place that he started from [*Beardsell Ltd. v. CIT*, (2000) 246 ITR 505, 508 (Mad)]. In that case, the Tribunal was held right in holding that the limits of daily allowance specified in rule 6D of the 1962 Rules is not restricted to the time spent on actual travelling.

This Madras view [246 ITR 505 (Mad)] has been **followed in** *Sundaram Finance Ltd. v. CIT,* (2001) 250 ITR 86, 89-90 (Mad).

In *CIT v. Bharat Commerce & Industries Ltd.,* (2001) 170 CTR (Del) 285, 287, the High Court has directed that while carrying out the direction of the Tribunal, the ITO shall also take into account the effect of section 37(3) of the 1961 Act read with rule 6D of the 1962 Rules.

LexisNexis

Guest-house maintenance—disallowance of expenditure on—section 37(4) of 1961 Act.—Expenditure incurred by an assessee on the maintenance of guest-houses was, till 28-2-1970, allowed as a deduction in computing the profits and gains of business or profession, subject to certain limits and conditions prescribed in rule 6C[19] of the Income-tax Rules, 1962. That rule covered expenditure on guest-houses maintained at the principal place of the business or profession in India, any place where the assessee had an establishment for processing of raw materials, manufacture or processing or production of any article or thing or any other industrial establishment employing not less than fifty whole-time employees throughout the relevant year, and, in the case of a business or profession having not less than 100 whole-time employees on its rolls, also "holiday homes" for the use of such employees while on leave. That rule also covered guest-houses at Delhi and at the two other places in India which may be either the capital of a State Government or any other place which was of direct importance to the business or profession. Banking companies were allowed to maintain guest-houses at Bombay to facilitate liaison with the Reserve Bank of India. Accommodation hired or reserved in a hotel for a period of more than six months during the year was treated as guest-house for the purposes of that rule.

In order to place an effective check on lavish expenditure on maintenance of guest-houses, section 37(4) of the 1961 Act was inserted by the Finance Act, 1970 (19 of 1970). That sub-section provides for disallowance altogether of expenditure incurred after 28-2-1970, on the maintenance of guest-houses other than "holiday homes", in computing the profits and gains of business or profession. The provision covers not only the establishment and other charges for running the guest-house but also depreciation on building where that is owned by the assessee, and rent paid for the accommodation where it is taken on hire or lease. Depreciation on assets, such as air conditioners, refrigerators, cooking ranges, furniture and fittings, etc., in the guest-house is also to be disallowed under these provisions. Where any charges are recovered from persons using the guest-house, these are to be deducted from the expenditure on maintenance and the depreciation, and only the balance is to be disallowed in computing the profits of the business or profession. The provision does not,

19. Rule 6C has been omitted by the Income-tax (Amendment) Rules, 1973, with effect from 1-4-1972.

however, apply to "holiday homes" maintained by an assessee employing in his business or profession not less than 100 whole-time employees throughout the relevant year, where the "holiday home" is intended for the exclusive use of such employees while on leave. [**Quoted with approval** in *Kesoram Industries & Cotton Mills Ltd. v. CIT,* (1991) 191 ITR 518, 524 (Cal), **followed in** *Goodricke Group Ltd. v. CIT*, (2011) 338 ITR 97 (Cal) without any reference to this book]. In other words, the only exception is where the guest house was maintained by the assessee having more than 100 employees for the purposes of being used by the employees during their holidays [*CIT v. Maddi Venkataratnam & Co. Pvt. Ltd.,* (1996) 217 ITR 571, 576 (AP)]. The provisions of section 37(4) of the 1961 Act took effect from 1-4-1970, *i.e.*, for and from assessment year 1970-71. However, the provisions for disallowance of depreciation on the building in which the guest-house is located and on the assets in the guest-house have application for and from assessment year 1971-72.

For elucidation of the provisions of section 37(5) of the 1961 Act, operative for and from assessment year 1979-80, reference may be made to "*Guest-house, what it is*?", under section 37(5), *ante.*

What clause (*i*) of section 37(4) of the 1961 Act refers to is not a guest house, but any residential accommodation in the nature of a guest house. The expression 'any residential accommodation in the nature of a guest house' will have much wider meaning than 'guest house'. Therefore, the accommodation which is maintained by the assessee for providing boarding and lodging facilities to its employees is a guest house [*CIT v. Gaekwar Mills Ltd.,* (1992) 193 ITR 734, 741 (Guj)].

Maintenance of a guest house will include provisions for food, drinks, and also lodging. If an assessee's guest house provides residential accommodation and also food, drinks and other amenities, these expenditures will come within the mischief of the phrase 'maintenance of any residential accommodation in the nature of a guest house' [*Kanoria Chemicals & Industries Ltd. v. CIT,* (1995) 78 Taxman 455, 466 (Cal)].

Viewed in the light of the object behind the introduction of the provisions of section 37(4) of the 1961 Act, the expression 'on the maintenance of any residential accommodation in the nature of a guest house' should be given a wider meaning and it cannot be construed in a narrow or restricted manner. If such a wider meaning is given, the said expression would encompass not only the expenditure incurred on the maintenance of guest house like whitewashing of the walls, employment of watchman, repairs, etc., but it would include other expenditure also which are essential for the proper functioning of the guest house and the said expression should include the expenditure incurred on the purchase of the provisions or other essential items for giving refreshment or meals to the guests staying in the guest house [*CIT v. Mathurantakam Co-operative Sugar Mills Ltd.,* (1998) 146 CTR (Mad) 730, 734 = (2000) 241 ITR 817, 821 (Mad)].

In *CIT v. Upper Ganges Sugar Mills Ltd.,* (1994) 206 ITR 215, 218-19 (Cal), **SLP dismissed:** (1994) 206 ITR (St.) 277 (SC), **approved in** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC). Also see, *Goodricke Group Ltd. v. CIT*, (2011) 338 ITR 97 (Cal); *CIT v. Baghpat Co-operative Sugar Mills Ltd.,* (2014) 363 ITR 319 (All)], it has been held that the cost of food provided to the employees in the guest house and the salary paid to them constituted the cost of maintenance of the guest houses because the object of employment of the said employees was the maintenance of the guest houses. It was these employees who maintained and ran the guest houses. Therefore, the expenses relating to food, tiffin and salary paid to guest house staff and depreciation on assets used in the assessee's guest houses, were not deductible by virtue of the provisions of section 37(4) of the 1961 Act. In view of this ruling, and more particularly the provisions of section 37(4) of the 1961 Act, the contrary decisions in *CIT v. New India Sugar Mills Ltd.,* (1992) 105 CTR (Cal) 246, 247 and *CIT v. Bharat Sugar Mills Ltd.,* (1992) 107 CTR (Cal) 306, 308 cannot be said to have correctly been decided on the point.

Following the Calcutta decisions [191 ITR 518 (Cal) and 206 ITR 215 (Cal)], it has been held that on a true and proper interpretation of section 37(1) read with section 37(3) and section 37(4) of the 1961 Act, the claim for depreciation, repairs and maintenance and rent of the guest house can be disallowed as falling within the scope of the said provisions [*Britannia Industries Ltd. v. CIT*, (2002) 257 ITR 681, 685-86 (Cal), **affirmed in** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC)]. Also see, *GKW Ltd. v. CIT*, (2012) 347 ITR 429 (Cal); *CIT v. Radico Khaitan Ltd.,* (2014) 360 ITR 462 (All).

Thus, having regard to the unambiguous bar incorporated in section 37(4) of the 1961 Act, the benefits indicated in sections 30 to 36, although independent of section 37 of the 1961 Act, cannot be related to a guest house maintained by the assessee [*CIT v. Biswanath Tea Co. Ltd.*, (2003) 264 ITR 166, 171 (Cal), **following** 191 ITR 518 (Cal) and 206 ITR 215 (Cal), **approved in** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC)].

In *CIT v. Ponni Sugars & Chemicals Ltd.,* (2003) 260 ITR 605, 608, 614-15 (Mad), the Tribunal was held not right in holding that depreciation on guest house should not be disallowed under section 37(4) of the 1961 Act for the assessment year 1989-90.

In *CIT v. Rajasthan Spinning & Weaving Mills Ltd.,* (2004) 271 ITR 460, 463 (Raj), it has been held that in view of the specific provisions contained in section 37(4) of the 1961 Act, depreciation cannot be allowed, for assessment year 1986-87, in respect of a guest house.

In *CIT v. Rampur Distillery & Chemical Co. Ltd.,* (2003) 131 Taxman 508 (All), the Tribunal was held right in law in not sustaining the disallowance of repair expenses of a guest house under the provisions of section 37(4) of the 1961 Act.

In *CIT v. Maddi Venkataratnam & Co. Pvt. Ltd.,* (1996) 217 ITR 571, 572, 578 (AP), the amount spent on salary and bonus of the employees working in a bungalow maintained by the assessee-company as a guest house for foreign customers and the amount spent on lighting charges of the guest house have been held not to be allowed deduction as such expenditure was within the teeth of section 37(4) of the 1961 Act.

In *CIT v. Coramandel Fertilisers Ltd.,* (1996) 220 ITR 298, 302-03 (AP), the finding recorded by the Tribunal that the accommodation provided was not in the nature of a guest house was held to be based on material and the same was rationally possible.

In *National Newsprint & Paper Mills Ltd. v. CIT,* (1998) 149 CTR (MP) 244, 245-46 = (1999) 234 ITR 729, 730 (MP), the Tribunal was held right in disallowing the expenditure of Rs. 2,90,659 under section 37(4) of the 1961 Act which was incurred by the assessee on the residential accommodations maintained by it in its industrial township for the stay of persons connected with the business.

It is pertinent to note that section 37(4) of the 1961 Act is no doubt a *non obstante* clause, but it is a *non obstante* clause *vis-a-vis* sub-section (1) and sub-section (3) of section 37 of the 1961 Act only. In other words, the provisions of section 37(4) of the 1961 Act override the provisions of sections 37(1) and 37(3) of the 1961 Act only and not any other section. In that view of the matter, if an expenditure or allowance is allowable under other sections of the 1961 Act, the allowance cannot be withdrawn or denied to the assessee because of the prohibitory provisions in section 37(4) of the 1961 Act [*Century Spinning & Manufacturing Co. Ltd. v. CIT,* (1991) 189 ITR 660, 662 (Bom)]. In that case, the assessee was held entitled to depreciation on the premises used as guest house. In that case, their Lordships have failed to notice the specific ban contained in clause (*ii*) of section 37(4) of the 1961 Act.

Keeping in view the specific ban contained in section 37(4)(*ii*) of the 1961 Act and applying the principle of *generalia specialibus non derogant* (which means that a particular provision excludes the general provision), it has been held that depreciation on a guest house cannot be allowed as a deduction [*Hindustan Electro Graphites Ltd. v. CIT,* (1998) 96 Taxman 163, 165 (MP)]. Such view has also been taken in *T.V. Sundaram Iyengar & Sons Ltd. v. CIT,* (2000) 244 ITR 133, 136 (Mad); *CIT v. Instrumentation Ltd.,* (2002) 258 ITR 513, 517 (Raj).

Where the Tribunal has recorded a finding that the house at Bombay was used by the assessee for accommodating the officers and executives as and when they were on official business on behalf of the assessee-company, the Tribunal was held not justified in confirming the disallowance of Rs. 30,577 in respect of the expenditure incurred by the assessee for maintenance of that house at Bombay invoking the provisions of section 37(5) of the 1961 Act [*CIT v. Mihir Textiles Ltd.*, (2002) 256 ITR 528, 531 (Guj)].

Similarly, the expenditure incurred for the water proofing work of the terrace of the guest house, which is covered by section 30(*a*)(*ii*) of the 1961 Act, cannot be disallowed by invoking the provisions of section 37(4) of the 1961 Act [*CIT v. Kaira District Co-operative Milk Producers Union Ltd.,* (1991) 192 ITR 608, 611 (Guj)]. Also see, *CIT v. Sarabhai Technological Development,* (1993) 115 Taxation 151, 152 (Guj); *CIT v. Saurashtra Co-operative Spinning Mills Ltd.,* (1993) 115 Taxation 170, 171 (Guj).

In *CIT v. Ahmedabad Mfg. & Calico Printing Co. Ltd.,* (1992) 197 ITR 538, 543 (Guj), **not been approved in** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC), rent paid for premises and amount spent on repairs of such premises used by the assessee as residential accommodation for temporary stay of employees while on duty have been held to be covered by section 30(*a*)(*i*) of the 1961 Act. Therefore, such expenditures could not be disallowed by invoking section 37(4) of the 1961 Act. Also see, *CIT v. Sarabhai Technological Development Syndicate,* (1993) 115 Taxation 166, 168 (Guj).

In *CIT v. Maharana Mills Ltd.,* (1994) 208 ITR 972, 974 (Guj), it has been held that as the current repairs of the guest house is allowable under section 30 of the 1961 Act, no disallowance is possible by resorting to section 37(4) of the 1961 Act.

Not following the above view, the Kerala High Court has, in *United Catalysts India Ltd. v. CIT,* (1998) 229 ITR 233, 237, 238 (Ker), held that in view of the specific provisions of sections 37(4) and 37(5) of the 1961 Act, the assessee cannot put forward a claim under the general provisions of section 30 of the 1961 Act in respect of rent and maintenance expenditure relating to a guest house. Further, it cannot be held that the amount spent on repairs of the guest house would not come within the purview of section 37(4) of the 1961 Act. Also see, *CIT v. Modi Xerox Ltd.*, (2012) 344 ITR 407 (All), **followed in** *CIT v. Modi Xerox Ltd.*, (2012) 344 ITR 411 (All); *CIT v. Modi Xerox*, (2012) 344 ITR 435 (Del).

Where the assessee is carrying on the business of providing facilities to staff members of various sister concerns, the expenditure incurred on payment of rent in respect of the premises taken on rent for running the aforesaid business has been held as a trading expenditure, deduction whereof is permissible under section 28 of the 1961 Act itself. In such circumstances the question of disallowing the said expenditure on payment of rent under section 37(4) of the 1961 Act does not arise [*CIT v. Sarabhai Management Corporation Ltd.,* (1992) 196 ITR 436, 437 (Guj)].

In *CIT v. South India Viscose Ltd.,* (2003) 259 ITR 107, 108 (Mad), it has been held that the term 'maintenance' normally refers to keeping a thing in the condition that it was and keeping it in a condition that enables the thing to be used in the way in which it was intended to be used. The rent paid for the guest house, in the absence of any other indication in section 37(4)(*i*) of the 1961 Act, cannot be regarded as part of the maintenance, especially when rent in specifically dealt with in another section—section 30 of the 1961 Act — which expressly provides for deduction of such rental. In that view of the matter, the Tribunal was held right in law in holding that lease rent paid for guest house cannot be disallowed under section 37(4) of the 1961 Act for the assessment year 1984-85.

In *N.G.E.F. Ltd. v. CIT,* (1985) 153 ITR 197 (Karn), the expenditure incurred on the maintenance of guest-houses at Delhi and Bombay was held not allowable because there was no evidence to show that the guest-houses were meant exclusively for the use of the employees while on leave as holiday homes. Also see, *CIT v. Syndicate Bank,* (1986) 159 ITR 464 (Karn).

In *CIT v. Parshva Properties Ltd.,* (1987) 164 ITR 673 (Cal), the assessee had a bungalow situated in a remote corner of a district in Bihar. Employees, etc., went there on duty and stayed there temporarily for doing their work. Expenses were incurred on the stay of such persons at the bungalow. The Tribunal allowed such expenses on the ground that the maintenance of the bungalow could not be held to be maintenance of a guest-house within the meaning of section 37(4) of the 1961 Act. The Tribunal's view was upheld by the High Court.

In *CIT v. Orient Paper Mills Ltd.,* (1988) 171 ITR 181 (Cal),the assessee provided accommodation at places where no accommodation of any kind was available. The same was not meant for entertainment or relaxation. Further, the persons availing the accommodation had been paying charges covering almost the entire expenditure. It was held that such accommodation facilities could not be treated as a guest-house so as to attract the provisions of section 37(4) of the 1961 Act.

LexisNexis

Distinguishing the decisions in *CIT v. Parshva Properties Ltd.,* (1987) 164 ITR 673 (Cal) and *CIT v. Orient Paper Mills Ltd.,* (1988) 171 ITR 181 (Cal), the Calcutta High Court, in *Kesoram Industries & Cotton Mills Ltd. v. CIT,* (1991) 191 ITR 518, 524 (Cal), **approved in** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC), has taken the view that a guest house is a guest house whatever may be the category of guests to which it caters and whatever may be the standard of comforts and amenities provided and no matter whether the intention of the party is merely to provide them with shelter and food or to entertain and amuse or gratify the visitors. In that case, the assessee was maintaining transit bungalows in remote interior places. These transit bungalows were held to be guest houses and, accordingly, the assessee was held not entitled to deduction in respect of the amounts spent on the maintenance of such transit bungalows. Also see, *Kesoram Industries & Cotton Mills Ltd. v. CIT,* (1992) 196 ITR 845, 851-52 (Cal); *Goodricke Group Ltd. v. CIT*, (2011) 242 CTR (Cal) 509; *CIT v. Rassi Cements Ltd.* : *Deccan Cements Ltd.*, (2013) 351 ITR 169 (AP).

In *CIT v. West Coast Paper Mills Ltd.,* (1992) 193 ITR 349, 354 (Bom), the assessee was held not entitled to any deduction of expenditure, incurred after 28-2-1970, on maintenance of a guest house by virtue of the provisions of section 37(4) of the 1961 Act.

In *CIT v. Gaekwar Mills Ltd.,* (1992) 193 ITR 734, 741 (Guj), the expenditure incurred for providing messing facilities to the employees of the assessee was held not having been incurred for maintenance of any residential accommodation, no part thereof is disallowable under section 37(4)(*i*) of the 1961 Act. However, since the accommodation maintained by the assessee for giving boarding and lodging facilities to its employees and merchants was residential accommodation in the nature of a guest house within the meaning of section 37(4)(*i*) of the 1961 Act, depreciation on that part of the building of the assessee used as guest house was not allowable under section 37(4)(*ii*). This Gujarat view [193 ITR 734 (Guj)] has been **followed in** *CIT v. Arvind Mills Ltd.,* (2001) 248 ITR 187, 189 (Guj) **on both the points**; *CIT v. Gujarat State Fertilizer Co.,* (2002) 255 ITR 294, 297 (Guj) **on the former point**.

In *Commercial Ahmedabad Mills Co. Ltd. v. CIT,* (1993) 204 ITR 505, 508 (Guj), the assessee was paying charges for stay of its officers, in a guest house maintained by one S, while they visited Bombay for the assessee's work. It was not the case of the Revenue that it was a hotel. Therefore, the expenditure incurred in paying charges for such stay was held not hit by the provisions of section 37(4) of the 1961 Act. Such expenditure was incurred for business purposes and the same was deductible.

In *CIT v. Mehsana District Co-operative Milk Producers Union Ltd.,* (1994) 207 ITR 140, 142 (Guj), it has been held that expenses incurred for the purpose of serving tea, snacks and food to the primary members of the assessee-society and its customers and visitors having work with the assessee did not represent the expenditure for the purpose of maintenance of guest house so as to attract section 37(4) of the 1961 Act.

In *Raja Bahadur Motilal Poona Mills Ltd. v. CIT,* (1995) 212 ITR 175, 176-77 (Bom), for assessment years 1971-72 and 1972-73, the expenditure incurred for maintenance of residential accommodation in the nature of a guest house was held not deductible by virtue of the provisions of section 37(4) of the 1961 Act.

Where a finding has been recorded by the Tribunal that the so called transit house was in fact a guest house, the expenditure incurred for its maintenance were held not allowable [*Salem Co-operative Sugar Mills Ltd. v. CIT*, (1999) 240 ITR 910, 912 (Mad)].

Where the Tribunal has arrived at a finding of fact that the assessee was maintaining a structure to provide certain common facilities to the staff and workers, who had to be provided a shelter at the mines for the purpose of taking meals and recreation facilities during the working of the mines and also for providing safety zone while the blasting in the mines is in operation, such a structure cannot be regarded as a guest house and, therefore, the expenditure incurred in maintaining such structure would not fall within the gamut of disallowance under section 37(4) of the 1961 Act [*CIT v. Wolkem India Ltd.*, (2002) 178 CTR (Raj) 301, 303, 305].

In *CIT v. Shivaji Works Ltd*., (2007) 295 ITR 542, 546 (Bom), it has been held that the expenditure incurred in respect of repairs and maintenance expenses of guest house held not admissible. Also see, *CIT v. Tata Lucent Technologies Ltd*., (2009) 318 ITR 110, 112 (Karn).

The expenditure for maintenance of accommodation for visitors in the estate and the expenditure towards rent incurred for hiring out the residential accommodation as expenditure for maintenance of guest house held not admissible [*Aspinwall & Co.* (*Travancore*) *Ltd. v. Deputy CIT*, (2007) 295 ITR 553, 556, 560 (Ker)].

In *CIT v. H.P. Agro Industries Corporation Ltd.,* (2008) 301 ITR 118, 120 (HP), it has been held that a sum of Rs. 67,237 paid on account of rent of guest house maintained by the assessee not admissible as there being specific provision for disallowance under section 37(4) of the 1961 Act. Also see, *CIT v. Sir Shadi Lal Enterprises Ltd*., (2009) 310 ITR 283, 289 (All).

LexisNexis

Even though the accommodation provided was for the entire duration of the project, what was sought to be covered by section 37(4) read with section 37(5) of the 1961 Act was the type of accommodation provided to the employee who merely used them on transitory or temporary basis and not in the circumstances of the instant case. Thus, the expenses incurred by the assessee on the maintenance of accommodation provided to its employees and executives in Iraq held admissible [*CIT v. Ansal Properties & Industries Ltd.*, (2013) 352 ITR 637 (Del)]. Also see, *CIT v. Ansal Housing Finance & Leasing : Ansal Properties & Industries Ltd. : Ansal Housing & Construction Ltd.,* (2013) 354 ITR 180 (Del).

In *Mangal Chand Tubes Pvt. Ltd. v. CIT*, (1994) 208 ITR 729, 733 (Raj), the matter was remanded to the Tribunal for examining the issue as to what was the nature of the expenditure incurred by the assessee and then to give a decision in accordance with law.

The question whether a building was used as a guest house or not is a question of fact [*CIT v. Maharaja Shri Umed Mills Ltd.,* (1991) 96 CTR (Raj) 72, 74].

In *CIT v. Vardhaman Spinning & General Mills Ltd.,* (1999) 237 ITR 795, 796, 797 (Punj), the question whether the Tribunal was right in law in allowing guest house expenses when they are not allowable as per section 37(4) of the 1961 Act for the assessment year 1985-86 has been held to be not a referable question of law.

In *CIT v. Registhan* (*P.*) *Ltd.,* (2003) 131 Taxman 505, 506 (Raj), the Tribunal was directed to refer the following question of law: Whether on the facts and in the circumstances of the case, the Tribunal was justified in relying upon the tax auditors and allowing the guest house expenses of Rs. 32,166 without first deciding as to whether the premises in question were used for business purposes. Also see, *CIT v. Registhan* (*P.*) *Ltd.*, (2003) 132 Taxman 894 (Raj).

Where the Tribunal has come to a categorical finding that the director's bungalow maintained by the assessee is not a guest house and such a finding has not been challenged, repairing expenses of such a bungalow and its furniture should be allowed to be deducted [*CIT v. Bahadur Tea Co.* (*P.*) *Ltd.,* (1996) 222 ITR 310, 313 (Gauh)].

The question whether the Tribunal was correct in law in holding that Sterling Apartment Flat could not be treated as guest house and, as such, the expenses incurred thereupon were allowable, has been held to be one of law [*CIT v. Modipon Ltd.,* (1995) 212 ITR 656, 658, 663 (Del)]. However, no question of law was held to have arisen in respect of expenses incurred on the maintenance of cottage at Marve Malad, Bombay, and Jindal House, Calcutta. Also see, *CIT v. Modipon Ltd.,* (1995) 80 Taxman 228, 232 (Del).

In *CIT v. India Sugars & Refineries Ltd.,* (1995) 124 CTR (Bom) 167, 169 the question concerning the applicability of section 37(4)(*i*) of the 1961 Act referred to the High Court at the instance of the Revenue was returned unanswered in view of the facts obtaining in the case coupled with the fact that there would not be any tax effect whether the question was answered in favour of the Revenue or against it.

Also see, *CIT v. Seshasayee Paper & Boards Ltd.,* SLP (Civil) No. 121 of 1985 : (1992) 193 ITR (St.) 3 (SC); *CIT v. Nizam Sugar Factory,* SLP (Civil) No. 14657 of 1985 : (1992) 193 ITR (St.) 11 (SC); *CIT v. Hindusthan Sugar Mills,* SLP (Civil) Nos. 17501-17502 of 1993 : (1994) 206 ITR (St.) 274 (SC); *CIT v. Mihir Textiles,* SLP (Civil) No. 11198 of 1994 : (1995) 211 ITR (St.) 5-6 (SC).

In *CIT v. Hindusthan Aluminium Corporation Ltd.,* (1989) 176 ITR 206 (Cal), expenditure was incurred by the assessee on maintenance and running of an accommodation at a place where its factory was located. The finding of the Tribunal was that the assessee was realising expenses from the visitors who stayed in the accommodation provided by it. It is also the finding of the Tribunal that at the place where the assessee's factory premises are situated, there is no hotel or other accommodation available in which the visitors of the assessee can be housed during their visit to the factory premises. In that view of the matter, the accommodation was held not a guest-house as contemplated by section 37(3) of the 1961 Act. Therefore, the expenditure was held allowable as a deduction.

In *CIT v. Modi Industries Ltd.,* (1990) 184 ITR 318 (Del), the Tribunal restricted the disallowance of expenses on the guest-house to a certain sum. The High Court declined to call for a reference.

In *Associated Stone Industries* (*Kota*) *Ltd. v. CIT,* (1992) 194 ITR 401, 403 (Raj), the revenue was not allowed to challenge the allowability of certain expenses on the strength of section 37(4) of the 1961 Act as such question was neither raised before nor considered by the Tribunal.

In view of the insufficiency of material on record, the question about the allowability of certain expenditure under section 37(4) of the 1961 Act has been declined to be answered by the High Court [*CIT v. Parshuram Pottery Works Co. Ltd.,* (1996) 131 CTR (Guj) 548, 549; *Parshuram Pottery Works Co. Ltd. v. CIT,* (1996) 131 CTR (Guj) 549, 551].

In *CIT v. Atul Products Ltd.,* (1998) 9 SCC 622, 623 (SC), the Supreme Court has directed the Tribunal to refer the following question of law to the High Court: 'Whether the Appellate Tribunal is right in law and on facts in directing the Assessing Officer to allow depreciation on guest house building and other assets?'.

While the expression 'premises and buildings' in sections 30 and 32 of the 1961 Act and the expression 'residential accommodation including any accommodation in the nature of guest house' in sections 37(3), 37(4) and 37(5) of the 1961 Act can be similarly interpreted, a distinction has been sought to be introduced for the purpose of section 37 of the 1961 Act by specifying the nature of the building to be a guest house. The intention of the Legislature being clear and unambiguous was to exclude from deduction the expenses towards rent, repairs and also maintenance of premises/accommodation used for the purpose of a guest house of the nature indicated in section 37(4) of the 1961 Act [*Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546, 558 (SC), **affirming** *Britannia Industries Ltd. v. CIT*, (2002) 257 ITR 681 (Cal) and **approving** *CIT v. Biswanath Tea Co, Ltd*., (2003) 264 ITR 166 (Cal); *Kesoram Industries & Cotton Mills Ltd. v. CIT*, (1991) 191 ITR 518 (Cal); *CIT v. Upper Ganges Sugar Mills Ltd*., (1994) 206 ITR 215 (Cal) and **followed in** *CIT v. Punjab Tractors*, (2007) 289 ITR 125, 127-28 (Punj); *Tata Sponge Iron Ltd. v. CIT*, (2007) 292 ITR 175, 177-78 (Ori); *CIT v. Deepchand Naresh Chand*, (2007) 293 ITR 517, 520 (All)] and **applied in** *CIT v. Hindustan Zinc Ltd.,* (2010) 322 ITR 478, 484-85 (Raj); *Oriental Insurance Co. Ltd. v. CIT*, (2013) 351 ITR 270 (Del). The Punjab decision [289 ITR (Punj)] has been **followed in** *CIT v. Punjab Tractors Ltd*., (2007) 289 ITR 130, 133 (Punj). Also see, *CIT v. Ramco Industries Ltd*., (2009) 316 ITR 434, 436-37 (Mad); *Purolator India Ltd. v. CIT*, (2007) 164 Taxman 164, 165 (Del); *CIT v. Mahavir Spinning Mills Ltd*., (2008) 171 Taxman 371, 373 (Punj).

In *CIT v. Deepchand Naresh Chand,* (2007) 293 ITR 517, 520 (All), **following** *Britannia Industries Ltd. v. CIT*, (2005) 278 ITR 546 (SC), it has been held that the view of the Tribunal was not correct in so far as it related to the guest house expenses since the provisions of section 37(4) of the 1961 Act were attracted to a case where the provisions of section 30 of the 1961 Act were applicable.

In *CIT v. Sir Shadi Lal Enterprises Ltd*., (2008) 214 CTR (All) 357, 363 = (2009) 310 ITR 283 (All), it has been held that the Tribunal was not justified in restricting the disallowance to 30% where entire expenditure on maintenance of guest house even for stay of assessee's employees was disallowable in view of section 37(4) of the 1961 Act.

In *CIT v. Hindustan Zinc Ltd*., (2009) 221 CTR (Raj) 631, 637 = (2010) 322 ITR 478 (Raj), it has been held that even though the expenses are not admissible under the specific provisions of section 37(4) and section 37(5) of the 1961 Act, Tribunal was not justified in upholding the order of CIT(A) reducing the disallowance made by AO in respect of expenditure on guest house.

In *Gurcharanjeet Singh & Sons v. ITO,* (2008) 169 Taxman 179, 180 (Del), the assessee running a guest house paid commission to auto rickshaw drivers and rickshaw pullers for bringing customers to the guest house

LexisNexis

and on the reasonable estimates the commission allowable as deduction to the extent of 25% of the actual rent received.

In *CIT v. Modipon Ltd*., (2008) 172 Taxman 278, 279 (Del), the Tribunal was not correct in directing to exclude expenditure incurred on account of rent, repairs, insurance and depreciation on the reasons that the same were specifically admissible under sections 30, 31 and 32 of the 1961 Act and were not hit by the provisions of section 37(4) of the 1961 Act.

Also see, *CIT v. Modi Pan Ltd.,* (1987) 163 ITR 714 (All).

PARTIAL DISALLOWANCE OF CERTAIN EXPENSES
[Omitted ss. 37(3A) to 37(3D) of 1961 Act]

Scope and effect of sub-sections (3A), (3B), (3C) and (3D) (operative for assessment years 1979-80 and 1980-81) of section 37 of 1961 Act.—In inserting the aforestated sub-section (3A), the intention of the Legislature was to restrict the colossal expenditure by the taxpayers on advertisement, publicity and sales promotion. It is pertinent to note that any expenditure, *inter alia*, on advertisement is to be allowed within the limits prescribed by rule 6B of the 1962 Rules. The said section 37(3A) of the 1961 Act was devised in order to impose a further limit on the aggregate expenditure on account of advertisement, publicity and sales promotion. Where, for instance, the aggregate expenditure to be allowed under section 37(3) of the 1961 Act read with rule 6B of the 1962 Rules was less than Rs. 40,000, the assessee was entitled to claim full deduction of the sum. Where, however, the aggregate expenditure to be allowed under section 37(3) of the 1961 Act read with rule 6B of the 1962 Rules exceeded the sum of Rs. 40,000, section 37(3A) of the 1961 Act imposed a further limitation. No doubt, the further limitation specified in the said section 37(3A) of the 1961 Act are without prejudice to the provisions contained in section 37(3A) of the 1961 Act. By saying so, the Legislature did not intend to ensure that whatever expenditure is allowable under section 37(3) of the 1961 Act is allowed without subjecting the same to the further limitation under section 37(3A) of the 1961 Act. Indeed, the expression "without prejudice", etc., indicates that the amount to be considered for the purpose of section 37(3A) of the 1961 Act is not the actual expenditure incurred by the assessee but the expenditure as is quantified by the application of rule 6B of the 1962 Rules which intention is made explicit by the definition of 'adjusted expenditure' in the *Explanation* to sub-section (3A) of section 37 of the 1961 Act. In that view of the matter, the expenditure on account of advertisement, publicity and sales promotion should, in the first instance, be subject to the limitation specified in section 37(3) of the 1961 Act and the aggregate of such expenditure should further be subject to the limitation in section 37(3A) of the 1961 Act [*CIT v. Raj Brothers*, (1988) 171 ITR 249, 252, 253 (AP)]. In *CIT v. Ampro Food Products*, (1991) 191 ITR 695 (AP), the Tribunal was called upon to record its finding on the question whether the expenditure on note books and gift coupons can be treated as an expenditure on sales promotion or not within the meaning of the said section 37(3A) of the 1961 Act.

LexisNexis

For further cases, reference may be made to:—

(1) *Popular Automobiles v. CIT,* (1991) 187 ITR 86, 95 (Ker) [The Tribunal was held right in law in holding that an appeal against an order of the Commissioner of Income-tax (Appeals) not acceding to the request of the Income-tax Officer for enhancing the assessment by disallowance under section 37(3A) of the 1961 Act was competent].

(2) *Bangalore Soft Drinks* (*P.*) *Ltd. v. CIT,* (1991) 187 ITR 127, 129 (Karn) [The exception in section 37(3D) of the 1961 Act from the operation of section 37(3A) of the 1961 Act was available to an undertaking which was new and which otherwise qualified in terms of the provisions made in section 37(3D) of the 1961 Act. The mere investment on new machinery and capital goods would not entitle an old undertaking to claim to be a new undertaking within the meaning of that section 37(3D) of the 1961 Act].

(3) *CIT v. Hindustan Times Ltd.,* SLP (Civil) No. 13542 of 1991 : (1991) 191 ITR (St.) 305 (SC) [The Supreme Court has dismissed a special leave petition by the Department to appeal against the order dated 24-4-1991 of the Delhi High Court in ITC No. 33 of 1991, whereby the High Court dismissed a reference application on the question whether out of commission paid to distributing agents and claimed by the assessee as business expenditure, the Officer could disallow two-thirds thereof on the ground that it was sales promotion expense under section 37(3A) of the 1961 Act].

(4) *CIT v. Hindusthan Motors Ltd.,* (1991) 192 ITR 619, 631 (Cal) [Brokerage and commission paid for selling the goods would not come within the mischief of the phrase 'advertisement, publicity and sales promotion' as employed in section 37(3A) of the 1961 Act. The departmental circular No. 240, dated 17th May, 1978, in its paragraph 12.4, is also indicative of the types of expenditure which will be treated as for the purpose of sales promotion]. Also see, *CIT v. Sutlej Cotton Mills Ltd.,* (1992) 194 ITR 66, 68 (Cal); *CIT v. Birla Cotton Spg. & Wvg. Mills Ltd.,* (1993) 69 Taxman 609, 610 (Cal), **SLP**

dismissed: (1993) 204 ITR (St.) 7-8 (SC); *CIT v. Kusum Products Ltd.,* (1993) 71 Taxman 611, 613 (Cal).

(5) *Smith Kline & French* (*India*) *Ltd. v. CIT,* (1992) 193 ITR 582, 586 (Karn), **affirmed in** *ESKAYEF v. CIT*, (2000) 245 ITR 116 (SC) [Expenditure incurred on physician's samples amounted to expenditure on advertisement, publicity and sales promotion falling within the restrictive provisions of section 37(3A) of the 1961 Act].

(6) *CIT v. Meera & Co.,* SLP (Civil) No. 970 of 1987 : (1992) 197 ITR (St.) 404-05 (SC) [The Supreme Court has dismissed a special leave petition by the Department to appeal against the order dated 6-10-1986 of the Punjab and Haryana High Court in ITC No. 117 of 1986, rejecting a reference application on the question whether sales promotion commission paid to certain parties by the assessee was hit by the limit imposed by section 37(3A) of the 1961 Act].

(7) *Indian Oxygen Ltd. v. CIT,* (1994) 210 ITR 274, 282 (Cal) [Expenditure incurred by the assessee-company in the publication of the chairman's speech in newspapers and journals as well as the cost of calendars and gifts distributed by it was held clearly falling within the expression 'advertisement, publicity and sales promotion' as appearing in section 37(3B)(*i*) of the 1961 Act and had, therefore, to be considered in working out the disallowance under section 37(3A) of the 1961 Act].

(8) *CIT v. Popular Automobiles Ltd.,* (1995) 212 ITR 611, 613 (Ker) [As the Tribunal was correct in holding that the payment of commission to sales representatives was in effect remuneration for work done which would not be sales promotion expenses hit by the limitation in section 37(3A) of the 1961 Act, no question of law arose].

(9) *CIT v. Ampro Food Products,* (1995) 215 ITR 904, 912-13 (AP) [Expenditure of Rs, 1,24,091 incurred for the purpose of distributing free note-books and expenditure of Rs. 1,08,565 incurred for placing gift coupons in the assessee's products, *viz.*, biscuit tins, in order to promote sales have been held covered by section 37(3A) of the 1961 Act for the assessment year 1980-81].

(10) *CIT v. J&J Dechane Laboratories* (*P.*) *Ltd.,* (1996) 222 ITR 11, 15 (AP) [Expenditure on physicians' samples distributed to doctors is outside the scope of section 37(3A) of the 1961 Act because such expenditure was incurred to test the efficacy of the drug and such expenditure would be within the ambit of bare minimum to carry on the business.

(11) *CIT v. Digvijay Textiles,* (1998) 96 Taxman 209, 211 (Raj) [The question whether the Tribunal was right in holding that expenditure incurred on commission payment to selling agent, sales incentive and cash discount do not come within the purview of section 37(3A) of the 1961 Act has been held to be a question of fact, giving rise to no question of law].

(12) *CIT v. Tamil Nadu Mercantile Bank Ltd.,* (1997) Tax LR 125, 126 (Mad) [Tribunal was held justified in law in holding that the expenditure of Rs. 60,863 on the Navarathna Cash Certificate Scheme was neither advertisement nor publicity nor sales promotion expenses but in the nature of payment of interest in disguised form].

(13) *K.N. Oil Industries v. CIT,* (1998) 232 ITR 479, 480 (MP) [Tribunal was held right in law in holding that the disallowance for the purposes of section 37(3A) of the 1961 Act should be made out of total specified expenses of the assessee and not from such expenses for separate business and/or separate offices computed separately under section 37(3A) of the 1961 Act as claimed by the assessee].

(14) *Kali Aerated Water Works v. CIT*, (2000) 242 ITR 79, 93 (Mad) [Disallowance of advertisement expenditure, for the assessment year 1979-80, was upheld even though such expenditure was incurred prior to 1-4-1979].

(15) *CIT v. A.P. Small Scale Industries Development Corporation*, (2000) 242 ITR 576, 578 (AP) [Where the Tribunal has found that the expenditure incurred by the assessee could not be treated to be an expenditure on publicity or advertisement, no disallowance can be made under section 37(3A) of the 1961 Act for the assessment year 1979-80. It may be noted that in that judgment section 37(3A) of the 1961 Act has been extracted as it was operative for the assessment years 1984-85 and 1985-86].

(16) *CIT v. Print System Products*, (2000) 243 ITR 8, 9-10 (Mad) [Tribunal was held correct in law in holding that the commission paid to intermediaries who canvassed the sales are not sales promotion expenses and will not fall within the ambit of section 37(3A) of the 1961 Act for the assessment years 1979-80 and 1980-81. As clarified by the Board in paragraph 12.4 of the **departmental circular** No. 240, dated 17-5-1978, which has been extracted under sections 37(3A) to (3D) of the 1961 Act, only promotional expenses are to be covered by section 37(3A) of the 1961 Act].

LexisNexis

(17) *CIT v. Hyderabad Bottling Co. P. Ltd.*, (2000) 243 ITR 476, 477, 479 (AP) [Assessee was held entitled to be covered, for the assessment year 1979-80, by exemption under section 37(3D) of the 1961 Act in respect of the expenditure on advertisement and publicity incurred on its new product 'Thums up' on the ground that the assessee had set up a new industrial undertaking for manufacturing the said new product].

(18) *CIT v. Ananda Corporation*, (2000) 245 ITR 217, 220-21 (Mad) [Expenditure incurred in offering prizes to attract more members to join the scheme thereby increasing the turnover was held to be sales promotion expenditure attracting the restrictive provisions of section 37(3A) of the 1961 Act for the assessment year 1980-81].

(19) *CIT v. India Pistons Ltd.*, (2001) 250 ITR 279, 280 (Mad) [Discount offered on the sale of the assessee-company's product cannot be regarded as expenditure on sales promotion so as to attract the restrictive provisions of section 37(3A) of the 1961 Act].

(20) *Innosearch Ltd. v. CIT*, (2001) 251 ITR 384, 385-86 (Guj) [Where the Tribunal has concluded that the expenditure incurred on supply of items like danglers, posters, streamers and tin plates to dealers to exhibit assessee's products formed part of the publicity expenditure so as to attract the provisions of section 37(3A) of the 1961 Act for the assessment year 1979-80, such conclusion was based on facts and did not give rise to any question of law].

(21) *CIT v. Ashok Leyland Ltd.*, (2002) 253 ITR 425, 427 (Mad) [Commission paid to the dealers could not be included for the purpose of disallowance under section 37(3A) of the 1961 Act for the assessment year 1980-81].

(22) *CIT v. Ponds India Ltd.*, (2002) 253 ITR 686, 687-88 (Mad) [The assessee-company, which took over the business run by an American company, was held not entitled to exemption as provided in section 37(3D) of the 1961 Act for the assessment year 1980-81 because no new industrial undertaking was set up by it].

(23) *CIT v. Indo Asian Switchgears* (*P.*) *Ltd.*, (2002) 257 ITR 645, 646, 648-49 (Punj) [Expenses on account of commission paid to the agents/marketing organisers, as also turnover discount paid to the distributors, were held not to be taken into account for the purpose of disallowance under section 37(3A) of the 1961 Act for the assessment year 1980-81].

(24) *Ethnor Ltd. v. CIT* : *CIT v. Khandelwal Laboratories P. Ltd.* : *German Remedies Ltd.*, (2003) 260 ITR 401, 404-05, 410-11, 412, 412-13, 413-14 (Bom) [Expenditure incurred by the assessee on medical literature was expenditure on advertisement, publicity and sales promotion and as such includible for disallowance under section 37(3A) of the 1961 Act for the assessment year 1979-80. Such expenditure was not in the nature of publication and distribution of journals within the meaning of section 37(3B)(*vii*) of the 1961 Act. Further, the estimated expenditure of Rs. 2,00,000 on samples distributed free of cost to medical practitioners by the assessee was also held to be hit by the provisions of section 37(3A) of the 1961 Act. However, the Tribunal was held justified in holding that the expenses in bringing out pamphlets, booklets, etc., on various diseases and the effect of various medicine manufactured by the assessee-company for the use of the medial profession were expenses on scientific information and the same were not hit by the provisions of section 37(3A) of the 1961 Act].

(25) *Filmyug Pvt. Ltd. v. CIT* : *CIT v. Uttam Chitra*, (2003) 261 ITR 263, 270-71 (Bom) [The exemption provisions of section 37(3D) of the 1961 Act held applicable to every new product for 3 previous years, irrespective of the fact whether the new product was manufactured by an existing undertaking or by a newly set up undertaking. In other words, irrespective of the year in which the undertaking is set up, the benefit under section 37(3D) of the 1961 Act is available to the new product for three previous years, commencing from the previous year in which the undertaking beings to manufacture that product]. This view has been **followed in** *CIT v. S.M. Sagar* [(2003) 261 ITR 271, 272, 274-75 (Bom)], wherein the Tribunal was held right in deleting disallowance of Rs. 57,287, being the amount spent for publicity expenses, holding that the business of film production is an industrial undertaking falling under exemption provisions in section 37(3D) of the 1961 Act for the assessment year 1979-80.

(26) *CIT v. Lakhanpal National Ltd*., (2007) 292 ITR 167, 168 (Guj), **relying on** *CIT v. Zippers India*, (2006) 284 ITR 142 (Guj) [The incentive paid to the sales representatives of the distributors held deductible as the same was paid for the services rendered by them].

LexisNexis

(27) *CIT v. Agra Beverages Corporation P. Ltd*., (2008) 300 ITR 286, 295 (All) [Deduction under section 37(3D) of the 1961 Act exigible in respect of expenditure incurred on launch of new product towards advertisement and publicity].

(28) *CIT v. Bakeman's Home Products*, (2007) 213 CTR (Punj) 83, 92 [Provisions of section 37(3D) of the 1961 Act are applicable where assessee having set up an industrial undertaking for manufacture of articles by taking a factory on lease].

(29) *CIT v. Chawla Plastics*, (2007) 164 Taxman 165, 166 (Del) [For purpose of disallowance under section 37(3A) of the 1961 Act, Tribunal was right in holding that expenditure on commission was not in the nature of sales promotion as defined in section 37(3B) of the 1961 Act]. Also see, *CIT v. Rollatainers Ltd*., (2008) 166 Taxman 114 (Del); *CIT v. Khetu Ram Bishamber Das*, (2008) 166 Taxman 273, 274 (Del).

(30) *CIT v. Benaras House Ltd*., (2007) 165 Taxman 32, 33 (Del) [Repair and maintenance of motor cars is not subject to the restrictions provided in section 37(3A) read with section 37(3B) of the 1961 Act].

(31) *Kesharwani Zarda Bhandar v. CIT*, (2012) 349 ITR 519 (All) [The reasons given for disallowing the expenses of Rs. 68,425 on the ground that advertisement was not made in small newspapers and further disallowance of Rs. 1,70,699 for the purposes of section 37(3A) of the 1961 Act on the ground that the presentation articles were given under the scheme to stockists and not to consumers, held to be a debatable issue].

(32) *Novopan India Ltd. v. CIT,* (2013) 356 ITR 580 (AP) [for the purpose of disallowance under sections 37(3A) to (3D) of the 1961 Act, the Tribunal was right in holding the daily allowance paid to employees of the assessee as having the same character as hotel expenses].

Expression 'has set up an industrial undertaking' used in section 37(3D) of 1961 Act, implication of.— On a plain reading of the expression 'has set up an industrial undertaking' used in section 37(3D) of the 1961 Act shows the requirement that an industrial undertaking must be 'set up'. The words 'set up' as defined in various dictionaries means established and organised. The words 'set up' used in the section does not qualify the words 'set up' by adding before it the word 'new'. Hence, the benefit of section 37(3D) of the 1961 Act would also be available to the assessee which was an industrial establishment already set up but had launched a new product. The requirement of the section was not that of setting up of a new undertaking but would be satisfied where the industry has undertaken the production of a new article [*CIT v. Agra Beverages Corporation P. Ltd*., (2008) 300 ITR 286, 295 (All)].

LexisNexis

In *CIT v. Khatu Ram Bishambar Das,* CC Nos. 445-446 of 1998 : (1998) 230 ITR (St.) 90 (SC), their Lordships of the Supreme Court have, by an order dated 23-1-1998, issued notice on the special leave petition filed by the Department against the judgment dated 6-3-1997 of the Delhi High Court in ITR Nos. 242-243 of 1985, whereby the High Court answered the reference against the Department on the questions: (*i*) Whether, in respect of the advertisement expenses on presentation article of Rs. 50 each admissible under section 37(3) of the 1961 Act read with rule 6B of the 1962 Rules, the Tribunal was justified in law in taking the view that section 37(3A) of the 1961 Act and the disallowance laid down therein was applicable; (*ii*) whether the expenditure of Rs. 4,37,265 on annual basis as bonus paid to the dealers was not in the nature of sales promotion expenses and the provisions of section 37(3A) of the 1961 Act were not applicable in the assessment year under consideration; (*iii*) whether the Tribunal was right in law in deleting the addition of Rs. 65,580 as made by the ITO under section 37(3A) of the 1961 Act.

The effect of the subsequent amendments to sections 37(3A) and 37(3B) of the 1961 Act has been indicated at the appropriate places by way of footnotes.

The said **sub-sections (3A), (3B), (3C) and (3D)** of the 1961 Act as **so amended were omitted by the Finance (No. 2) Act, 1980** (44 of 1980), with effect from 1-4-1981. Thus, the 1978-inserted sub-sections remained operative for assessment years 1979-80 and 1980-81.

Scope and effect of sub-sections (3A), (3B), (3C) and (3D) (operative for assessment years 1984-85 and 1985-86) of section 37 of 1961 Act.—New sub-sections (3A), (3B), (3C) and (3D) were inserted in section 37 of the 1961 Act by the Finance Act, 1983 (11 of 1983), with effect from 1-4-1984, making provisions for partial disallowance of certain expenses on account of advertisement, publicity and sales promotion, etc. The scope and effect of the 1983-inserted sub-sections have been elaborated in paragraphs 33.1 to 33.5 of the departmental circular No. 372, dated 8th December, 1983. Section 37(3A) of the 1961 Act has been held **not violative** of Article 14 of the Constitution [*Mysore Kirloskar Ltd. v. Union of India,* (1986) 160 ITR 50 (Karn)]. These sub-sections have, however, been omitted by the Finance Act, 1985 (32 of 1985), with effect from 1-4-1986. Thus, these sub-sections remained operative for assessment years 1984-85 and 1985-86.

For further cases, reference may be made to—

(1) *CIT v. The Statesman Ltd.,* (1992) 198 ITR 582, 591 (Cal) [The expenditure incurred as and by way of commission paid to sales agents and advertisement agents did not attract the disallowance under section 37(3A) read with section 37(3B) of the 1961 Act. Such expenditure for maintaining circulation was the ordinary selling cost and could not be said to be of the nature prohibited in section 37(3A) of the 1961 Act].

(2) *CIT v. Bata India Ltd.,* (1993) 201 ITR 884, 889 (Cal) [Discount allowed to wholesale dealers from the listed retail price and commission paid to the selling agents did not come within the purview of section 37(3A) of the 1961 Act inasmuch as trade discount merely represented lesser realisation of the sale price itself and the commission paid to selling agents were actual selling expenses. Further, amounts paid as contributions to various organisations during the Puja and other festivals could not be considered as sales promotion expenses attracting the provisions of section 37(3A) of the 1961 Act].

(3) *Dollar Co. Pr. Ltd. v. Union of India,* (1993) 204 ITR 103, 109 (Mad) [The provisions of section 37(3A) and section 37(3B) of the 1961 Act do not violate Article 14. These provisions are not discriminatory and do not interfere with the freedom of trade guaranteed under Article 19(1)(*g*)].

(4) *Coates of India Ltd. v. CIT,* (1994) 205 ITR 373, 377 (Cal) [Reimbursement of motor-car expenses incurred by the assessee's employees in using their own motor-cars for the purposes of the assessee's business operations was clearly hit by section 37(3A)/(3B) of the 1961 Act, more particularly in view of the provisions of clause (*c*)(*ii*) of the *Explanation* to section 37(3B) of the 1961 Act].

(5) *CIT v. Tungabhadra Industries Ltd.,* (1994) 207 ITR 553, 563-64 (Cal) [Expenditure incurred on repairs and insurance of motor car, which are covered under section 31 of the 1961 Act and not under section 37(1) of the 1961 Act, could not be disallowed under section 37(3A) of the 1961 Act which overrides the provisions of only section 37(1) of the 1961 Act and not of sections 30 to 36 of the 1961 Act]. Also see, *CIT v. Price Waterhouse,* (1994) 207 ITR 564, 566 (Cal); *CIT v. Orient Paper & Industries Ltd.,* (1995) 214 ITR 473, 474-75 (Cal); *CIT v. A.V. Thomas & Co. Ltd.,* (1997) 225 ITR 29, 33-34 (Ker); *CIT v. Midland Rubbers & Produce Co. Ltd.,* (1998) 232 ITR 530, 531-32 (Ker).

(6) *Balsara Hygiene Products Ltd. v. D.S. Saxena,* (1994) 208 ITR 623, 636 (Bom) [Sub-sections (3A) and (3B) of section 37 of the 1961 Act do not violate Article 19(1)(*a*) of the Constitution and are valid. That Article 19(1)(*a*) guarantees the right to freedom of speech and expression. Commercial advertising constitutes speech and expression within the meaning of that Article 19(1)(*a*)].

(7) *CIT v. Santosh Agencies,* (1994) 210 ITR 78, 82 (Cal) [Neither the special discount nor the foreign tour expenses of the dealers were held covered by the expression 'sales promotion' expenditure as appearing in section 37(3A) read with section 37(3B) of the 1961 Act].

(8) *CIT v. Assam Asbestos Ltd.,* (1995) 215 ITR 847, 849 (Gauh) [Where the Tribunal has directed the AO to exclude the sum of Rs. 30,115 which was incurred on account of advertisement expenses for recruitment of personnel while making the disallowance under section 37(3A) read with section 37(3B) of the 1961 Act, no question of law has been held to have arisen out of the Tribunal's order].

(9) *CIT v. Veneers & Laminations* (*India*) *Ltd.,* (1996) 222 ITR 30, 32 (Ker) [As the Tribunal was correct in holding that the commission paid on export sales was not for sales promotion activity, no question of law arose].

(10) *George Williamson* (*Assam*) *Ltd. v. CIT,* (1997) 223 ITR 203, 206 (Gauh) [Section 37(3A) of the 1961 Act did not cover repairs of motor cars but the motor vehicles tax paid was covered by section 37(3A) of the 1961 Act].

(11) *Assam Carbon Products Ltd. v. CIT,* (1997) 224 ITR 57, 59, 60-61 (Gauh) [Expenditure on insurance and current repairs which are covered by section 31 of the 1961 Act would not fall within the gamut of section 37(3A) of the 1961 Act].

(12) *CIT v. Ayurved Sewa Ashram Ltd.,* (1997) 225 ITR 778, 780-81 (Raj) [The finding of the Tribunal that the amount spent on the repairs and maintenance of car was not covered by section 37(3A) of the 1961 Act was a finding of fact, giving rise to no question of law].

(13) *CIT v. Navodaya,* (1997) 225 ITR 399, 405, 408 (Ker), **applying** *Mohan Meakin Breweries Ltd. v. CIT,* (1979) 118 ITR 101 (HP) [The natural impact of the *non obstante* clause at the beginning of section 37(3A) of the 1961 Act is that it excludes the considerations which are contemplated by section 37(1) of the 1961 Act and in the context of section 37(3A) of the 1961 Act, it is plain that the question whether the expenditure is capital expenditure or otherwise is not relevant because that

LexisNexis

section 37(3A) of the 1961 Act would have to be understood as independent and separate in existence and consequent enforcement in regard thereto].

(14) *CIT v. Bharat Industrial Works,* (1997) 226 ITR 543, 546-47 (MP) [Expenditure on maintenance of motor cars has been held to be covered by section 37(3B)(*ii*) of the 1961 Act so as to restrict its allowability as per section 37(3A) of the 1961 Act]. Here, it is pertinent to note that although the question in that case related to assessment year 1984-85 or 1985-86 as is evident from the wordings of the question as also the discussion at pages 546-47 of the judgment, sections 37(3A) and 37(3B) of the 1961 Act, as they stood for the assessment years 1979-80 and 1980-81 have been reproduced. This view has been **followed in** *CIT v. K.N. Oil Industries,* (1997) 226 ITR 547, 549 (MP).

(15) *CIT v. Steel Tubes of India Ltd.,* (1997) 228 ITR 418, 420 (MP) [Tribunal was held right in holding that the expenditure incurred on repairs of the car was required to be excluded while computing the disallowance under section 37(3A) of the 1961 Act].

(16) *CIT v. Travancore Cements Ltd.,* (1997) 138 CTR (Ker) 51, 53 [Tribunal was held not right in law in holding that the repairs will not fall within the mischief of section 37(3A) of the 1961 Act].

(17) *CIT v. M.P. State Handloom Weavers' Co-operative Society,* (1998) 233 ITR 62, 65 (MP) [Tribunal was held justified in law in holding that the amount of Rs. 1,15,625 disallowed by the AO as per provisions of sections 37(3A) and 37(3B) of the 1961 Act and confirmed by CIT(*A*) could not be disallowed simply because the expenses incurred on publicity, propaganda and vehicle maintenance on directives of the State Government; and also held justified in law to hold that simply because the expenditure were incurred as per directives of the State Government, they did not partake the character of sales promotion in so far as the assessee, a co-operative society exempt from tax under section 80P(2) of the 1961 Act, is concerned].

(18) *CIT v. Mohd. Ishaque Gulam,* (1998) 232 ITR 869, 874 (MP) [Brokerage and commission paid for selling the goods would not come within the mischief of the phrase 'advertisement, publicity and sales promotion' as employed in section 37(3A) of the 1961 Act]. This Madhya Pradesh decision [232 ITR 869 (MP)] and Calcutta decision [194 ITR 66 (Cal)] have been **followed in** *CIT v. Davangere Cotton Mills Ltd.,* (2000) 243 ITR 864, 866 (Karn).

(19) *National Engineering Industries Ltd. v. CIT*, (1999) 236 ITR 577, 580 (Cal) [The ceilings and restrictions under section 37(3A) of the 1961 Act are not applicable in regard to repairs and insurance of motor cars and provident fund and bonus payable to drivers by the assessee-company].

(20) *CIT v. Travancore Cements Ltd.*, (1999) 240 ITR 816, 824-25 (Ker—FB), **reversing** *CIT v. Travancore Cements Ltd.*, (1999) 240 ITR 825 (Ker), discussed, *ante*., **overruling** *CIT v. Navodaya*, (1997) 225 ITR 399 (Ker); and **affirming** *CIT v. A.V. Thomas & Co. Ltd.*, (1997) 225 ITR 29, (Ker) and *CIT v. Midland Rubbers & Produce Co. Ltd.*, (1998) 232 ITR 530 (Ker), both these cases dealt with, *ante*. [Expenditure incurred on repairs of motor cars, which constitute plant, is not subject to the ceiling prescribed by section 37(3A) of the 1961 Act]. It may be noted that the reference to the Full Bench has originated in view of the decision in *CIT v. Travancore Cements Ltd.,* (1999) 238 ITR 781, 782 (Ker).

(21) *CIT v. Sholinger Textiles Ltd.*, (1999) 240 ITR 908, 909 (Mad) [Tribunal was held right in law in holding that the driver's salary should not be taken into consideration, while making the disallowance under section 37(3A) of the 1961 Act]. This view has been **followed in** *CIT v. Tamil Nadu Poultry Development Corporation Ltd.,* (2002) 254 ITR 360, 361 (Mad).

(22) *Karnataka State Financial Corporation v. CIT*, (2000) 242 ITR 623, 626 (Karn) [In view of the specific provisions contained in clause (*c*)(*ii*) of the *Explanation* to section 37(3B) of the 1961 Act, conveyance allowance paid to the employees would be hit by the provisions of section 37(3A) of the 1961 Act].

(23) *CIT v. M.N. Dastur & Co.* (*P.*) *Ltd.*, (2000) 243 ITR 10, 18 (Cal) [Insurance and repairs, which are allowable under section 31 of the 1961 Act, are beyond the purview of section 37(3A) read with section 37(3B) of the 1961 Act].

(24) *E.I.D. Parry* (*India*) *Ltd. v. CIT*, (2000) 243 ITR 116, 119, 121 (Mad) [Tribunal was justified in holding that a jeep constituted a motor car for the purposes of section 37(3A) of the 1961 Act (operative for assessment year 1985-86)].

LexisNexis

(25) *Griffen Laboratories Ltd. v. CIT*, (2000) 244 ITR 68, 70 (Cal) [Expenditure on medical literature and journals distributed by the assessee-company to the members of the medical profession cannot be hit by the provisions of sections 37(3A) and 37(3B) of the 1961 Act for the assessment year 1985-86].

(26) *CIT v. Torrent Laboratories Pvt. Ltd.*, (2000) 245 ITR 29, 30 32-33 (Guj) [Expenditure incurred for printing of calendars and informative literature distributed to doctors, held not to be hit by the provisions of section 37(3A) of the 1961 Act].

(27) *Dolphin Laboratories Ltd. v. CIT*, (2001) 249 ITR 538, 539 (Cal) [Expenditure incurred by the assessee on free medical samples has been held to attract the provisions of section 37(3A) of the 1961 Act. However, expenditure on distribution of technical literature has been held not to be hit by the provisions of section 37(3A) of the 1961 Act].

(28) *CIT v. Wockhardt Pvt. Ltd.*, (2001) 250 ITR 118, 120 (Bom) [Expenditure incurred on distribution of free samples by the assessee, a pharmaceutical company, to doctors to test efficacy of the products has been held to be hit by the provisions of section 37(3A) of the 1961 Act for the assessment year 1984-85].

(29) *CIT v. Dabur* (*Dr. S.K. Burman*) *P. Ltd.*, (2001) 250 ITR 301, 303-04 (Cal) [Expenditure incurred on calendars, *panchang* which gave the details and publicity of the company and its product was for the purpose of publicity and advertisement and for sales promotion and such expenditure was hit by the provisions of section 37(3A) of the 1961 Act for the assessment year 1985-86].

(30) *CIT v. Indian Hume Pipe Co. Ltd.*, (2001) 250 ITR 592, 593 (Bom) [Expenses on hiring yellow taxis were to be excluded from disallowance under section 37(3A) of the 1961 Act in view of the provisions contained in clause (*c*)(*i*) of the *Explanation* to section 37(3B) of the 1961 Act, for the assessment year 1985-86].

(31) *CIT v. Mahindra Ugine & Steel Co. Ltd.*, (2001) 250 ITR 696, 699 (Bom) [Conveyance allowance paid to employees owning two wheelers or who were commuting by train or bus could not fall within the purview of clause (*c*)(*ii*) of the *Explanation* to section 37(3B) of the 1961 Act because that clause could be attracted only in respect of conveyance allowance paid to the employees owning cars].

(32) *Widia* (*India*) *Ltd. v. CIT*, (2001) 251 ITR 577, 584 (Karn) [Expenditure incurred by the assessee towards conducting seminars and exhibitions, as also expenditure incurred on hotel payments, attracted the provisions of section 37(3A) read with section 37(3B) of the 1961 Act for the assessment year 1984-85].

LexisNexis

(33) *CIT v. Coates of India Ltd.*, (2002) 254 ITR 232, 233, 234 (Cal) [Expenditure on repairs of motor cars was not to be taken into account for disallowance under section 37(3A) read with section 37(3B) of the 1961 Act for the assessment year 1985-86].

(34) *CIT v. Mahaveer Polymers*, (2002) 256 ITR 598, 599, 600 (Raj) [Amount paid to the agents in addition to their regular commission or discount on a sale beyond a particular limit is nothing but expenditure for promoting the sale and the same is to attract the disallowance under section 37(3A) of the 1961 Act for the assessment year 1985-86. However, expenditure incurred on the maintenance of delivery vans, motor cycles and scooters cannot be taken into account for invoking the provisions of section 37(3A) read with section 37(3B) of the 1961 Act].

(35) *CIT v. General Electric Co. of India Ltd.*, (2002) 256 ITR 632, 635-36 (Cal) [Expenditure incurred by the assessee on metered taxis when the employees of the assessee were on tour was held not hit by the provisions for disallowance under section 37(3A) read with section 37(3B) of the 1961 Act and *Explanation* (*c*) thereto, for the assessment year 1985-86].

(36) *State Bank of Indore v. CIT*, (2002) 257 ITR 463, 466 (MP) [Expenditure on salary and dress allowance of drivers of the motor cars was hit by the provisions of section 37(3A) read with section 37(3B) of the 1961 Act for the assessment year 1984-85].

(37) *CIT v. Klas Engineering* (*P.*) *Ltd.*, (2002) 258 ITR 779, 780 (Karn) [Commission payment on sales, not to constitute sales promotion expenses within the meaning of section 37(3A) of the 1961 Act for the assessment year 1984-85].

(38) *Rane* (*Madras*) *Ltd. v. CIT*, (2003) 259 ITR 307, 309 (Mad) [Although the Madras decision : 240 ITR 908 (Mad), has been **purported to be followed**, a contrary view has been taken to the effect that the Tribunal was right in holding that the sum of Rs. 75,706 being salary paid to the drivers should be taken into account for the purpose of computing the disallowance under section 37(3A) of the 1961 Act for the assessment year 1984-85].

(39) *CIT v. Gogte Textiles Ltd.*, (2003) 260 ITR 229, 231 (Karn) [Commission paid to the agents on actual sales could not form sales promotion expenses so as to attract the restrictive provisions of section 37(3A) of the 1961 Act for the assessment year 1985-96].

(40) *CIT v. Tuticorin Alkali Chemicals & Fertilizers*, (2003) 261 ITR 80, 81-82 (Mad) [Commission and discounts on sales amounting to Rs. 9,15,115 not be taken into account while considering the disallowance under section 37(3A) of the 1961 Act for the assessment year 1985-86].

(41) *CIT v. Investment Trust of India Ltd.*, (2003) 264 ITR 506, 508, 511, 512 (Mad) [Expenditure incurred by the assessee on advertisements in newspapers in compliance with the provisions contained in section 58A of the Companies Act, 1956[20], for inviting fixed deposits from public could not be regarded as sales promotion expenditure falling under section 37(3A) of the 1961 Act for assessment year 1984-85. For such a view, support has also been taken from the portion of the **departmental circular** No. 240, dated 17-5-1978 in its paragraph 12.3(*iii*), which has been reproduced in connection with sections 37(3A) to 37(3D) operative for assessment years 1979-80 and 1980-81].

(42) *CIT v. Srinivasa Textile Processing Ltd.*, (2002) 177 CTR (Karn) 10, 11-12 [Commission paid to the agents who have effected sales could not be treated as sales promotion expenses so as to attract the provisions of section 37(3A) of the 1961 Act for disallowance].

(43) *CIT v. Southern Roadways Ltd.*, (2004) 265 ITR 404, 406 (Mad) [Expenses incurred in running and maintenance of motor car as stated under section 37(3B) of the 1961 Act would not necessarily include repair and replacement in relation to assessment year 1984-85. Further, driver's salary should not be included for the purpose of computing disallowance of expenditure on maintenance of motor car under section 37(3A) of the 1961 Act for that assessment year].

(44) *CIT v. Udaipur Distillery Co. Ltd.*, (2004) 266 ITR 667, 673 (Raj) [Once the marketing expenditures, a proportionate share whereof is to be borne by the assessee, are excluded from the purview of expenses on advertisement, publicity and sales promotion and such expenses do not fall in any other categories of expenditure detailed in section 37(3B) of the 1961 Act, the question of invoking any part of section 37(3A) read with section 37(3B) of the 1961 Act cannot arise. In other words, where the expenditure on account of marketing overheads or salary component of marketing expenditure is not an expenditure governed by sections 37(3A) and 37(3B) of the 1961 Act, such expenses cannot be disallowed by referring to the inapplicability of *Explanation* (*b*) to section 37(3B) of the 1961 Act on the ground that the employees to whom salaries have been paid were not the employees of the assessee]. Also see, *CIT v. Udaipur Distillery Co. Ltd.*, (2004) 186 CTR (Raj) 50, 51.

(45) *CIT v. Thangamaligai*, (2003) 130 Taxman 487, 487-88 (Mad) [The Tribunal was held not right in law in holding that the chit investments/gifts to chit subscribers would not constitute sales/business promotion expenditure and is outside the scope of the provisions of section 37(3A) of the 1961 Act].

(46) *CIT v. Sitalakshmi Mills Ltd.*, (2003) 131 Taxman 509, 510 (Mad) [Sales commission could not be subjected for disallowance under section 37(3A) of the 1961 Act for the assessment year 1984-85].

(47) *Ghulam Rasool & Co. v. CIT*, (2005) 184 Taxation 537, 540 (MP) [Expenditure incurred on lottery styled as Inami Yojna Scheme and same being a sales promotion expenditure should not have been disallowed by the Tribunal by treating it otherwise].

(48) *CIT v. Krishna Kumar & Bros*., (2006) 154 Taxman 287, 289 (All) = (2008) 296 ITR 684 (All) [Prize Scheme was in the nature of sales promotion scheme so as to attract customers and was not a case of giving discount to them as every customer was not getting prize coupon and the Tribunal was not justified in deleting disallowance].

(49) *CIT v. Arunodaya Mills Ltd*., (2008) 296 ITR 438, 439 (Guj) [The sales commission been given to various sales representatives or dealers would not come within the definition of 'sales promotion' and the said payment held deductible].

(50) *CIT v. Jagaran Prakashan P. Ltd*., (2008) 296 ITR 627, 628 (All) [Expenditure on taxi fare charges for delivering newspapers could not be allowed as the same being not necessary to business].

(51) *CIT v. Somaya Organics* (*India*) *Ltd*., (2008) 296 ITR 634, 635-36 (All) [The expression 'motor cars' used in section 37(3B) of the 1961 Act means passenger cars and does not include goods vehicles and in the absence of any reason given by the Tribunal, it was not justified in holding that the 'jeep' being not a goods vehicle but a passenger car could not be equated with 'motor cars' for the purpose of section 37(3A) of the 1961 Act].

(52) *CIT v. Somaya Orgnics* (*India*) *Ltd*., (2008) 296 ITR 634, 636 (All) [Under section 37(3B) of the 1961 Act, the word 'repair' was covered by the word 'maintenance' and the Tribunal was not justified

20. Repealed and replaced by Act 18 of 2013.

LexisNexis

in holding that the expenditure on repair of motor cars should not be included for the purposed of section 37(3A) of the 1961 Act].

(53) *CIT v. Krishna Kumar & Bros*., (2008) 296 ITR 684, 687 (All) [Section 37(3B) of the 1961 Act refers to expenditure incurred on advertising, publicity and sales promotion and as the expenditure in questing clearly fell under the heading sales promotion, deletion of disallowance by the Tribunal not justified].

(54) *CIT v. Onkar Nath Aggarwal*, (2008) 307 ITR 346, 347 (Punj) [Commission and export markets development allowance held not to be expenditure on sales promotion and as such cannot be disallowed].

(55) *CIT v. Oswal Woollen Mills*, (2009) 311 ITR 230, 234 (Punj) [While working out the disallowance under section 37(3A) of the 1961 Act, the driver's salary must be included as the expression 'running and maintenance of motor cars' clearly indicate that the same include the expenditure on hiring a driver for running the said motor car].

(56) *Brihan Maharashtra Sugar Syndicate Ltd. v. Deputy CIT*, (2010) 320 ITR 658, 664 (Bom) [The amount been spent by way of commercial expediency for promoting products of the assessee and the finding is that this is by way of sales promotion and the deduction is admissible].

(57) *CIT v. Mewar Oil & General Mills Ltd*., (2008) 216 CTR (Raj) 65, 71 [For computing disallowance under section 37(3A)/(3B) of the 1961 Act, driver's salary, depreciation on car and repairs of car are to be excluded].

(58) *CIT v. Vadilal Industries Ltd*., (2008) 217 CTR (Guj) 318, 323 [for disallowance under section 37(3A) of the 1961 Act gross expenditure less amount recovered by assessee from its dealers could be considered, *i.e.*, only the net amount of expenditure on advertisement and sales promotion to be considered].

(59) *Jyoti Ltd. v. CIT*, (2009) 224 CTR (Guj) 399, 409 = (2010) 321 ITR 135 (Guj) [For the purpose of computing disallowance under section 37(3A) of the 1961 Act, amount spent on publication and distribution of literature to dealers giving details of the goods manufactured and offered for sale in the market by the assessee not being advertisement cannot be included].

(60) *CIT v. Bajaj Auto Ltd*., (2009) 182 Taxman 163, 167-68 (Bom) = (2010) 322 ITR 29, 34 (Bom) [The expenditure incurred by the assessee on advertisement for appointment of dealers was not akin to recruitment of personnel as contemplated under section 37(3B)(*ii*) of the 1961 Act and, hence such expenditure was not outside the purview of disallowance under section 37(3A) of the 1961 Act].

Where the Tribunal has found that chit incentive expenses and chit expenses incurred by the assessee could not be considered to be sales promotion expenditure liable to be disallowed under section 37(3A) of the 1961 Act, the same is a finding of fact giving rise to no question of law [*CIT v. Thangamaligai & Co.*, (2000) 241 ITR 525, 526, 527 (Mad)].

In *CIT v. Dawn Mills Co. Ltd.,* (1997) 93 Taxman 573, 574 (Bom), it has been held that the questions of law concerning disallowance under section 37(3A) of the 1961 Act sought to be referred did not arise out of the order of the Tribunal.

LexisNexis

Omitted/Phased-out provisions of section 39 of the 1961 Act

Enactment of the provisions.—The Indian Income-tax (Amendment) Act, 1939 (7 of 1939), inserted section 12A in the 1922 Act which provided that in case there was an agreement for adequate consideration to share managing agency commission, the parties to the agreement shall file a declaration to that effect and the Assessing Officer (upto 31-3-1988, Income-tax Officer) on satisfaction of the facts in such declaration shall assess the income of the managing agents from such managing agency at a figure to their share as per the agreement.

Section 39 of the 1961 Act corresponded to section 12A of the 1922 Act. Section 39 made it clear that the agreement for sharing the managing agency commission should be in writing [see, *B.P. Jain v. CIT,* (1976) 105 ITR 195, 202 (Pat)].

When there were no such statutory provisions.—Even before 1939, when there were no such statutory provisions, if the managing agents of a company had agreed, for adequate consideration, to pay a share of the commission receivable from the managed company, the share so agreed to be given away was allowable as a business expenditure in the computation of income from the managing agency of the managing agent [*CIT v. Tata Sons Ltd.,* (1939) 7 ITR 195 (Bom)]. If, however, the managing agency agreement was so worded, the portion of the commission payable to others could be held to be diverted at source [see, *B.P. Jain v. CIT,* (1976) 105 ITR 195, 202 (Pat)].

Provisions.—Section 39 covered all types of cases where there was a sharing of the managing agency commission. It was a special provision for apportioning the charging of the tax on the total managing agency commission in separate hands, according to the respective shares of the recipients, on fulfilment of the requirements of that section [see, *B.P. Jain v. CIT,* (1976) 105 ITR 195, 202-03 (Pat)].

Requirements.—The section came into operation where—

(*a*) there existed an agreement in writing,

(*b*) which agreement had been made for adequate consideration,

(*c*) for the purpose of sharing the managing agency commission payable by the managed company to one of the executants of the agreement; and

(*d*) the parties to the agreement filed a declaration with the Assessing Officer (upto 31-3-1988, Income-tax Officer) showing the proportion in which such commission was shared between them under the agreement; and

(*e*) produced evidence before the Assessing Officer (upto 31-3-1988, Income-tax Officer) to prove the facts stated in such declaration,

then, each such declarant party shall be chargeable to tax only on the share to which he was entitled under the agreement.

Filing of declaration was a condition precedent.—Having regard to the clear language of this section, there was no escape from the conclusion that the submission of a declaration as specified in the section was a condition precedent to the managing agents' claiming that they were chargeable only on the share to which they were entitled under the particular agreement [*Jhajharia Bros. Ltd. v. CIT,* (1950) 18 ITR 126, 130 (Cal)].

Section 39 *vis-a-vis* section 28(*i*) or 37(1).—Section 39 enacting a special provision in respect of the sharing of the managing agency commission, an assessee must fulfil the requirements of the special provision. If he fails to do so, he cannot fall back upon the general provisions of section 28(*i*) [*B.P. Jain v. CIT,* (1976) 105 ITR 195, 203 (Pat)] or of section 37(1) [*Jhajharia Bros. Ltd. v. CIT,* (1950) 18 ITR 126, 131 (Cal), **dissented from in** *B.P. Jain v. CIT,* (1976) 105 ITR 195 (Pat)].

When to file the declaration?—A declaration required to be filed under these provisions had to be filed at the time of each assessment. A declaration once made and acted upon by the Officer could not enure for the benefit of the assessee in subsequent assessment years. A declaration might, on sufficient cause having been shown for default in filing at the assessment stage, have been admitted by the appellate authority but, then, the appellate authority had to send the matter back to the Officer who was required to

LexisNexis

be satisfied with regard to the proof of the facts contained in the declaration [*Govindram Ramnath & Co. v. CIT,* (1953) 23 ITR 1 (Bom)].

Managing agency system abolished.—The managing agency system, which prevailed for a long time, was finally abolished by insertion by the Companies (Amendment) Act, 1969 (17 of 1969), of a new section 324A in the Companies Act, 1956[1] (1 of 1956), with effect from 3-4-1970.

LexisNexis

1. Repealed and replaced by Act 18 of 2013.

Omitted/Phased-out provisions of sections 40 & 40A of the 1961 Act

Legislative amendments of section 40 under 1961 Act.—I. *The Finance Act, 1963.*—By **the Finance Act, 1963** (13 of 1963), the following **amendments** (**w. e. f. 1-4-1963**) have been made—

—**section 40(*c*)(*iii*)** has been **inserted**; and

—***Explanation* to section 40(*c*)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 1(95)-63/TPL, dated 9-9-1963*, as follows:—

'*Disallowance of remuneration, etc., exceeding ₹ 5,000 per mensem.*—**19.** Section 6 of the Finance Act, 1963, introduces a new sub-clause (*iii*) in section 40(*c*) of the Income-tax Act, 1961, providing for the disallowance of any expenditure incurred by a company for providing any remuneration or benefit or amenity to its employees in excess of an amount calculated at the rate of ₹ 5,000 per month for each employee for any period after 28th February, 1963, *such disallowance is to be made only in cases where the employee concerned is an Indian citizen*. In calculating the total expenditure in respect of a particular employee, certain extraordinary items are to be excluded, namely, gratuities, the transferred balance of an employee in a newly recognised Provident Fund, and any compensation or other payments falling within section 17(3) of the Income-tax Act, 1961. It has to be noted that section 40(*c*)(*iii*) relates to disallowance in the assessment of the company, and what is important is, therefore, the expenditure incurred by the company and not necessarily the quantum of assessable income to which it gives rise in the hands of the employee.'.

II. *The Finance Act, 1964.*—By **the Finance Act, 1964** (5 of 1964), the following **amendments** (**w. e. f. 1-4-1964**) have been made—

—**section 40(*c*)(*iii*)** has been **substituted**;

—***Explanation* to section 40(*c*)** has been **numbered** as ***Explanation 1* thereof**; and

—***Explanation 2* to section 40(*c*)(*iii*)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 20, dated 7-7-1964*, as follows:—

'*Restriction over deduction of expenditure on perquisites of employees of companies.*—**42.** Section 40(*c*)(*iii*) (inserted by the Finance Act, 1963), which provided for the disallowance in the assessment of companies of expenditure incurred by them after 28th February, 1963, on providing remuneration and perquisites to their employees of Indian citizenship, to the extent such expenditure exceeded five thousand rupees per month in the case of each such employee, has been substituted by section 10 of the Finance Act, 1964, by a new provision. It has to be noted that as the previous provision has been substituted by the new provision with effect from 1st April, 1964, the former one will not be applicable in respect of assessments for the assessment year 1964-65.

43. Under the new provision, as substituted by the Finance Act, 1964, any expenditure incurred by a company after 29th February, 1964, on providing any benefit, amenity or perquisite directly or indirectly to its employees (whether of Indian or foreign citizenship) in cash or kind (subject to certain exclusions) will, to the extent such expenditure exceeds 20% of the salary of the employee concerned, be disallowed in computing the assessable income of the company. The items of expenditure which are to be excluded in computing the expenditure for the purpose of the above-mentioned provision have been enumerated in the proviso to section 40(*c*)(*iii*), these, *inter alia*, being the expenditure incurred by the company by way of payments of gratuity to its employees; providing travel concessions or assistance to an employee of Indian citizenship and his wife and children for proceeding on leave to his home-district in India, and passage moneys or value of free or concessional passage to an employee of foreign citizenship for himself and his wife and children for proceeding on home leave outside India; payments made (otherwise than through a recognised provident fund or approved superannuation fund) for effecting an insurance on the life of the employee or a contract for an annuity; payments of compensation to an employee in connection with the termination of his employment or the modification of the terms and conditions relating thereto; payments made to an employee from an unrecognised provident fund or superannuation fund to the extent of employer's contributions thereto; and contributions made to a recognised provident fund or an approved superannuation or gratuity fund.

44. The term "salary" as used in section 40(*c*)(*iii*) of the Income-tax Act has been assigned the same meaning as in rule 2(*h*) in Part A of the Fourth Schedule to the Act, and so, it will include, dearness allowance if it is payable under the terms and conditions of the employment of the employee, but will not include any other allowances or perquisites. The term "perquisite" in the expression "any benefit or amenity or perquisite" will cover all the items in the definition of "perquisite" in section 17(2) of the Income-tax Act, but it will have a wider meaning as that definition has not been applied for the purpose of section 40(*c*)(*iii*); thus, the value of any benefit or amenity referred to in section 17(2)(*iii*) will be taken as a pequisite, even

LexisNexis

where an employee does not have a substantial interest in the company or his salary is less than ₹ 18,000 per annum. It has also to be noted that what is sought to be disallowed under section 40(*c*)(*iii*) of the Act in the assessment of the company is the excess amount of expenditure incurred by it directly or indirectly on providing any benefit or amenity or perquisite to its employees; the actual expenditure incurred by the company is, therefore, to be taken into account, which may be different from the amount which may be assessable in the hands of the employees as the value of the perquisite under the provisions of the Income-tax Rules, 1962. Any depreciation allowance admissible to a company in respect of residential accommodation, furniture or appliances, etc., owned by it and provided by it to its employees free of rent or hire at a concessional charge will also not be taken into account for the purpose of section 40(*c*)(*iii*) of the Income-tax Act as it may not be regarded as "expenditure" incurred by the company.

45. It has to be noted that the new provision applies to expenditure incurred by companies after 29th February, 1964. For the purpose of assessments for the assessment year 1964-65, the expenditure of the type referred to in section 40(*c*)(*iii*), incurred during the relevant previous year after the aforesaid date, has to be compared with the amount of 20% of the salary of each employee due in respect of the service of the employee after that date, and the excess amount has to be disallowed. As the form of the return of income-tax in the case of companies has not yet been amended in this behalf I.T.O.s should obtain relevant particulars from companies for the purpose of assessments for the assessment year 1964-65.'.

III. *The Finance Act, 1965.*—By **the Finance Act, 1965** (10 of 1965), the following **amendments** (**w. e. f. 1-4-1965**) have been made—

—**proviso to section 40(*c*)(*iii*)** has been **amended** at two places; and

—**2nd proviso to section 40(*c*)(*iii*)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 3P, dated 11-10-1965*, as follows:—

'Liberalisation of the provision in section 40(c)(iii) of the Income-tax Act for disallowance in the assessment of companies of expenditure incurred on providing perquisites to their employees in excess of 20 per cent of the salary of each employee.—**109.** Section 40(c)(*iii*) of the Income-tax Act has been amended by the Finance Act, 1965, with effect from 1st April, 1965. The effect of one of these amendments is that (*a*) any payment made by a company towards tax on the salary of a foreign technician in its employment [in a case where such technician is exempt from tax under section 10(6)(*vii*) of the Income-tax Act on the perquisite represented by such payment] and (*b*) any expenditure incurred by the company for promoting family planning amongst its employees, will not be taken into account in computing the expenditure incurred by it on providing any benefit, amenity, or perquisite to the employees concerned. The effect of another amendment is that the provisions of section 40(c)(*iii*) will not apply in respect of expenditure incurred by a company on providing any benefit, amenity or perquisite to an employee whose income chargeable under the head "Salaries" does not exceed ₹ 7,500 per annum. Consequently, no disallowance will be made in the assessment of a company in respect of the expenditure incurred by it on providing perquisites to such an employee in excess of 20 per cent of his salary income.'.

IV. *The Finance Act, 1968.*—By **the Finance Act, 1968** (19 of 1968), the following **amendments** (**w. e. f. 1-4-1969**) have been made—

—**section 40(*a*)(*v*)** has been **inserted**;

—**section 40(*c*)(*iii*)** has been **omitted**;

—***Explanation 1* to section 40(*c*)** has been **amended**; and

—***Explanation 2* to section 40(*c*)** has been **omitted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 6P, dated 6-7-1968*, as follows:—

'*Expenditure on providing perquisites, benefits or amenities to higher paid employees in businesses and professions.*—**68.** Under section 40(*c*)(*iii*) of the Income-tax Act, the deductible amount of expenditure incurred by companies in providing perquisites, benefits or amenities (subject to certain exceptions) to their higher paid employees is already limited to 20% of the basic salary of each employee. With a view to making this provision more effective in achieving its purpose and to check extravagance on provision of perquisites and fringe benefits to employees in the non-corporate sector, the Finance Act, 1968, has introduced a new sub-clause (*v*) in clause (*a*) of section 40 of the Income-tax Act with effect from the 1st April, 1969. Under the new sub-clause (*v*) which is applicable to all businesses and professions, whether carried on by a company or by a person other than a company, the deduction in respect of expenditure which results directly or indirectly in the provision of any benefit, amenity or perquisite to an employee will be limited to an amount equal to 1/5th of the salary paid to the employee during the relevant year or an amount calculated at the rate of ₹ 1,000/- for each month or part of a month comprised in the period of his employment during the year, whichever is less. ['Salary' for this purpose has the same meaning as in rule 2(*h*) of Part A of the Fourth

LexisNexis

Schedule to the Income-tax Act.] Further, any allowance admissible to the employer in respect of any assets provided by him to the employee free of charge or on a concessional basis is also brought within the purview of these limits. Thus, where an employer has provided residential accommodation or household equipment, such as refrigerator, air-conditioner, etc., owned by him to his employees free of charge, any expenditure incurred by the employer on the maintenance of these assets, and any depreciation allowance admissible to him in respect of such assets, will also be within the purview of the limit over the deductible amount of expenditure in providing perquisites, benefits or amenities to employees.

69. As under the provisions of section 40(*c*)(*iii*), the limitation over the deductible amount of expenditure in new sub-clause (*v*) of section 40(*a*) will not apply to expenditure on providing perquisites, amenities, etc., to employees whose annual emoluments amount to ₹ 7,500/- or less. The limitation will also not be applicable to expenditure incurred by the employer on provision of gratuities to the employees, travel concessions or passage moneys, tax paid by the employer on the salary of a foreign technician which is exempt from tax under section 10(6)(*vii*), employer's contributions to the accounts of the employees in recognised provident fund or approved superannuation funds; compensation or other payments to employees, etc.

70. As the new provision in section 40(*a*)(*v*) applies to all taxpayers, including companies, section 40(*c*)(*iii*) has been omitted with effect from 1-4-1969.

71. The provision in new sub-clause (*v*) of section 40(*a*) is operative for the assessment year 1969-70 and later years. It is applicable also for the purpose of computation of "Income from other sources". [*Section 30 of the Finance Act, 1968, read with items 6 and 8 of the Third Schedule*]'.

V. *The Taxation Laws (Amendment) Act, 1970.*—By **the Taxation Laws (Amendment) Act, 1970** (42 of 1970), **1st proviso (*d*) to section 40(*a*)(*v*)** has been **substituted** (**w. e. f. 1-4-1971**).

For the scope and effect of the above substitution, reference may be made to para. 75 of the *Departmental Circular No. 56, dated 19-3-1971*.

VI. *The Finance (No. 2) Act, 1971.*—By **the Finance (No. 2) Act, 1971** (32 of 1971), the following **amendments** (**w. e. f. 1-4-1972**) have been made—

—**section 40(*a*)(*v*)** has been **omitted**; and

—**section 40(*c*)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 72, dated 6-1-1972*, as follows:—

'*Expenditure on provision of remuneration, benefit or amenity to directors of companies and certain other persons.*—**20.** Under section 40(*c*) of the Income-tax Act, expenditure incurred by a company on the provision of any remuneration or benefit or amenity to a director or a person who has a substantial interest in the company or to a relative of the director or of such person, and the expenditure or allowance in respect of any assets of the company which are used by such persons for their own purposes or benefit, is not allowable as a deduction in computing the taxable profits of the company, to the extent such expenditure or allowance is, in the opinion of the Income-tax Officer, excessive or unreasonable. This provision has been amended by section 9 of the Finance (No. 2) Act, 1971, in order to secure that the aggregate of such expenditure and allowance will be further subject to an overall ceiling limit of ₹ 72,000, in a year, in respect of any one director or person who has a substantial interest in the company or a relative of the director or such person. Where such expenditure or allowance relates to only a part of a year, the monetary ceiling will be an amount calculated at the rate of ₹ 6,000 per month or part of a month comprised in the period to which the expenditure or allowance relates. Where the director or other person or relative is also an employee of the company, expenditure of the nature referred to in clauses (*i*), (*ii*), (*iii*) and (*iv*) of the second proviso to section 40A(5)(*a*).....will not be taken into account for applying the ceiling.

21. It has been specifically provided [in the first proviso to section 40A(5)(*a*)] that where a company incurs expenditure on payment of any salary or the provision of any perquisite to a peson, who, besides being an employee of the company, is also a director of the company or a person who has a substantial interest in it or a relative of a director or such person, the deduction to the company in respect of such expenditure, taken together with the allowance in respect of assets provided for his use, shall not exceed ₹ 72,000 for the year. This provision will be relevant in a case where an individual is a director, etc., of the company for a part of the year and a mere employee (or former employee) for the remainder of the year, and the aggregate ceiling calculated under sections 40(*c*) and 40A(5) with reference to the number of months or part of months comprised in the two periods adds up to more than ₹ 72,000 for the year.

22. A consequential amendment to section 58 of the Income-tax Act by section 12 of the Finance (No. 2) Act, 1971, has omitted the reference to section 40(*a*)(*v*) in section 58(1)(*a*)(*iv*). The amended provisions of section 40(*c*) and also the new provisions in section 40A(5) and (6) will apply in computing the income

LexisNexis

chargeable under the head "Income from other sources", by virtue of the existing provisions in section 58(1)(*b*) and section 58(2).

23. The provisions set forth in paragraphs 15 to 22 above, will be effective from 1-4-1972 and will, accordingly, apply to the assessment year 1972-73 in relation to current incomes of the financial year 1971-72 or other accounting year corresponding to it.'.

VII. *The Finance Act, 1984.*—By **the Finance Act, 1984** (21 of 1984), the following **amendments** (**w. e. f. 1-4-1985**) have been made—

—**section 40(*c*)(*A*)** has been **amended**; and

—**section 40(*c*)(*B*)** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 387, dated 6-7-1984*, as follows:—

'**14.** *Modification of provisions relating to managerial remuneration.*—**14.1** Under section 40(*c*) of the Income-tax Act, expenditure incurred by a company on the provision of any remuneration or benefit or amenity to a director or person who has a substantial interest in the company or to a relative of the director or of such person, and expenditure or allowance in respect of any assets of the company which are used by such person for his own purposes or benefit, is not allowable as a deduction in computing the taxable profits of the company, to the extent such expenditure or allowance is, in the opinion of the Income-tax Officer, excessive or unreasonable. The aggregate of such expenditure and allowance is further subject to an overall ceiling limit of ₹ 72,000 in a year, in respect of any one director or person who has a substantial interest in the company or a relative of the director or of such person. Where such expenditure or allowance relates to only a part of a year, the monetary ceiling is the amount calculated at the rate of ₹ 6,000 per month or part of a month comprised in the period to which the expenditure or allowance relates.

14.2 Having regard to the guidelines issued by the Company Law Board in regard to managerial remuneration, the Finance Act, 1984, has raised the aforesaid monetary limit under section 40(*c*) of the Income-tax Act as follows:—

(*i*) the monthly ceiling limit of ₹ 6,000 has been raised to ₹ 8,500;

(*ii*) the overall ceiling limit in respect of the aggregate expenditure and allowance during the year has been raised from ₹ 72,000 to ₹ 1,02,000.

14.3 The amendment takes effect from 1st April, 1985, and will, accordingly, apply in relation to the assessment year 1985-86 and subsequent years. [*Section 9 of the Finance Act, 1984*]'.

Legislative amendments of section 40A under 1961 Act.—I. *The Finance (No. 2) Act, 1971.*—By **the Finance (No. 2) Act, 1971** (32 of 1971), the following **amendments** (**w. e. f. 1-4-1972**) have been made—

—**section 40A(2)** has been **amended**; and

—**sections 40A(5) & (6)** have been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 72, dated 6-1-1972*, as follows:—

'*Expenditure on payment of salaries or provision of perquisites to employees.*—**15.** With a view to imposing restraints on business expenses so as to reduce income disparities, a provision has been made in a new sub-section (5) introduced in section 40A of the Income-tax Act by section 10 of the Finance (No. 2) Act, 1971, placing certain ceiling limits on the deductible amount of expenditure incurred by a taxpayer on payment of salary to any employee or a former employee or in providing any perquisites, etc., to any such employee. Under the new provision, expenditure incurred by an assessee on payment of salary to an employee in respect of the period of his employment in India during the relevant year will not be allowed as a deduction in computing the taxable profits to the extent it exceeds an amount calculated at the rate of ₹ 5,000 for each month or part of such period. Similarly, expenditure incurred by the assessee on payment of salary to a former employee, *i.e.*, an individual who ceases or ceased to be the employee of the assessee during the previous year or any earlier previous year, will not be allowed as deduction in computing the taxable profits to the extent it exceeds ₹ 60,000 for the year. For this purpose, 'salary' has been defined, broadly, on the lines of the provision in section 17 of the Income-tax Act, subject to certain modifications. The expression "salary" will include wages, any annuity or pension; any gratuity; any fees or commission; profits in lieu of or in addition to any salary or wages; any advance of salary; and the annual accretion to the balance at the credit of an employee participating in a recognised provident fund to the extent it is chargeable to tax. In this context, the expression "profits in lieu of salary" will have the same meaning as in section 17(3) of the Income-tax Act, and will, therefore, include any compensation paid by the assessee to an employee or a former employee in connection with the termination of his employment or modification of the terms and conditions relating thereto. The term "Salary" will, however, not include

LexisNexis

"perquisite" and the sums transferred from the account of the employee in an unrecognised provident fund to a recognised provident fund.

16. Under section 40(*a*)(*v*) of the Income-tax Act (as it stood before its omission by the Finance (No. 2) Act, 1971), any expenditure which resulted directly or indirectly in the provision of any benefit or amenity or perquisite to an employee or any expenditure or allowance in respect of any assets of the assessee used by such employee either wholly or partly for his own purposes or benefit, was not allowable as deduction in computing the taxable profits of the business or profession to the extent the aggregate of such expenditure and allowance exceeded one-fifth of the salary payable to the employee or an amount calculated at the rate of ₹ 1,000 for each month or part thereof comprised in the period of his employment during the relevant accounting year, whichever is less. This provision has now been omitted from section 40 by section 9 of the Finance (No. 2) Act, 1971, and a modified provision has been incorporated in the new sub-section (5) of section 40A inserted by section 10 of the Finance (No. 2) Act, 1971. Under the new provision, the aggregate of expenditure incurred by an assessee in providing any perquisite, whether convertible into money or not, to an employee, and the amount of expenditure or allowance (such as depreciation allowance) in respect of assets of the assessee used by the employee for his own purposes or benefits, will not be allowed as deduction, in computing the profits of the business or profession, to the extent it exceeds 20% of the amount of salary payable to the employee or an amount calculated at the rate of ₹ 1,000 for each month or part thereof comprised in the period of employment of the employee in India during the relevant accounting year, whichever is less. For this purpose, the expression "perquisite" has been defined to mean: (*i*) rent-free accommodation provided to the employee by the assessee; (*ii*) any concession in the matter of rent respecting any accommodation provided to the employee by the assessee; (*iii*) any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessee; (*iv*) payment by the assessee of any sum in respect of any obligation which but for payment by the assessee would have been payable by the employee, *e.g.*, provision of educational facilities for the employee's children, reimbursement of employee's club bills, hotel bills, etc., by the assessee; (*v*) payment by the assessee of any sum, whether directly or through a fund (other than a recognised provident fund or an approved superannuation fund), to effect an assurance on the life of the employee or to effect a contract for an annuity.

17. It has been specifically provided that the following items will not be taken into account in computing the expenditure or allowance that will not be deductible under the new provisions set forth in paragraphs 15 and 16:

(*i*) The value of any travel concession or assistance granted by the assessee to an employee who is a citizen of India (and his spouse and children) in connection with his proceeding to any place in India, whether on leave or after retirement from service, to the extent the amount thereof does not exceed the value of the travel concession or assistance which would have been received by the employee if he had proceeded to his home district in India. [The value of such travel concession or assistance is already exempt from tax under section 10(5) of the Income-tax Act.]

(*ii*) Passage moneys or the value of any free or concessional passage granted by the assessee to an employee who is not a citizen of India (and his spouse and children) in connection with his proceeding to his home country out of India, whether on leave or on retirement from service. [Such passage moneys and the value of such free or concessional passage is already exempt from tax under section 10(6)(*i*) of the Income-tax Act.]

(*iii*) The employer's contributions to the employee's account in a recognised provident fund or an approved superannuation fund or for the employee's benefit to an approved gratuity fund.

(*iv*) Where the assessee is a company, expenditure incurred by it for the purpose of promoting family planning amongst its employees.

18. The ceiling limit over the deductible amount of expenditure in respect of salary and perquisites, etc., as explained above, will, however, not be applicable to the expenditure or allowance in relation to the following:

(*i*) Any employee in respect of any period of his employment outside India.

(*ii*) Any employee being a foreign technician who is entitled to exemption from tax on his remuneration under section 10(6)(*vii*) or section 10(6)(*viia*) of the Income-tax Act.

(*iii*) Any employee whose income chargeable under the head "Salaries" does not exceed ₹ 7,500 per annum.

19. In order to prevent the frustration of the new restrictions set forth in the preceding paragraphs by converting 'contracts of service' into 'contracts for service', it has been provided in a new sub-section (6) of section 40A of the Income-tax Act that the expenditure incurred by an assessee in payment of fees for services rendered by a person, who at any time during the 24 months immediately preceding the relevant

accounting year was his employee, will not be allowed as a deduction in computing the taxable profits of the assessee to the extent it exceeds ₹ 60,000 in a year. In a case where the assessee also incurs, in relation to such person, any expenditure on payment of salary [as defined under sub-section (5)], the deduction in respect of expenditure on payment of fees and that on payment of salary will be limited to ₹ 60,000 in the aggregate.

* * *

23. The provisions set forth in paragraphs 15 to 22 above, will be effective from 1-4-1972 and will, accordingly, apply to the assessment year 1972-73 in relation to current incomes of the financial year 1971-72 or other accounting year corresponding to it.'.

II. *The Direct Taxes (Amendment) Act, 1974.*—By **the Direct Taxes (Amendment) Act, 1974** (26 of 1974), **proviso to section 40A(5)(*c*)(*i*)** has been **inserted** (**w. r. e. f. 1-4-1974**).

For the scope and effect of the above insertion, reference may be made to paras. 18 to 20 of the *Departmental Circular No. 145, dated 9-9-1974*.

III. *The Finance Act, 1975.*—By **the Finance Act, 1975** (25 of 1975), **section 40A(8)** has been **inserted** (**w. e. f. 1-4-1976**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 169, dated 23-6-1975*, as follows:—

'*Deduction in respect of interest paid by non-banking non-financial companies on deposits.*—**32.** In order to discourage unrestricted growth of deposits in the non-banking sector, the Finance Act, 1975, has inserted a new sub-section (8) in section 40A of the Income-tax Act to provide for partial disallowance of interest paid by non-banking non-financial companies on deposits received by them. Under new section 40A(8), 15 per cent of the expenditure incurred by way of interest paid on deposits will be disallowed in computing the profits and gains of business in the case of a company other than a "banking company" or a "financial company".

33. For the purposes of the new provisions, a "banking company" means a company to which the Banking Regulation Act, 1949, applies and includes any bank or banking institution referred to in section 51 of that Act. In particular, it will include the State Bank of India and its subsidiaries, as also all nationalised banks.

34. The expression "financial company" will include the following categories of companies, namely:—

(*i*) hire-purchase finance companies, that is to say, companies which carry on, as their principal business, hire-purchase transactions or the financing of such transactions;

(*ii*) investment companies, that is to say, companies which carry on, as their principal business, the acquisition of shares, stocks, bonds, debentures, debenture stocks, or securities issued by the Government or local authorities, or other marketable securities of a like nature;

(*iii*) housing finance companies, that is to say, companies which carry on, as their principal business, the business of financing of acquisition or construction of houses, including acquisition or development of land in connection therewith;

(*iv*) loan companies, that is to say, companies other than companies referred to in (*i*) to (*iii*) above, which carry on, as their principal business, the business of providing finances, whether by making loans or advances or otherwise;

(*v*) mutual benefit finance companies, that is to say, companies which carry on, as their principal business, the business of acceptance of deposits from their members and which are declared by the Central Government under section 620A of the Companies Act, 1956, to be *Nidhis* or Mutual Benefit Societies;

(*vi*) miscellaneous finance companies, that is to say, companies which carry on exclusively, or almost exclusively, two or more classes of business referred to in (*i*) to (*v*) above.

35. The term "deposit" means any deposit of money with a company and includes any money borrowed by it, except the following, namely:—

(*i*) moneys received from the Central Government or any State Government or any local authority;

(*ii*) moneys received from any source where the repayment of the amount is guaranteed by the Central Government or a State Government;

(*iii*) moneys borrowed from foreign sources;

(*iv*) loans received from banking companies or from co-operative societies engaged in carrying on banking business (including co-operative land mortgage banks or co-operative land development banks);

LexisNexis

(*v*) loans received from institutions or bodies specified in the list in the Tenth Schedule to the Income-tax Act or such other institutions or bodies as may be specified by the Central Government in this behalf by notification in the Official Gazette;

(*vi*) moneys received from other companies;

(*vii*) moneys received from employees of the company by way of security deposit;

(*viii*) moneys received by way of security or advance from any purchasing agent, selling agent or other agent in the course of, or for the purposes of, the business of the company, or as advance against orders for the supply of goods or for the rendering of any service;

(*ix*) moneys received by way of subscription to any shares or stocks, or secured bonds or debentures *pending the allotment of such shares, stocks, bonds or debentures,* as well as calls in advance on shares;

(*x*) secured loans, that is to say, loans (including debentures) secured by the creation of a mortgage, charge or pledge of any assets of the company or any part thereof, if the amount of the loan does not exceed 75 per cent of the market value of the assets charged as security for the loan. Where the assets have already been charged as security for an earlier debt or loan, the later loan will not be regarded as deposit only if the aggregate amount of the earlier debt or loan and the later loan does not exceed 75 per cent of the market value of the assets on the date of creation of the charge for the later loan.

36. The above amendment will come into force with effect from 1st April, 1976, and will accordingly apply in relation to the assessment year 1976-77 and subsequent years. [*Section 6(b) and 23 of the Finance Act, 1975*]'.

IV. *The Finance Act, 1984.*—By **the Finance Act, 1984** (21 of 1984), the following **amendments** have been made—

—**1st proviso to section 40A(5)(*a*)** has been **amended** (**w. e. f. 1-4-1985**);

—**section 40A(5)(*c*)(*i*)** has been **amended** (**w. e. f. 1-4-1985**) at two places;

—**2nd proviso to section 40A(5)(*c*)(*i*)** has been **inserted** (**w. e. f. 1-4-1985**); and

—**section 40A(6)** has been **amended** (**w. e. f. 1-4-1985**).

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 387, dated 6-7-1984*, as follows:—

'*Modification of provisions relating to managerial remuneration.*—**15.1** Section 40A(5) of the Income-tax Act also places certain ceiling limits on the deductible amount of expenditure incurred by a taxpayer on account of payment of salary to any employee or a former employee or in providing any perquisite, etc., to any such employee. Under this provision, expenditure incurred by a taxpayer on the payment of salary to an employee in respect of the period of his employment in India during the relevant year is not allowed as deduction in computing the taxable profits of the employer to the extent it exceeds an amount calculated at the rate of ₹ 5,000 for each month or part of a month. In addition, the aggregate of expenditure incurred by a taxpayer in providing any perquisites, whether convertible into money or not, to an employee and the amount of expenditure or allowance (such as depreciation allowance) in respect of assets of the taxpayer used by the employee for his own purposes or benefit, is not allowed as deduction in computing the income from business or profession, to the extent it exceeds 20% of the amount of salary payable or an amount calculated at the rate of ₹ 1,000 for each month or part thereof comprised in the period of employment in India during the relevant accounting year, whichever is less. In the case of a person who ceased to be an employee of the taxpayer, at any time during the twenty-four months immediately preceding the relevant year, the ceiling limit in respect of any expenditure by way of fees for services rendered is ₹ 60,000. Where the taxpayer has also incurred, in relation to such person, any expenditure by way of salary, the aggregate of such expenditure by way of fees and salary is also restricted to ₹ 60,000 per annum.

15.2 Having regard to the guidelines issued by the Company Law Board in regard to managerial remuneration, the Finance Act, 1984, has raised the monetary limits contained in sections 40A(5) and 40A(6) of the Income-tax Act as follows:—

(*i*) The monetary ceiling under section 40A(5) in respect of expenditure or payment of salary has been raised from ₹ 5,000 to ₹ 7,500 per month, that is, ₹ 90,000 per annum.

(*ii*) In the case of a former employee, who ceases or ceased to be an employee of the assessee during the relevant previous year or any earlier previous year, the annual ceiling in respect of allowable expenditure on payment of salary has been raised from ₹ 60,000 to ₹ 90,000.

15.3 Expenditure incurred on payment of any salary to a research worker engaged in scientific research during any one or more of the three years immediately preceding the commencement of business, which is deemed under section 35(1)(*i*) of the Income-tax Act to have been laid out or expended in the previous year in which the business is commenced, is allowed as deduction, by virtue of the proviso to section 40A(5)(*c*)(*i*), to the extent it does not exceed ₹ 5,000 for each month or part thereof comprised in the period of employment during the previous year in which the business is commenced and in the period of his employment during which he was engaged in scientific research during the three years immediately preceding that year. In consequence of the increase in deductible amount of remuneration from ₹ 5,000 to ₹ 7,500, the Finance Act, 1984, has inserted another proviso to section 40A(5)(*c*)(*i*) to the effect that in relation to any such period of employment falling in the previous year relevant to the assessment year 1985-86 and any subsequent year, the ceiling in respect of deductible remuneration will be ₹ 7,500 per month, as against ₹ 5,000 at present.

15.4 These amendments take effect from 1st April, 1985, and will, accordingly, apply in relation to the assessment year 1985-86 and subsequent years. [*Section 10(a) and (b) of the Finance Act, 1984*]'.

V. *The Taxation Laws (Amendment) Act, 1984.*—By **the Taxation Laws (Amendment) Act, 1984** (67 of 1984), the following **amendments** (**w. e. f. 1-4-1985**) have been made—

—***Explanation 2(b)(iv)* to section 40A(5)** has been **amended**;

—***Explanation 2(b)(v)* to section 40A(5)** has been **amended**; and

—***Explanation 2(b)(vi)* to section 40A(5)** has been **inserted**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 397, dated 16-10-1984*, as follows:—

'**8.** *Expenses or payments not deductible in certain circumstances.*—**8.1** Section 40A(5) of the Income-tax Act places certain limits on the deductible amount of expenditure incurred by an assessee in respect of payment of salary to any employee or a former employee or in providing any perquisite, etc., to such employee. *Explanation* 2 to 40A(5) defines the expressions "salary" and "perquisite" for the purposes of the aforesaid provision.

8.2 The Amending Act has inserted a new sub-clause (*vi*) in clause (*b*) of the aforesaid *Explanation*. This is consequential to insertion of sub-clause (*vi*) in clause (2) of section 17 of the Income-tax Act, referred to in paragraphs 4.1 to 4.5 above.

The effect of the new sub-clause will be that the amount of interest referred to in item (*a*) or item (*b*), as the case may be, of sub-clause (*vi*) of section 17(2) of the Income-tax Act shall be regarded as perquisite provided by the assessee to his employee for the purposes of section 40A(5) of the Act.

8.3 The amendment takes effect from 1st April, 1985, and will, accordingly, apply in relation to the assessment year 1985-86 and subsequent years. [*Section 11 of the Amending Act*]'.

VI. *The Finance Act, 1985.*—By **the Finance Act, 1985** (32 of 1985), the following **amendments** have been made—

—***Explanation 2(b)(iv)* to section 40A(5)** has been **amended** (**w. e. f. 1-4-1985**);

—***Explanation 2(b)(v)* to section 40A(5)** has been **amended** (**w. e. f. 1-4-1985**);

—***Explanation 2(b)(vi)* to section 40A(5)** has been **omitted** (**w. e. f. 1-4-1985**);

—**section 40A(8)** has been **omitted** (**w. e. f. 1-4-1986**); and

—**section 40A(12)** has been **inserted** (**w. e. f. 1-4-1986**).

For the scope and effect of the amendment made with effect from 1-4-1985, reference may be made to paras. 13 to 13.3 of the *Departmental Circular No. 421, dated 12-6-1985*.

The scope and effect of the amendments made with effect from 1-4-1986 have been elaborated in the following portion of the *Departmental Circular No. 421, dated 12-6-1985*, as follows:—

'**20.** *Withdrawal of provision for partial disallowance of interest paid by non-banking non-financial companies on public deposits.*—**20.1** Sub-section (8) of section 40A of the Income-tax Act, 1961, provides for partial disallowance of interest paid by non-banking non-financial companies on deposits [other than those specifically excluded under clause (*b*) of the *Explanation* to the said sub-section] received by them. Under this provision, fifteen per cent of the expenditure incurred by way of interest paid on such deposits is disallowed in computing the profits and gains of business in the case of a company other than a banking company or a financial company.

20.2 This provision was introduced in the context of the levy of interest-tax on the interest income of banks. As the levy of interest-tax is being discontinued under section 41 of the Finance Act, 1985, the

LexisNexis

aforesaid provision relating to disallowance of a portion of the interest paid by companies on their deposits has also been discontinued. As a consequence of omission of section 40A(8) of the Income-tax Act, the Tenth Schedule to the Act containing the list of institutions and bodies which are exempt from the operation of section 40A(8) has also been omitted by the Finance Act, 1985.

20.3 The *Explanation* to sections 269SS and 269T provide that, for the purposes of the respective sections, "banking company" shall have the meaning assigned to it in clause (*a*) of the *Explanation* to section 40A (8). With the omission of section 40A(8), the Finance Act, 1985, has provided a definition of the term "banking company" on the same lines in section 269SS. This definition will also apply for the purposes of section 269T of the Income-tax Act.

20.4 These amendments take effect from 1st April, 1986, and will, accordingly, apply in relation to the assessment year 1986-87 and subsequent years. [*Sections 12(b), 36(f), 36(g) and 36(h) of the Finance Act, 1985*]

21. *Disallowance of expenditure incurred in connection with certain proceedings under the Income-tax Act.*—**21.1** Under section 80VV of the Income-tax Act, 1961, any expenditure incurred by an assessee in respect of any proceedings before any income-tax authority or the Appellate Tribunal or any court relating to the determination of any liability under the Income-tax Act by way of tax, penalty or interest is allowed as a deduction in the computation of the taxable income, subject to a ceiling of ₹ 5,000. The Finance Act, 1985, has deleted the aforesaid provision and inserted a new sub-section (12) in section 40A of the Income-tax Act to provide that no deduction shall be allowed in excess of ₹ 10,000 for any assessment year in respect of any expenditure incurred by the assessee by way of fees or other remuneration paid to any person (other than an employee of the assessee)—

(*a*) for services (not being services by way of preparation of return of income) in connection with any proceeding under the Income-tax Act before any income-tax authority or the Settlement Commission or the competent authority under Chapter XXA of the said Act or the Appellate Tribunal or any court;

(*b*) for services in connection with any other proceeding before any court, being a proceeding relating to tax, penalty, interest or any other matter under the Income-tax Act; and

(*c*) for any advice in connection with tax, penalty, interest or any other matter under the Income-tax Act.

LexisNexis

21.2 The Finance Act, 1985, has also inserted a new sub-clause (*ia*) in clause (*a*) of sub-section (1) of section 58 of the Income-tax Act to provide that any expenditure of the nature referred to in sub-section (12) of section 40A of the Income-tax Act shall not be allowed as deduction in computing the income chargeable under the head "Income from other sources". The effect of this amendment is that no part of the expenditure of the nature referred to in clauses (*a*) to (*c*) of sub-section (12) of section 40A will be allowed as a deduction in computing the income chargeable under the head "Income from other sources". This prohibition will apply even in cases where such expenditure is not in excess of ₹ 10,000.

21.3 These amendments take effect from 1st April, 1986, and will, accordingly, apply in relation to the assessment year 1986-87 and subsequent years. [*Sections 11(a), 12(c), 15, 25 and 36(a)(i) of the Finance Act, 1985*]'.

VII. *The Direct Tax Laws (Amendment) Act, 1987.*—By **the Direct Tax Laws (Amendment) Act, 1987** (4 of 1988), **sections 40A(5) & (6)** have been **omitted** (**w. e. f. 1-4-1989**).

The scope and effect of the omissions have been elaborated in the following portion of the *Departmental Circular No. 551, dated 23-1-1990*, as follows:—

'*Omission of sub-sections (5) and (6) of section 40A.*—**6.11** Sub-section (5) of the section laid down ceilings on the remuneration and perquisites paid by any assessee to its employees or former employees. Sub-section (6) laid down the ceiling up to which any expenditure by way of fees for services rendered by a person, who at any time during the period of 24 months immediately preceding the previous year was an employee of the assessee could be allowed. The Amending Act, 1987, has omitted both these sub-sections. Consequently, the artificial ceilings laid down on the remuneration or fees payable to employees or former employees of an assessee are removed. However, if excessive or unreasonable payments are made to relatives or connected persons, the same can still be disallowed under the provisions of section 40A(2).'.

VIII. *The Finance Act, 1992.*—By **the Finance Act, 1992** (18 of 1992), **section 40A(12)** has been **omitted** (**w. e. f. 1-4-1993**).

For the scope and effect of the above omission, reference may be made to paras. 30 to 30.2 of the *Departmental Circular No. 636, dated 31-8-1992*.

EXCESSIVE OR UNREASONABLE REMUNERATION, BENEFITS, AMENITIES OR PERQUISITES TO DIRECTORS, EMPLOYEES, ETC. [Omitted ss. 40(*c*), 40(*a*)(*v*) & 40A(5) of 1961 Act]

Excessive remuneration to directors, etc. [omitted ss. 40(*c*) and 40(*a*)(*v*) of 1961 Act].—The provisions relating to excessive remuneration to directors, etc., were, up to assessment year 1971-72, dealt with under

sections 40(*c*) and 40(*a*)(*v*) of the 1961 Act. For assessment years 1972-73 to 1988-89, the provisions were governed by the provisions of section 40A(5) of the 1961 Act.

Corresponding provisions in the 1922 Act.—Sub-clauses (*i*) and (*ii*) of section 40(*c*) of the 1961 Act corresponded to the provisions of clauses (*a*) and (*b*), respectively, of section 10(4A) of the 1922 Act except that while the 1922 Act provisions did not include "relatives" within its sweep, the 1961 Act provisions did include them. That sub-section was inserted in the 1922 Act by the Finance Act, 1956. Before such insertion, an assessee company could claim deduction of any remuneration, etc., paid to directors, etc., and the department was forbidden to sit in the armchair of the management of the company and to decide what would be the proper remuneration [see, *Raman & Raman Ltd. v. CIT,* (1962) 46 ITR 400 (Mad); *CIT v. Chari & Chari Ltd.,* (1965) 57 ITR 400 (SC); *CIT v. Raman & Raman Ltd.,* (1969) 71 ITR 345 (Mad); *Newtone Studios v. CIT,* (1955) 28 ITR 378 (Mad)]. After 1-4-1956, the law laid down in these decisions on the point of reasonableness, etc., is **no more good law**.

Intention behind the provisions of section 40(*c*) of 1961 Act.—The object of introducing section 40(*c*) of the 1961 Act was to have a check on the quantum of allowance in respect of any expenditure which relates directly or indirectly to the provision of any remuneration, benefit or amenity to a privileged person [*Sri Krishna Tiles and Potteries* (*Madras*) *Pr. Ltd. v. CIT,* (1973) 90 ITR 439 (Mad)]. It is intended to prevent companies from claiming expenditure or allowance which really benefits the directors, etc., under the mask of expenditures or allowances under sections 36 and 37 of the 1961 Act [*Harbour Engineering P. Ltd. v. CIT,* (1964) 52 ITR 249 (Mad); *Natesan & Co. P. Ltd. v. CIT,* (1964) 51 ITR 386 (Mad); *Garg Association P. Ltd. v. CIT,* (1979) 119 ITR 705, 707-08 (All)].

Provisions of section 40(*c*) of 1961 Act had overriding effect.—From the *non obstante* clause at the beginning of section 40 of the 1961 Act, it is clear that the provisions of section 40(*c*) of the 1961 Act had an overriding effect over those of sections 30 to 39 of the 1961 Act [see, *Mehta Parikh & Co. Ltd. v. CIT*, (1980) 124 ITR 448, 451-52 (Guj); *CIT v. Edward Keventer P. Ltd.*, (1972) 86 ITR 370, 380-81 (Cal), **affirmed in** (1978) 115 ITR 149 (SC)]. Thus, if a particular expenditure or allowance was covered by section 40(*c*) of the 1961 Act, the same was to be tested, for its allowability or otherwise, not only against the phraseology of sections 30 to 39 of the 1961 Act but also against that of section 40(*c*) of the 1961 Act [*Stadmed Pr. Ltd. v. CIT,* (1983) 140 ITR 361 (Cal); *Mehta Parikh & Co. Pr. Ltd. v. CIT,* (1987) 163 ITR 126 (Guj)].

Section 40(c) of 1961 Act need not be invoked if the concerned expenditure is not allowable under section 37 of 1961 Act.—Unless an expenditure first gets qualified as an expenditure within the meaning of section 37 of 1961 Act, that is to say, unless it can be shown expended wholly and exclusively for the purposes of the business or profession, it cannot be allowed in computing the income chargeable under the relevant head. In case it satisfies this test, then it stands to get curtailed under section 40(*c*) of the 1961 Act, for, the *non obstante* clause therein clearly postulates that despite being allowable under section 37 of the 1961 Act, in the case of a company, it has to satisfy the test of section 40(*c*) of the 1961 Act as well. So, in working analysis, section 37 of the 1961 Act has to apply first and thereafter section 40(*c*) of the 1961 Act [*Ess Ess Kay Engg. Co. Pr. Ltd. v. CIT,* (1985) 151 ITR 636, 651 (Punj)]. In that case, the commission paid by the assessee-company was disallowed by the Income-tax Officer under section 40(*c*) of the 1961 Act. The Tribunal took the view that the commission was not allowable under section 37 of the 1961 Act itself because no specific services were rendered by the recipient. That view was upheld by the High Court.

Section 40(c) of 1961 Act was not merely clarificatory of section 37(1) of 1961 Act.—Section 40(*c*) of the 1961 Act was not merely clarificatory of section 37(1) of the 1961 Act. It was so because the clause would come into play even where the expenditure was wholly and exclusively laid out for the purpose of the business and because discretion was given to the Revenue to see whether the allowance was excessive or unreasonable in the case of a company. But, under section 37(1) of the 1961 Act, there is no discretion on the Revenue and once it is shown that a certain amount is wholly and exclusively laid out for the purpose of the business, there is no option for the department to probe into the reasonableness or otherwise but to grant the allowance [*CIT v. Raman & Raman Ltd.,* (1969) 71 ITR 345, 349 (Mad); *CIT v. Edward Keventer P. Ltd.,* (1972) 86 ITR 370 (Cal), **affirmed in** (1978) 115 ITR 149 (SC)].

Section 40(*c*) of 1961 Act applies to companies only.—Clause (*c*) of section 40 of the 1961 Act had application to assessments of companies and of no other taxable entity. It had three sub-clauses, of which sub-clause (*iii*) was omitted, with effect from 1-4-1969, by the Finance Act, 1968 (19 of 1968) and sub-clauses (*i*) and (*ii*) were omitted, with effect from 1-4-1989, by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988).

Section 40(*c*) of the 1961 Act cast a duty, and conferred the power, on the Assessing Officer [(up to 31-3-1988) Income-tax Officer] not to allow deduction in respect of excessive remuneration or benefit or amenity, etc. This power could be exercised by the Assessing Officer, in the matter of computation of the taxable profits

LexisNexis

and gains of the company, notwithstanding the provisions of sections 30 to 37 of the 1961 Act. Section 40(*c*) of the 1961 Act contained substantive provisions [*CIT v. Edward Keventer* (*Pr.*) *Ltd.,* (1972) 86 ITR 370, 380-81 (Cal), **affirmed in** (1978) 115 ITR 149 (SC)].

Which payees were vulnerable under section 40(*c*) of 1961 Act.—The provisions of section 40(*c*) of the 1961 Act had got no application unless the payee concerned was a director even though he was not having a substantial interest in the company [*Nund & Samonta Co. P. Ltd. v. CIT,* (1966) 62 ITR 538, 543 (Pat), **affirmed in** (1970) 78 ITR 268 (SC)]. Similarly, it had application where the payee, although not a director, had got a substantial interest in the company or was a relative of the director or of such person. The provisions were not attracted if the payee was neither a director nor a person having a substantial interest in the company as defined in section 2(32) of the 1961 Act nor such a relative [*CIT v. Edward Keventer P. Ltd.,* (1972) 86 ITR 370, 387 (Cal)].

The word 'person', as used in section 40(*c*) of the 1961 Act, cannot be interpreted to mean an individual, who is only one of the categories of 'persons' as included in the inclusive definition of the word 'person' as given in section 2(31) of the 1961 Act, which definition specifically includes 'a company' within its gamut. A company can hold shares of another company and it may be a person who has substantially interest in that company if such shareholding exceeds the limit specified in section 2(32) of the 1961 Act, which coins a definition of the expression 'person who has a substantial interest in the company'. In that view of the matter, there is no scope for restricting the expression 'person who has a substantial interest in the company' to an individual only. There is sufficient reason to hold that the Legislature intended to cover all categories of persons specified in section 2(31) of the 1961 Act including individuals, companies, etc. [*Filtrona India Ltd. v. CIT,* (1994) 207 ITR 545, 550, 551 (Bom)]. In that case, disallowance of ₹ 1,28,000 out of ₹ 2,00,000 paid by the assessee-company to another company for working as assessee's secretaries was upheld for each of the assessment years 1973-74, 1974-75 and 1975-76 wherein the payee-company held more than 20% of the equity shares of the assessee-company during all the relevant previous years.

Section 40(*c*) of the 1961 Act does not make any distinction between a full-time director or a part-time director. Once a person is found to be a director, whether whole time or part-time, and if the company pays any remuneration to him, then the remuneration paid to such a director is subject to the ceiling limit prescribed under section 40(*c*) of the 1961 Act [*McDowell & Co. Ltd. v. CIT,* (2000) 246 ITR 529, 531 (Mad)].

Section 40(c) of 1961 Act covered only payments to directors as directors and not in any other capacity.—A close reading of section 40(*c*)(*i*) of the 1961 Act showed that it referred to an expenditure incurred by making periodical payments to a person mentioned in that section apparently for any personal service that may be rendered by him. It could not have any reference to payments made by a company for all kinds of "services or facilities" referred to in section 40A(2)(*a*) of the 1961 Act. In that view of the matter, commission paid to a selling agent—although falling into the category of vulnerable persons referred to in section 40(*c*) of the 1961 Act—did not fall within the sweep of section 40(*c*)(*i*) of the 1961 Act. Therefore, the overall ceiling limit of ₹ 72,000 or ₹ 1,02,000, as the case might have been, had no relevance to such commission [*T.T. Pr. Ltd. v. ITO,* (1980) 121 ITR 551, 567 (Karn)]. Expenditure incurred by way of commission paid to a selling agent, who may be a proprietary concern of the director, to act as an independent entrepreneur with an independent organisation who is not subject to the control and supervision of the assessee-company for the services and the facilities provided to it cannot be considered as benefit within the meaning of section 40(*c*) of the 1961 Act. Only payments made to directors as directors (*qua* directors) fall within the gamut of section 40(*c*) of the 1961 Act [*Pai Paper & Allied Industries Pvt. Ltd. v. CIT,* (1994) 207 ITR 410, 415, 417 (Bom), **followed in** *CIT v. Melauto Industries P. Ltd.*, (1999) 240 ITR 74, 76 (Bom)]. Thus, where the director deals with the company not as a director but as a person otherwise than in his role as a director, the provisions of section 40(*c*) of the 1961 Act shall not touch such transactions [*CIT v. R.M. Investment & Trading Co.* (*P.*) *Ltd.*, (1994) 209 ITR 121, 130 (Cal)].

In that view of the matter, the following did not fall within the purview of section 40(*c*) of the 1961 Act:—

(1) Consultancy fee paid to the director in his capacity as adviser and consultant of the assessee-company [*CIT v. R.M. Investment & Trading Co.* (*P.*) *Ltd.,* (1994) 209 ITR 121, 130 (Cal), **followed in** *CIT v. R.M. Investment & Trading Co.* (*P.*) *Ltd.,* (1997) 225 ITR 537, 540 (Cal)].

(2) Remuneration paid, in annuity instalments, to a director for writing film script and also for acting in the film [*Nav Ketan International Films Pvt. Ltd. v. CIT,* (1994) 209 ITR 976, 981 (Bom)]; or payment made to the managing director as a technician in addition to the remuneration [*Flymyug Pvt. Ltd. v. CIT,* (1997) 140 Taxation 337 (Bom)]; or amount paid to the managing director for the professional work of directing motion pictures under production [*Filmyug Pvt. Ltd. v. CIT*, (2003) 261 ITR 263, 265 (Bom)]; or professional charges paid for directing and producing films [*CIT v. Rupam Pictures P. Ltd.*, (2015) 374 ITR 450, 452 (Bom)].

LexisNexis

(3) Commission paid to directors for their financial involvement and standing guarantors for the loans taken by the company [*CIT v. Khemchand Motilal Jain Co.,* (1997) 228 ITR 338, 342 (MP)]; or guarantee commission paid to a director for standing guarantee for the loans obtained by the assessee-company [*CIT v. Trade Wings Ltd.*, (2000) 241 ITR 198, 202 (Bom)]. Also see, *CIT v. South India Corporation Pvt. Ltd.*, (2001) 250 ITR 318, 320-21 (Mad).

(4) Royalty paid to a director as proprietor of a trade mark [*CIT v. Asoka Betalnut Co.*, (2002) 258 ITR 620, 621 (Mad), **applying** *Bharat Beedi Works* (*P.*) *Ltd. v. CIT*, (1993) 201 ITR 1063 (SC)].

Excessive or unreasonable remuneration, benefit or amenity to directors, etc. [s. 40(*c*)(*i*) of 1961 Act].—This section provided that any expenditure or allowance which resulted directly or indirectly in the provision of any remuneration or benefit or amenity to a director *or* to a *person who had a substantial interest in the company* [as defined in section 2(32) of the 1961 Act] or to a *relative* [as defined in section 2(41) of the 1961 Act] of such director or of such person shall not be deducted in computing the income of a company chargeable under the head "Profits and gains of business or profession" to the extent it was excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, subject to an overall ceiling limit described.

In order to attract section 40(*c*)(*i*) of the 1961 Act, the expenditure, etc., should have been incurred by the company and the company's such expenditure should have resulted in something in the shape of remuneration or benefit or amenity. Therefore, where the remuneration of a director was increased or other benefit or amenity was given to a director, etc., of the company, the expenditure incurred by the company would cause that result. The expression "resulted" was not an expression of art. Anything which is occasioned as a result of, or as a consequence of, something else can be said to be the result thereof [*Eastern Scales P. Ltd. v. CIT,* (1979) 117 ITR 477 (Cal)]. Thus, salary paid to a director may be screened against these provisions [*Dr. Sarmukh Singh & Co. P. Ltd. v. CIT,* (1962) 45 ITR 311 (Punj)].

The requirement of section 40(*c*)(*i*) of the 1961 Act was that a particular expenditure must result directly or indirectly in the provision of any benefit, etc., to the director or other vulnerable person. What that section required was not that anything connected with the expenditure must be connected in some way to the benefit of the director, etc. [*CIT v. Ambal Mills Pr. Ltd.,* (1983) 142 ITR 771 (Mad)].

In *Tractor Engineers Ltd. v. CIT*, (1997) 228 ITR 531, 534-35 (Bom), the payment made by the assessee-company to another company, having substantial interest in the assessee-company, for the services of its directors lent to the assessee-company for the management of the assessee-company was held squarely to fall within the purview of section 40(*c*) of the 1961 Act.

Remuneration.—'Remuneration' is the expression which would include that which is quantified in money and paid to a person for his services or work [*Rane* (*Madras*) *Ltd. v. CIT,* (1995) 212 ITR 583, 587 (Mad)].

In *Alembic Glass Industries Ltd. v. CIT*, (1994) 205 ITR 200, 204 (Guj), directors' fees or board meetings' fees were held to fall within the meaning of the word 'remuneration' as used in section 40(*c*)(*i*) of the 1961 Act as the same were in respect of the services rendered by the directors in their capacity as directors. **Following** the above Gujarat decision, in *CIT v. Orissa Cement Ltd.*, (2001) 250 ITR 846, 848 (Del), it has been held that the payment of sitting fees to directors by the assessee were to be included in computing the disallowance under section 40(*c*) of the 1961 Act.

Commission vis-à-vis remuneration or benefit or amenity.—It may be noted that the word "remuneration", in its ordinary meaning, connotes "reward, recompense, pay, wages or salary for service rendered". Since the Legislature has, wherever it thought so necessary, used the word "commission" separately from and along with "remuneration" [*e.g.*, in section 40(*b*) of the 1961 Act], the Punjab High Court, in *CIT v. Avon Cycles P. Ltd.*, (1980) 126 ITR 448, 459-60 (Punj), **SLP dismissed**: (1983) 144 ITR (St.) 14 (SC), has opined that the word "remuneration" in section 40(*c*)(*i*) of the 1961 Act did not include "commission". Thus, commission paid to a firm, having for its partners directors of the assessee-company or their relatives, for acting as the sole selling agent of the assessee-company has been held not to be disallowed under section 40(*c*) of the 1961 Act [*CIT v. Avon Cycles P. Ltd.,* (1980) 126 ITR 448 (Punj), **SLP dismissed**: (1983) 144 ITR (St.) 14 (SC); *Hemco Industries Pr. Ltd. v. CIT,* (1989) 178 ITR 200 (Punj); *CIT v. Maltex Malsters Ltd.,* (1989) 179 ITR 41 (Punj)]. Also see, *Saraswati Industrial Syndicate Ltd. v. CIT,* (1990) 183 ITR 120, 123-25 (Punj). **But** in *CIT v. Prakash Beedies* (*P.*) *Ltd.*, (1986) 161 ITR 241 (Karn), the assessee-company paid royalty to a firm constituted of three directors of the company as partners. It was held that the payment to the firm was payment to its partners who were directors of the company. Provisions of section 40(*c*) of the 1961 Act were attracted and the overall ceiling limit, then ₹ 72,000 for each director, did operate automatically. The sum in excess of ₹ 2,16,000 [72,000 × 3] was disallowed. The Karnataka decision in *CIT v. Prakash Beedies* (*P.*) *Ltd.*, (1986) 161 ITR 241 (Karn) has been **reversed** by the Supreme Court in *Bharat Beedi Works P. Ltd. v. CIT: Prakash Beedies P. Ltd. v. CIT*, (1993) 201 ITR 1063, 1068, 1070 (SC), where the Supreme Court has ruled that the ceiling on deduction under section 40(*c*) of the 1961 Act was not applicable to the royalty payments made by the assessee-company to a

LexisNexis

firm, whose partners were directors of the company, for use of the brand name. This was so because the payments were made in consideration of a valuable right parted with by the firm in favour of the assessee-company. Such payments may be liable to be scrutinised under section 40A(2) of the 1961 Act, but these certainly did not fall within the four corners of section 40(*c*) of the 1961 Act. So long as the agreement whereunder the said payments were made is not held to be a mere device or a mere screen, the said payments cannot be treated as payments made to the directors as directors (*qua* directors). In taking the above view, the Supreme Court has **approved** *T.T.P. Ltd. v. ITO*, (1980) 121 ITR 551 (Karn) and has **impliedly approved** *CIT v. Avon Cycles P. Ltd.*, (1980) 126 ITR 448 (Punj) and *India Jute Co. Ltd. v. CIT*, (1989) 178 ITR 649 (Cal).

Since the expression 'commission' has not been used in section 40(*c*) of the 1961 Act, any commission paid as a percentage of the profits to the director is neither 'remuneration' nor 'benefit' or 'amenity' within the meaning of section 40(*c*) of the 1961 Act and the same cannot be taken into account for the purposes of computing disallowance under section 40(*c*) of the 1961 Act [*CIT v. Coromandal Fertilizers*, (2001) 247 ITR 417, 419, 421 (AP)]. Similarly, in the facts of *Hindustan Cocoa Products Ltd. v. CIT*, (2001) 250 ITR 755, 757, 758-59 (Bom), the Tribunal was held not right in holding that the commission payments made to a director were to be treated as remuneration for the purposes of computing the disallowance under section 40(*c*) of the 1961 Act. Still, where the commission becomes due to the director for the reason that the payee undertook a contractual liability, the commission paid to him may be treated distinctly from common remuneration [*Union Carbide India Ltd. v. CIT,* (1994) 72 Taxman 63, 70 (Cal)]. Also see, *CIT v. Jayanthi Films* (*Madras*) (*P.*) *Ltd.,* (1991) 54 Taxman 313, 314 (Mad).

It may, **however**, be noted that section 40(*c*)(*i*) of the 1961 Act employed "remuneration or benefit or amenity" and, therefore, commission had also to be kept into spectrum. In that view of the matter, the Tribunal was held justified in not excluding commission paid to the managing director for the purpose of remuneration to be allowed as deduction to the company under section 40(*c*) of the 1961 Act [*Godavari Sugar Mills Ltd. v. CIT,* (1994) 208 ITR 801, 804 (Bom), **following** *CIT v. Kores India Pr. Ltd.,* (1989) 176 ITR 500, 502-03 (Bom)]. Also see, *Ceat Tyres of India Ltd. v. CIT,* (1994) 121 CTR (Bom) 80, 82; *Khatau Makanji Spg. & Wvg. Co. Ltd. v. CIT,* (1996) 222 ITR 472, 474 (Bom); *Rohit Pulp & Paper Mills Ltd. v. CIT,* (1995) 215 ITR 919, 921 (Bom); *CIT v. Bakelite Hylam Ltd.,* (1996) 217 ITR 469, 479 (AP); *CIT v. Rohit Mills Ltd.,* (1996) 219 ITR 228, 232 (Guj); *CIT v. Dodsal Pvt. Ltd.,* (1997) 138 Taxation 754, 755 (Bom); *Tata Chemicals Ltd. v. CIT,* (1997) 140 Taxation 338 (Bom); *Indmag Pvt. Ltd. v. CIT,* (1997) 138 Taxation 572 (Bom). Thus, the commission paid to the director at a fix percentage of the net profits of the company is also remuneration, though it may be termed as commission, and, therefore, the payment of commission was subject to the ceiling limit prescribed under section 40(*c*)(*i*) of the 1961 Act [*Metal Powder Co. Ltd. v. CIT*, (1999) 238 ITR 756, 758-59 (Mad), **followed in** *T.P. Sokkalal Ramsait Factory* (*P.*) *Ltd. v. CIT*, (2000) 244 ITR 369, 370-71 (Mad); *Metal Powder Co. Ltd. v. CIT*, (2002) 258 ITR 123, 124-25 (Mad). Also see, *CIT v. Mihir Textiles Ltd.*, (2002) 256 ITR 528, 530-31 (Guj); *Dinesh Mills Ltd. v. CIT*, (2004) 268 ITR 502, 504 (Guj)]. This view has been **followed in** *McDowell & Co. Ltd. v. CIT*, (1999) 240 ITR 877, 879-80 (Mad). In other words, the amount of commission could not be excluded from the computation under section 40(*c*) of the 1961 Act [*Mettur Chemical & Industrial Corporation Ltd. v. CIT*, (2000) 242 ITR 424, 425 (Mad)]. Also see, *McDowell & Co. Ltd. v. CIT*, (2000) 246 ITR 529, 530, 532, (Mad).

The guarantee commission does not come within the ambit of the phrase "remuneration or benefit or amenity" and, therefore, did not attract the provisions of section 40(*c*)(*i*) of the 1961 Act. This is so because the liability of the guarantor is co-extensive with that of the debtor. If the debtor fails to pay the loan, the guarantor will be liable to pay the loan. If the guarantor fails to pay the loan, his personal assets and properties may be attached and sold in execution of any decree that may be passed in respect of that loan. Therefore, by giving the guarantee, the person concerned has exposed himself to a liability. It is for his undertaking that liability that remuneration is being paid. This cannot be described as a benefit. If anything, he has taken upon himself the liability for which he is being remunerated [*India Jute Co. Ltd. v. CIT,* (1989) 178 ITR 649, 652 (Cal)]. In that case, the guarantee commission paid to a relative of a director was held not hit by the overall ceiling limit prescribed by section 40(*c*) of the 1961 Act. Also see, *CIT v. McDowell & Co. Ltd.,* (2007) 288 ITR 666 (Karn).

Cash payments.—Cash payments made to the assessee were not covered by the expression "expenditure" under section 40(*c*) of the 1961 Act [*CIT v. Mafatlal Gangabhai & Co.* (*P.*) *Ltd.,* (1996) 219 ITR 644 (SC)]. Also see, *HMM Ltd. v. CIT*, (2001) 252 ITR 842 (Punj); *HMM Ltd. v. CIT*, (2009) 313 ITR 401 (Punj).

It has been held, in *CIT v. Ahmedabad New Cotton Mills Co. Ltd.*, (2002) 253 ITR 762, 763 (Guj), that the payment of house rent allowance by the assessee to its managing director in cash could not be considered for the purpose of disallowance under section 40(*c*) of the 1961 Act. Similar view has been taken in *CIT v. Arvind Mills Ltd.*, (2002) 254 ITR 529, 532 (Guj). However, a **contrary view** has been taken in *CIT v. Nutan Mills Ltd.*, (2002) 254 ITR 519, 521 (Guj).

Reimbursement of medical expenses.—In Gujarat Steel Tubes Ltd. v. CIT, (1994) 210 ITR 358, 365 (Guj), it has been held that section 40(*c*)(*i*) of the 1961 Act is very wide and includes remuneration, benefit or amenity

given either in cash or kind. Reimbursement of medical expenses as well as hospitalisation expenses incurred by the directors has been held to be a benefit to a director within the meaning of section 40(*c*)(*i*) of the 1961 Act [see, *Indian Oxygen Ltd. v. CIT,* (1994) 210 ITR 274, 280 (Cal)]. Also see, *CIT v. Synpol Products Pvt. Ltd.,* (1996) 217 ITR 154, 157 (Guj); *CIT v. Raipur Manufacturing Co.,* (1998) 231 ITR 598, 600 (Guj); *Ambica Mills Ltd. v. CIT,* (1998) 231 ITR 583, 596-97 (Guj), **distinguishing** *CIT v. Mafatlal Gangabhai & Co.* (*P.*) *Ltd.,* (1996) 219 ITR 644 (SC); *Sundaram Industries Ltd. v. CIT,* (1998) 147 CTR (Mad) 290, 297-98 = (1999) 239 ITR 405 (Mad); *Ambica Mills Ltd. v. CIT,* (1998) 147 CTR (Guj) 347, 355 = (1999) 235 ITR 264 (Guj); *CIT v. Ambica Mills Ltd.,* (1998) 147 CTR (Guj) 340, 343-44 = (1999) 236 ITR 921, 924-25 (Guj); *Sundaram Clayton Ltd. v. CIT*, (1999) 239 ITR 416, 417 (Mad); *Lucas TVS Ltd. v. CIT*, (2000) 242 ITR 136, 138 (Mad); *CIT v. Ambica Mills Ltd.*, (2000) 244 ITR 742, 744, 745 (Guj); *Beardsell Ltd. v. CIT*, (2000) 246 ITR 505, 509 (Mad); *CIT v. Arvind Mills Ltd.*, (2001) 248 ITR 187, 189 (Guj); *CIT v. South India Corporation Pvt. Ltd.*, (2001) 250 ITR 318, 320, 323-24 (Mad); *CIT v. Ahmedabad New Cotton Mills Co. Ltd.*, (2002) 253 ITR 762, 763 (Guj); *CIT v. Nutan Mills Ltd.*, (2002) 254 ITR 519, 520-21 (Guj); *CIT v. Arvind Mills Ltd.*, (2002) 254 ITR 529, 532 (Guj); *Rane* (*Madras*) *Ltd. v. CIT*, (2003) 259 ITR 307, 309 (Mad); *Ennore Foundries Ltd. v. CIT*, (2003) 259 ITR 414, 416 (Mad); *CIT v. Rohit Mills Ltd.*, (2004) 187 CTR (Guj) 623, 624. In *Mentha & Allied Products P. Ltd. v. CIT*, (2007) 293 ITR 49, 52-53 (All), the Tribunal was correct in holding that the medical expenses of the managing director could not be allowed under section 37(1) of the 1961 Act and had to be considered subject only to the limit under section 40(*c*)(*i*) of the 1961 Act as it stood before its amendment by the Direct Tax Laws (Amendment) Act, 1987.

But, in *Asbestos Cement Ltd. v. CIT*, (1991) 192 ITR 89, 90 (Bom), it has been held that reimbursement of medical expenses of directors were not covered by the provisions of section 40(*c*)(*i*) of the 1961 Act for the purpose of computing the disallowance under that section. Also see, *CIT v. Indian Explosives Ltd.,* (1991) 192 ITR 144, 147 (Cal).

Interest.—In *CIT v. Chotanagpur Engineering Works Ltd.*, (1987) 163 ITR 705 (Pat), it has been held that the interest paid by the assessee-company, at normal rates, on deposits by directors, their relatives, etc., is not an "expenditure" within the meaning of section 40(*c*) of the 1961 Act. This is so because wherever the intention of the legislature was to cover also interest payment it has specifically mentioned such payment, as has been done in section 40(*b*) of the 1961 Act. It seems that any such generalisation needs scrutiny.

Other applications.—In *Indian Oxygen Ltd. v. CIT*, (1987) 164 ITR 466 (Cal), gratuity paid to a retired director in excess of the overall ceiling limit was held not allowable by reason of the provisions of section 40(*c*) of the 1961 Act even though the gratuity is exempt in the hands of the recipient-director to the extent prescribed by section 10(10) of the 1961 Act. **However**, **following** *CIT v. Colgate Palmolive* (*India*) *Pvt. Ltd.*, (1994) 210 ITR 770 (Bom), it has been held that the amount of gratuity paid on retirement to the managing director was not a periodic payment and the same was not includible for disallowance under section 40(*c*) of the 1961 Act to the extent of it being in excess of the amount under section 10(10)(*iii*) of the 1961 Act, but such amount could be claimed by the assessee under the general provisions of section 37(1) of the 1961 Act [*CIT v. Commercial Ahmedabad Mills Co. Ltd.*, (2001) 251 ITR 364, 369 (Guj)]. Also see, *Fenner* (*India*) *Ltd. v. CIT*, (2002) 124 Taxman 264, 266 (Mad).

In *CIT v. Ambica Mills Ltd.*, (2000) 244 ITR 742, 744, 745 (Guj), it has been held that personal accident insurance premium and telephone expenses paid by the assessee-company to its directors and managing director were to be considered for disallowance under section 40(*c*) of the 1961 Act.

In *Kunal Engineering Co. Ltd. v. CIT*, (2000) 241 ITR 340, 344 (Mad), it has been held that as the liability to pay bonus to the managing director has accrued only when the Government has conveyed its approval and not prior to that, such bonus liability can be taken note of by the Officer, only for the assessment year relevant to the previous year in which such approval was given by the Government, for invoking the provisions of section 40(*c*) of the 1961 Act. In *CIT v. Mehta Parikh & Co.* (*P.*) *Ltd.*, (2002) 124 Taxman 466, 467, 468 (Guj), it has been held that the payments on account of bonus and leave encashment to the directors were not to be excluded for computing the disallowance under section 40(*c*) of the 1961 Act. Similar view has been taken also in respect of leave travel concession to a director, in addition to the bonus and leave encashment, in *CIT v. Mehta Parikh & Co. Pvt. Ltd.*, (2003) 174 Taxation 554, 556 (Guj). Also see, *CIT v. Mihir Textiles Ltd.,* (2006) 287 ITR 232, 236 (Guj).

Non-applicability.—In *CIT v. Ambal Mills Pr. Ltd.,* (1983) 142 ITR 771 (Mad), the company borrowed money from bank and paid interest thereon. A managing director was found to have overdrawn money from the company and no interest was charged by the company. The Income-tax Officer estimated the overdrawals and calculated interest on such amount at the rate on which borrowals were made. The so worked interest was disallowed under section 40(*c*) of the 1961 Act. It was held that section 40(*c*) of the 1961 Act could not be so invoked because the connection for invoking that section between the expenditure as such (in this case, the payment of interest on borrowed capital) and the benefit to the director had not been established.

LexisNexis

Where there is a finding of fact recorded by the Tribunal that there was no evidence that telephone was installed at the residence of the managing directors to give benefits or amenities to such persons, the provisions of section 40(*c*) of the 1961 Act could not be applied in respect of telephone expenses on the telephone so installed [*Cellulose Products of India Ltd. v. CIT,* (1996) 218 ITR 490, 494-95 (Guj)].

In *CIT v. Sudarsan Chits* (*India*) *Ltd.*, (1990) 182 ITR 94 (Ker), **SLP dismissed**: (1993) 201 ITR (St.) 58-59 (SC), the payment made by the assessee-company to its holding company under an agreement, which was entered into *bona fide* and in the interest of the business, for use of services of the managing director and four officers of the holding company was held not hit by the provisions of sections 40(*c*) of the 1961 Act. This Kerala decision [182 ITR 94 (Ker)] has been **followed in** *CIT v. Sudarsan Chits* (*India*) *Ltd.*, (1999) 239 ITR 174, 175 (Mad); *CIT v. Sudarsan Chits* (*I.*) *Ltd.*, (1999) 240 ITR 319, 323 (Mad).

In *CIT v. Fenner* (*India*) *Ltd.*, (1998) Tax LR 555, 557, 559 (Mad) = (2000) 241 ITR 645, 649-50, 653 (Mad), it has been held that the contribution made to provident fund and pension fund cannot be regarded as 'remuneration, benefit or amenity' within the meaning of section 40(*c*) of the 1961 Act. Further, the premium paid to the Life Insurance Corporation towards a policy which is akin to the accident insurance policy cannot be regarded as benefit or remuneration or amenity to the employee-director.

In the facts of *Sundaram Fasteners Ltd. v. CIT*, (2001) 247 ITR 219, 223 (Mad), it has been held that the expenditure incurred by the assessee-company by payment of club subscription to the managing director could not fall within the permissible limit of the deduction prescribed in section 40(*c*)(*i*) of the 1961 Act.

A harmonious reading of sections 10(6)(*viia*), 40(*c*) and 40A(5) of the 1961 Act would indicate that the remuneration which was exempt under the provisions of section 10(6)(*viia*) of the 1961 Act to the extent to which the exemption was granted could not be said to be either unreasonable or excessive having regard to the business needs of the company. In that view of the matter, the amount of income actually exempt under section 10(6)(*viia*) of the 1961 Act would be excluded from consideration for the purposes of disallowance under section 40(*c*) read with section 40A(5) of the 1961 Act in the case of a director-*cum*-foreign technician and such amount shall not be taken into account for fixing the ceiling limit as well [*CIT v. Lucas TVS Ltd.,* (1997) 226 ITR 281, 291-92, 295 (Mad), **followed in** *CIT v. Indo National Ltd.,* (1998) 148 CTR (Mad) 338, 340-41; *Lucas TVS Ltd. v. CIT*, (1999) 239 ITR 534, 536 (Mad)]. The said Madras decision [226 ITR 281 (Mad)] has also been reported as *Lucas TVS Ltd. v. CIT*, (1999) 236 ITR 752 (Mad).

Excessive or unreasonable expenditure or allowance in respect of any assets of the company used by a director, etc. [s. 40(*c*)(*ii*) of 1961 Act].—This section concerned the expenditure or allowance incurred or given by the company to a director *or* a *person who had a substantial interest in the company* [as defined in section 2(32) of the 1961 Act] or to a *relative* [as defined in section 2(41) of the 1961 Act] of the director or of such person in respect of any assets of the company used by him, either wholly or partly for his own purposes or benefit shall not be deducted in computing the income of a company chargeable under the head "Profits and gains of business or profession" to the extent it was excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, subject to an overall ceiling limit described.

The word 'allowance' in section 40(*c*)(*ii*) of the 1961 Act itself contemplated the statutory allowances made or liable to be made under the provisions of sections 28 to 39 of the 1961 Act. Therefore, the view that a statutory allowance could not be scrutinised under section 40(*c*)(*ii*) of the 1961 Act is the product of a misapprehension of the provision which was brought into the statute only to curb the excessive generosity at the expense of the revenue, practised by some erring companies, for the benefit of the directors or persons controlling their affairs [*CIT v. Kisenchand Chellaram* (*India*) *P. Ltd.,* (1981) 130 ITR 385, 391 (Mad)].

The allowance of depreciation on assets used by the director, etc., was to be made keeping in view the provisions of section 40(*c*)(*ii*) of the 1961 Act [*CIT v. Har Prasad & Co. P. Ltd.,* (1981) 129 ITR 388 (Del)]. In other words, as section 40(*c*)(*ii*) of the 1961 Act included both expenditure as well as allowance in respect of any assets of the company used by any person referred to in section 40(*c*)(*i*) of the 1961 Act either wholly or partly for his own purposes or his benefit, the amount of depreciation allowed to the assessee-company on cars maintained by it and which has been used for the personal purposes of the directors of the assessee-company can be taken into consideration for purposes of disallowance under section 40(*c*) of the 1961 Act [*CIT v. Sundaram Industries,* (1998) 232 ITR 337, 339 (Mad); *Sundaram Industries Ltd. v. CIT,* (1998) 147 CTR (Mad) 290, 298-300 = (1999) 239 ITR 405 (Mad)].

Similarly, the maintenance expenditure of the motor cars, which were used even partly for the personal purposes of the directors, has to be taken into account for the purpose of disallowance under section 40(*c*) of the 1961 Act [*Sundaram Industries Ltd. v. CIT,* (1998) 147 CTR (Mad) 290, 295 = (1999) 239 ITR 405 (Mad)]. In *CIT v. South India Corporation Pvt. Ltd.*, (2001) 250 ITR 318, 320, 321 (Mad), **applying** *CIT v. Madura Coats Ltd.*, (1999) 239 ITR 50 (Mad), it has been held that in respect of motor cars provided to the directors and others for their personal use, the actual expenditure incurred by the assessee in respect of the asset, *i.e.*, motor cars used

by the directors or other persons, should be taken into consideration for the purpose of computing the amount disallowable under section 40(*c*) of the 1961 Act. Rule 3 of the 1962 Rules has no relevance in determining the value of the perquisite for the purpose of disallowance under section 40(*c*) of the 1961 Act. **Following** *CIT v. British Bank of Middle East*, (2001) 251 ITR 217 (SC), it has been held that the value of benefit or amenity relating to expenses on a car for the purpose of applying the provisions of section 40(*c*) of the 1961 Act has to be restricted to the figures of actual expenditure and not the assessable value of such benefit or amenity as perquisite in the hands of the employee-director as per rule 3 of the 1962 Rules [*CIT v. Raunaq & Co. Pvt. Ltd.*, (2003) 262 ITR 86, 87 (Del)].

In *CIT v. New India Maritime Agencies* (*P.*) *Ltd.*, (2000) 246 ITR 344, 345 (Mad), it has been held, **following** *South India Corporation Agencies P. Ltd. v. CIT*, (1999) 239 ITR 305 (Mad), that the expenditure incurred by the assessee-company by way of property tax and urban land tax in respect of properties owned by the assessee-company and given as residential accommodation to its directors should not be considered for the purpose of disallowance under section 40(*c*) of the 1961 Act and expenditure towards maintenance of such properties alone could be included for the purpose of the disallowance. In *CIT v. Sundaram Clayton Ltd.*, (2003) 130 Taxman 64, 65 (Mad), the Tribunal was held right in law in directing the Assessing Officer to exclude the expenditure incurred by the assessee on maintenance of the building owned by the assessee and used by the managing director as residence in computing the disallowance under section 40(*c*) of the 1961 Act. This view has been taken **following** *CIT v. T.V. Sundaram Iyengar & Sons*, (1999) 235 ITR 491 (Mad) wherein, *inter alia*, expenditure incurred towards rates and taxes paid in respect of the buildings were held not to be treated as perquisites for the purposes of disallowance under section 40(*c*)/40A(5) of the 1961 Act.

In *CIT v. South India Corporation Pvt. Ltd.*, (2001) 250 ITR 318, 320, 322-23 (Mad), **following** *South India Corporation Agencies* (*P.*) *Ltd. v. CIT*, (1999) 239 ITR 305 (Mad), it has been held that the expenditure incurred on the house occupied by the Deputy Chairman of the assessee-company towards insurance premia, electricity charges, gardener's salary, depreciation and pest control expenses should be included in arriving at the amount of disallowance under section 40(*c*) of the 1961 Act.

Overall ceiling limit.—The overall ceiling limit up to which deduction on account of the aggregate of such expenditure and allowance incurred by a company on the provision of any remuneration or benefit or amenity may be allowed *in respect of any one person* [director, or a person having substantial interest in the company or a relative of the director or such interest-holder], was as follows:—

(1) Where such expenditure or allowance related to a period exceeding 11 months comprised in the previous year:—

(*i*) For any of the assessment years 1985-86 to 1988-89: ₹ 1,02,000; and

(*ii*) For any of the assessment years 1972-73 to 1984-85: ₹ 72,000.

(2) Where such expenditure or allowance related to a period of 11 months, or a lesser period, comprised in the previous year:—

(*i*) For any of the assessment years 1985-86 to 1988-89: an amount calculated @ ₹ 8,500 for each month or a part thereof; and

(*ii*) For any of the assessment years 1972-73 to 1984-85: an amount calculated @ ₹ 6,000 for each month or a part thereof.

If, however, such person was also an employee of the company, expenditure in the nature of travel concession, passage money, contributions to a recognised provident or superannuation or gratuity fund or for promoting family planning shall not be taken into account for the purpose of the above ceiling [*T.T. Pr. Ltd. v. ITO,* (1980) 121 ITR 551, 567-68 (Karn); *CIT v. Avon Cycles Pr. Ltd.,* (1980) 126 ITR 448, 458 (Punj), **SLP dismissed**: (1983) 144 ITR (St.) 14 (SC)]. This ceiling limit was operative for and from assessment year 1972-73 [*CIT v. P.R. Ramakrishnan,* (1980) 124 ITR 545 (Mad)].

The provisions laying down the overall ceiling limit were separate and independent of the provisions as to the excessiveness or unreasonableness to be judged as per the specified criteria. Where the aggregate of the expenditure or allowance as contemplated by section 40(*c*) exceeded ₹ 72,000 or ₹ 1,02,000, as the case might have been, for a particular year in relation to a director or a person having a substantial interest, etc., the excess might have been disallowed outright without giving any finding as to excessiveness or unreasonableness [*Bilaspur Spng. Mills & Industries Ltd. v. CIT,* (1982) 135 ITR 496 (Cal)]. Thus, the excess was disallowable outright immaterial of whether the payment is excessive or unreasonable [*Union Carbide India Ltd. v. CIT,* (1993) 203 ITR 584, 589 (Cal)].

In other words, any amount paid to a director-employee of the assessee-company, which was beyond the overall ceiling limit, has been held not allowable under clauses (*i*) and (*ii*) of section 40(*c*) of the 1961 Act irrespective of whether the expenditure was excessive or unreasonable having regard to the legitimate business needs of the assessee-company, and also irrespective of whether the remuneration has been approved by the Government of

LexisNexis

India under section 310 of the Companies Act, 1956 [*Rohit Pulp & Paper Mills Ltd. v. CIT,* (1995) 215 ITR 919, 921 (Bom)]. Also see, *Geoffrey Manners & Co. Ltd. v. CIT,* (1996) 221 ITR 695, 703 (Bom); *CIT v. National Pharmaceuticals & Medical Services* (*P.*) *Ltd.,* (1997) 226 ITR 518, 519, 526 (Ker); *Khaders International Constructions Ltd. v. CIT,* (1998) 229 ITR 452, 457 (Ker). Thus, the disallowance has been held to be required to be made under section 40(*c*) of the 1961 Act out of the remuneration paid to the managing director notwithstanding the fact that the remuneration was reasonable having regard to the business requirements of the company [*CIT v. Mihir Textiles Ltd.*, (2002) 256 ITR 528, 530 (Guj)].

In *Andhra Sugar Ltd. v. CIT*, (1987) 165 ITR 259 (AP), the liability to make payment of remuneration to directors related to assessment year 1971-72. But such liability was claimed as a deduction for assessment year 1972-73 as the sanction of the Company Law Board in that regard was obtained during the previous year relevant thereto. It was held that although the ceiling limit became operative for and from assessment year 1972-73, that ceiling limit could not be applied in the instant case because the remuneration pertained to the assessment year 1971-72.

In *India Carbon Ltd. v. CIT*, (1989) 175 ITR 27 (Gauh), the Tribunal passed orders under section 254(2) of the 1961 Act rectifying its appellate orders relating to assessment years 1972-73 and 1973-74 limiting the allowance of managing director's remuneration for each of those years to ₹ 72,000. It was held that the Tribunal was justified in passing the rectification orders as the interpretation of section 40(*c*) of the 1961 Act was not a debatable issue for these two years.

In *Mewar Sugar Mills Ltd. v. CIT*, (1993) 203 ITR 415, 418 (Raj), the Income-tax Officer was held justified in allowing the amount of remuneration paid to the assessee-company's three directors to the extent of ₹ 1,20,000 as fixed by the Company Law Board as per its order passed after the end of the previous year relevant to assessment year 1976-77 even though these directors were originally paid ₹ 1,56,901.

In *Mettur Chemical & Industrial Corporation Ltd. v. CIT*, (2000) 242 ITR 424, 425 (Mad), the Tribunal was held right in holding that the maximum permissible limit of expenditure on remuneration and perquisite to the managing director in this case could not exceed the limit of ₹ 72,000, for the assessment year 1979-80, even without a finding whether the remuneration was excessive or unreasonable having regard to the business needs of the assessee-company.

The ceiling limit of ₹ 72,000/₹ 1,02,000 is absolute and it cannot be varied with the length of the previous year beyond 12 months. In other words, it applies to all previous years, the duration of which exceeds 11 months. The fact that in the case of the assessee the previous year extended to 18 months is, therefore, is not a ground for applying a ceiling limit different from the one specified in the statute [*Engine Valves Ltd. v. CIT*, (2002) 256 ITR 449, 450-51 (Mad)].

LexisNexis

Excessiveness or unreasonableness, how to be judged.—No expenditure or allowance considered by the Assessing Officer [(up to 31-3-1988) Income-tax Officer] as excessive or unreasonable, having regard to the legitimate business needs of the company and the benefit derived by or accruing to the company therefrom, is permissible even though warranted by section 36 or 37 of the 1961 Act if it results directly or indirectly in the provision of any remuneration or benefit or amenity to a director, etc., or if it is in respect of any asset of the company used by the director, etc., wholly or partly for his own purposes or benefit. The authority has to weigh the expenditures or allowances against the legitimate needs of the company and the benefit derived by it from the expenditures or allowances. In other words, the enquiry directed was an enquiry involving an appreciation and evaluation of facts from a particular point of view, namely, the legitimate business needs of the assessee-company and the benefits which might be said to be derived by the assessee-company by the outlay of the expenditure in question [see, *Mycol* (*Pr.*) *Ltd. v. CIT,* (1984) 150 ITR 609 (Mad)]. The expenditures or allowances made should not weigh down the business needs of the company and the benefit accruing to it [*Harbour Engg. Pr. Ltd. v. CIT,* (1964) 52 ITR 249, 253 (Mad); *Natesan & Co. Pr. Ltd. v. CIT,* (1964) 51 ITR 386, 391 (Mad)]. What the legitimate business needs of a company are will vary from case to case depending upon the problems with which a company is faced in a particular year [*CIT v. Undan Sugar Mills P. Ltd.,* I.T. Ref. No. 1022 of 1975, decided on 13-7-1979 (All)].

The reasonableness of director's remuneration, etc., is to be judged on the wordings of section 40(*c*) of the 1961 Act and any other consideration is irrelevant [*Eastern Scales P. Ltd. v. CIT,* (1979) 117 ITR 488, 491 (Cal)]. The fact that the expenditure or allowance has been included in the taxable income of the director or person concerned was not a relevant or decisive consideration in the matter of the Assessing Officer's [(up to 31-3-1988) Income-tax Officer's] decision about the reasonableness or otherwise of any such expenditure or allowance [*CIT v. P.R. Ramakrishnan,* (1980) 124 ITR 545 (Mad)].

The reasonableness or otherwise of the amount spent must be formed having regard to the legitimate business needs of the company and the benefit derived by the company or accruing to the company from the said sum expended. It is the objective consideration of all the circumstances that should go into the verdict [*Kashiprasad Carpets* (*P.*) *Ltd. v. CIT,* (1984) 148 ITR 710, 713 (All); *Pheros & Co. P. Ltd. v. CIT,* (1989) 175 ITR 44, 47

(Gauh)]. It is to be judged from the businessman's point of view on consideration of actual work and not mere designation [*Caravan Containers P. Ltd. v. CIT,* (1979) 120 ITR 636 (Bom)]. That does not depend on the profit and loss of the company but upon the benefit derived by the company from the service rendered [*Calcutta Art Studio P. Ltd. v. CIT,* (1979) 118 ITR 752 (Cal)]. The paucity of profits will not be the deciding factor in allowing or disallowing the remuneration paid to a director, etc. [*Construction Machinery Pr. Ltd. v. CIT,* (1987) 164 ITR 394 (Cal)].

The word 'benefit' is a word of the widest amplitude incapable of delimitation and by no means is delimitable by measure of profit alone. Profit may be one of the indicia but not the sole one. Of course, the business needs of the company and the benefit derived by or accruing to it and the reasonableness of the remuneration in that perspective are to be doubtless put to the test but in a manner totally objective and uninfluenced by any obsession for higher tax revenue [*Sonar Airotech Pvt. Ltd. v. CIT,* (1993) 204 ITR 304, 311, 309 (Cal)].

Further, for disallowance under section 40(*c*) of the 1961 Act, the sum total of various payments, even though otherwise allowable under different sections, has to be weighed against the benefit accruing to the company. The claim for allowance made under each of the different sections cannot be considered separately or exclusively [*CIT v. Raman & Raman P. Ltd.,* (1977) 110 ITR 747, 749 (Mad); *Sri Krishna Tiles & Potteries* (*Madras*) *P. Ltd. v. CIT*, (1973) 90 ITR 439, 448 (Mad)].

In *Alkali Metals Ltd. v. CIT*, (1988) 169 ITR 359 (AP), the allowability or otherwise of the payment of commission made to either directors or their relations was held to be examined and determined solely on the basis of the requirements of section 40(*c*) of the 1961 Act without attaching any significance to the resolution passed in that regard. As, in that case, the Tribunal did not consider the question with specific reference to section 40(*c*) of the 1961 Act, the matter was remanded to the Tribunal for considering the same in terms of section 40(*c*) of the 1961 Act.

AO's duty and discretion in making enquiry.—The Assessing Officer [(up to 31-3-1988) Income-tax Officer], must, however, consider the entire position dispassionately and objectively and from the viewpoint of a prudent businessman. He must appreciate that the provisions are not to be applied capriciously as a matter of routine but judiciously and only where the necessary ingredients thereof are satisfied. His opinion as to the reasonableness or otherwise of the amount spent must not be arbitrary and is not to be the subjective and prejudiced opinion of an officer interested in collecting more revenue but must strictly be formed having regard to the legitimate business needs of the company and the benefit derived by, accruing to, the company from the sum expended, and that from the view-point of a businessman [*CIT v. Edward Keventer* (*P.*) *Ltd.,* (1972) 86 ITR 370, 381 (Cal), **affirmed in** (1978) 115 ITR 149 (SC); *Natesan & Co. P. Ltd. v. CIT,* (1964) 51 ITR 386, 391-92 (Mad); *Nund & Samont Co. P. Ltd. v. CIT,* (1970) 78 ITR 268 (SC); *Natsin India P. Ltd. v. CIT,* (1980) 121 ITR 672 (Cal); *Extrusion Process P. Ltd. v. CIT,* (1979) 119 ITR 287 (Bom)]. It is not open to him to mechanically follow an order for an earlier assessment year without applying a fresh judicial mind to the facts and circumstances of the relevant year [*Pioneer Spring & Steel Concern P. Ltd. v. CIT,* (1982) 135 ITR 522 (Cal)].

In considering whether a deduction for business expenditure claimed by a company assessee be allowed, the Assessing Officer must have, *firstly,* regard to the provisions of sections 36 and 37 of the 1961 Act, as may be applicable. *Secondly,* if the expenditure concerns a benefit, amenity or remuneration to a privileged person, the reasonableness of its quantum is to be tested against the touchstone of section 40(*c*) of the 1961 Act. The section vested the power to find out the reasonableness or excessiveness primarily on the Assessing Officer and his decision is subject to review by the appellate authority and the Tribunal. In that view of the matter, the Assessing Officer must expressly state the reasons for the disallowance to enable the appellate authorities to judge the propriety thereof [*CIT v. Raman & Raman P. Ltd.,* (1977) 110 ITR 747, 749 (Mad)]. The provisions may also be invoked by the appellate authorities [*Patiala Biscuit Manufacturers P. Ltd. v. CIT,* (1976) 103 ITR 208 (Punj)].

In considering whether the remuneration, etc., paid for services rendered by a director, etc., was allowable under section 40(*c*) of the 1961 Act, the Income-tax Officer must have regard to the statutory criteria referred to above and all the circumstances, such as, the nature and special character of the service, qualifications of the person concerned for rendering similar service, amount, if any, paid by the assessee to another person for rendering similar service, normalcy of the remuneration having regard to the practice in trade, existence of any other extraordinary and abnormal circumstances during the year under question, and the like [*India Tin Industries* (*Pr.*) *Ltd. v. CIT,* (1973) Tax LR 340 (Mys)].

The question whether any amount claimed as expenditure or allowance is excessive or unreasonable having regard to the legitimate business needs of the assessee and the benefit derived by or accruing to it therefrom has to be decided on the facts and in the light of circumstances of each case. But the final conclusion on the admissibility of an allowance claimed is one of law. The Tribunal should give reasons for the conclusion that the expenditure claimed is excessive. Where no reasons are given, such finding is liable to be held as defective in law [*India Tin Industries* (*Pr.*) *Ltd. v. CIT*, (1973) Tax LR 340 (Mys)].

LexisNexis

Whether commission paid by the assessee-company was excessive or unreasonable, having regard to the legitimate business needs of the assessee-company, and whether part disallowance on estimate was justified, are questions of law [*Hemco Industries P. Ltd. v. CIT,* (1979) 118 ITR 443 (Punj)]. Also see, *Gwalior Rayon Silk Mfg.* (*Wvg.*) *Co. Ltd. v. CIT,* (1982) 134 ITR 97 (MP); *CIT v. Hans Raj Gupta & Co.* (*P.*) *Ltd.,* (1990) 183 ITR 72 (Del).

Where, however, on facts, the Tribunal finds that a partial disallowance made under section 40(*c*) of the 1961 Act was not justified within those provisions, it may sustain such partial disallowance under section 37(1) of the 1961 Act if the circumstances so call for [*Steel Containers Ltd. v. CIT,* (1978) 112 ITR 995 (Cal)]. Where the Tribunal has arrived at the conclusion that the remuneration paid to a director is excessive after taking notice of all the relevant circumstances, *i.e.*, the education and technical experience of the director, the part played by him in promoting the company and the overall business of the company, it was held that no question of law arose [*Auto Piston Mfg. Co. P. Ltd. v. CIT,* (1981) 132 ITR 12 (Punj)]. Also see, *J.B. Bottling Co. Pr. Ltd. v. CIT,* (1975) 98 ITR 512 (Del)*; Reform Flour Mills P. Ltd. v. CIT,* (1978) 115 ITR 598 (Cal); *CIT v. Rajkumar Chit Funds P. Ltd.,* T.C. No. 476 of 1970, decided on 24-6-1976 (Mad).

In *Stadmed P. Ltd. v. CIT*, (1983) 140 ITR 361 (Cal), a part of the remuneration paid to a director was disallowed by the Income-tax authorities considering section 10(2)(*xv*) of the 1922 Act. The Tribunal sustained disallowance by invoking provisions of section 10(4A) of the 1922 Act [corresponding to section 40(*c*) of the 1961 Act] under the belief that the Appellate Assistant Commissioner had proceeded on such basis. On an application by the assessee, the Tribunal recalled its order. It was held that there was no mistake apparent from the record in the order already passed by the Tribunal and the recall was uncalled for.

Where the Income-tax Officer did not examine the assessee-company's claim about deduction of remuneration to the managing director with reference to the provisions of section 40(*c*) of the 1961 Act, the Tribunal was held justified in remanding the matter to the Income-tax Officer for examining the same in the light of the provisions of section 40(*c*) of the 1961 Act [*CIT v. Sarabhai Sons Ltd.,* (1983) 143 ITR 473 (Guj)]. Similarly, where the taxing authorities, inclusive of the Tribunal, did not at all enter into any discussion as respects the expenditure incurred by the assessee-company for payment of house rent allowance to the managing director being excessive or unreasonable, having regard to the legitimate business needs of the company, the question whether the amount spent on payment of house rent allowance was covered by section 40(*c*) of the 1961 Act could not be answered [*Sundaram Fasteners Ltd. v. CIT*¸ (2001) 247 ITR 219, 223 (Mad)].

Unless there is a suggestion that in making disallowance on the score of director's remuneration, etc., the Assessing Officer had travelled beyond the two grounds laid down in the provisions, *viz.*, (*i*) the legitimate needs of the company, and (*ii*) the benefit derived by or accruing to the company therefrom, or unless there was a suggestion that the decision of the Assessing Officer was arbitrary or capricious, no question of law can arise from the decision of the Income-tax Officer for reference to the High Court [*Mercantile Express Co. Pr. Ltd. v. CIT,* (1963) 47 ITR 125 (Cal)]. The High Court does not interfere with the quantum unless the decision of the authorities or the Tribunal is unreasonable, capricious or perverse [Cf. *CEPT v. N.M. Rayaloo Iyer & Sons,* (1961) 41 ITR 671 (SC); *Sri Krishna Tiles & Potteries* (*Madras*) *P. Ltd. v. CIT,* (1973) 90 ITR 439 (Mad); *Watkins Mayor* (*Agrico*) *P. Ltd. v. CIT,* (1979) 117 ITR 202 (Punj)]. At the same time, a plea for disallowance under section 40(*c*) of the 1961 Act could not, for the first time, be urged before the High Court in a reference [see, *CIT v. K.S. Subbaiah Pillai,* (1981) 127 ITR 505, 511-12 (AP)].

Onus.—In an enquiry under section 40(*c*) of the 1961 Act into the excessiveness or reasonableness of an item of expenditure contemplated by that section, it was for the taxpayer company to establish by evidence that the particular allowance was justifiable. If the taxpayer company did not produce any evidence in support of the claim for allowance, the Assessing Officer [(up to 31-3-1988) Income-tax Officer] was not bound independently to collect evidence and decide that the allowance claimed was excessive or unreasonable having regard to the legitimate business needs of the assessee-company before the power under section 40(*c*) of the 1961 Act might have been exercised [*Nund & Samont Co. P. Ltd. v. CIT,* (1970) 78 ITR 268 (SC); *J.B. Bottling Co.* (*P.*) *Ltd. v. CIT,* (1975) 98 ITR 512, 516-17 (Delhi); *Eastern Scales P. Ltd. v. CIT,* (1979) 117 ITR 477 (Cal); *CIT v. Westcoast Shipping Agencies P. Ltd.,* (1981) 127 ITR 442 (Ker); *Reform Flour Mills P. Ltd. v. CIT,* (1978) 115 ITR 598 (Cal); *Eastern Tea Estate P. Ltd. v. CIT,* (1977) Tax LR 134 (Gauh)].

In the case of director's remuneration, link between the remuneration and the benefit resulting to the company therefrom had to be established [*Shervani Sugar Syndicate P. Ltd. v. CIT,* (1980) 125 ITR 158 (All)]. At the same time, evidence on all points was not essential; overall circumstances of the case should guide [*CIT v. Karam Chand Thapar & Bros. P. Ltd.,* (1978) 115 ITR 688 (Cal)].

In the facts of *Sonar Airotech Pvt. Ltd. v. CIT*, (1993) 204 ITR 304, 310 (Cal), the assessee was held to have discharged its burden of proof by showing the quality of the expertise and experience of the directors and the benefit derived by the company attracting impressive custom.

LexisNexis

Illustrations under sections 40(*c*)(*i*) and (*ii*) of 1961 Act.—*Cases where disallowance (or partial disallowance) was upheld.*—(1) Three directors were paid @ ₹ 500 per month each—managing director, a technician, was paid ₹ 1,250 per month—ITO allowed ₹ 11,250 out of claim of ₹ 24,750—disallowance upheld [*Harbour Engineering P. Ltd. v. CIT,* (1964) 52 ITR 249 (Mad)].

(2) Two directors were paid ₹ 2,000 per month each—ITO disallowed entire claim—Tribunal allowed ₹ 500 to each on the ground that the persons had made investments in purchasing shares—High Court negatived any allowance because s. 10(2)(*xv*) does not take in return on investments [*CIT v. Motor and General Sales P. Ltd.,* (1968) 68 ITR 102 (All)].

Where no services have been rendered by the directors, no allowance is possible in respect of remuneration paid to the directors [*Marketing Services Agency* (*P.*) *Ltd. v. CIT,* (1991) 55 Taxman 305, 306 (All)].

(3) 30% of net profits to directors as remuneration held to be excessive and unreasonable [*Nund & Samont Co. Pr. Ltd. v. CIT,* (1970) 78 ITR 268 (SC)].

A lady director was given remuneration of ₹ 800 per month—Tribunal disallowed 50%—upheld by the High Court [*Garg Association P. Ltd. v. CIT,* (1979) 119 ITR 705 (All)].

Remuneration paid in excess of 50% salary per month paid to the working director was held to be excessive and unreasonable [*Mangal Chand Tubes Pvt. Ltd. v. CIT,* (1994) 208 ITR 729, 732-33 (Raj)].

(4) Joint managing director was given remuneration as well as free furnished accommodation—ITO disallowed both, but Tribunal sustained disallowance of one-third remuneration and also the free accommodation portion—High Court upheld Tribunal's view [*Reform Flour Mills P. Ltd. v. CIT,* (1978) 115 ITR 598 (Cal)].

Remuneration and commission were paid to the wife of the chairman who was appointed as a managing director—disallowance of commission upheld [*Mycol* (*Pr.*) *Ltd. v. CIT,* (1985) 150 ITR 609 (Mad)].

(5) Part disallowance from the remuneration of the managing director was upheld [*Watkins Mayor* (*Agrico*) *P. Ltd. v. CIT,* (1979) 117 ITR 202 (Punj)]. Also see, *CIT v. Westcoast Shipping Agencies P. Ltd.,* (1981) 127 ITR 442 (Ker); *Eastern Tea Estate P. Ltd. v. CIT,* (1977) Tax LR 134 (Gauh); *CIT v. Rajkumar Chit Funds P. Ltd.,* T.C. No. 476 of 1970, decided on 24-6-1976 (Mad); *Ganga Chit Fund* (*P.*) *Ltd. v. CIT,* (1993) 203 ITR 7, 10 (All).

(6) Salary paid to two sons of a director of the assessee-company—part disallowance upheld [*Amritsar Transport Co. Pr. Ltd. v. CIT,* (1986) 161 ITR 18 (Punj)]. Also see, *Amritsar Transport Co.* (*P.*) *Ltd. v. CIT,* (1988) 174 ITR 377 (Punj); *Amritsar Transport Co. P. Ltd. v. CIT,* (1989) 178 ITR 574 (Punj).

(7) 1/6th of the amount of the telephone expenses incurred by the assessee should be disallowed [*Ambica Mills Ltd. v. CIT*, (1998) 147 CTR (Guj) 347, 354, 355-56 = (1999) 235 ITR 264, 270-71 (Guj)].

Cases where disallowance (or partial disallowance) was not upheld.—(1) Where legitimate business need having been found to exist, disallowance of a part of the additional managing director's salary was to be deleted [*Carlton Hotel P. Ltd. v. CIT,* (1974) 94 ITR 311 (All)]. Also see, *CIT v. Govindram Bros. P. Ltd.,* (1983) 141 ITR 626 (Bom); *CIT v. Basti Sugar Mills Ltd.,* (1989) 178 ITR 216 (Del). Tribunal deleted the part disallowance of a director's remuneration made by ITO as it found that the remuneration was reasonable in view of the director's qualification and the work done—High Court upheld Tribunal's view [*CIT v. Sawyer's Asia Ltd.,* (1980) 122 ITR 259 (Bom)]. Also see, *CIT v. Phoenix Chemical Works P. Ltd.,* (1982) 138 ITR 321 (Bom).

Company having posts of a director and a managing director—on retirement of the managing director, director was appointed as the managing director at a higher remuneration—thereafter managing director carried out the work of the director as well as the managing director—part disallowance of the remuneration paid to the managing director held not sustainable [*Eastern Scales Pr. Ltd. v. CIT,* (1982) 134 ITR 37 (Cal)]. Similarly, increase in the salary of the directors on account of higher sales was held to be justified and there was no legal ground to the Tribunal to make partial disallowance [*Abbas Wazir* (*P.*) *Ltd. v. CIT*, (2004) 265 ITR 77, 81 (All)].

(2) Managing director was given 5% of net profits as remuneration—part thereof was disallowed by ITO as excessive—Tribunal found entire sum to be reasonable—Tribunal's view was upheld [*CIT v. India Carbon P. Ltd.,* (1977) 106 ITR 107 (Gauh)].

Part disallowance of the remuneration to the managing director and director-in-charge was made by the ITO—Tribunal found no cogent reason for disallowance—Tribunal's view was upheld [*CIT v. Kundan Sugar Mills P. Ltd.,* (1980) 121 ITR 848 (All)]. Also see, *Pheros & Co. P. Ltd. v. CIT,* (1989) 175 ITR 44 (Gauh).

Salaries paid to the four directors—part disallowance was not upheld as the margin drawn for disallowance of remuneration was arbitrary and without a nexus with any materials affording a basis [*Sonar Airotech Pvt. Ltd. v. CIT,* (1993) 204 ITR 304, 311 (Cal)].

LexisNexis

(3) Remuneration to four directors—ITO partly disallowed—Tribunal deleted disallowance—High Court and Supreme Court upheld Tribunal's view [*CIT v. Edward Keventer Pr. Ltd.,* (1978) 115 ITR 149 (SC)].

(4) Remuneration paid to the manager who was a son of the director—evidence showed that the remuneration was reasonable—part disallowance was not upheld [*CIT v. United Supply Agency* (*P.*) *Ltd.,* (1985) 155 ITR 262 (Cal)]. Also see, *CIT v. Karam Chand Thapar & Bros. P. Ltd.,* (1986) 157 ITR 212 (Cal).

(5) Guarantee commission paid to directors for standing personal surety for taking loans held not excessive [*L.H. Sugar Factories & Oil Mills P. Ltd. v. CIT,* (1979) 118 ITR 985 (All); *CIT v. L.H. Sugar Factories & Oil Mills P. Ltd.,* (1980) 123 ITR 599 (All); *CIT v. L.H. Sugar Factories & Oil Mills P. Ltd.,* (1980) 123 ITR 598 (All); *CIT v. L.H. Sugar Factories & Oil Mills P. Ltd.,* (1980) 123 ITR 596 (All); *Pheros & Co. P. Ltd. v. CIT,* (1980) 124 ITR 188 (Gauh)].

Commission paid to directors—part disallowance was held not justified [*Kashiprasad Carpets Pr. Ltd. v. CIT,* (1984) 148 ITR 710 (All)].

Section 40(*c*) and section 40A(5) of 1961 Act, distinction between.—In **section 40(*c*)(*i*) of the 1961 Act**, the expenditure incurred directly or indirectly is referable to the provision of any remuneration, benefit or amenity to a director, etc., whereas in **sections 40A(5)(*a*)(*i*) and (*ii*) of the 1961 Act**, the expenditure incurred directly or indirectly is referable not only to the payment of any salary to an employee, etc., but also the expenditure incurred directly or indirectly in making provision of any perquisite, whether convertible into money or not, to an employee. Thus, it is discernible that in section 40(*c*)(*i*) of the 1961 Act, there is an omission of any expenditure incurred directly or indirectly in making a provision of any perquisite, whether convertible into money or not in relation to a director of the company, etc. [*Sundaram Fasteners Ltd. v. CIT*, (2001) 247 ITR 219, 221, 222 (Mad)]. In that case, as the question framed by the Tribunal did not take into account such sort of distinction, the question was reframed by the High Court into two questions.

Disallowances out of expenditure incurred on payment of salaries and provision of perquisites to employee-directors should be made under provisions of section 40(*c*) of the 1961 Act and not under section 40A(5) of the 1961 Act [*Dorr-Oliver* (*India*) *Ltd. v. CIT*, (2009) 316 ITR 409, 412 (Bom)].

Ceiling on remuneration, etc., of employees, legislative background.—It was felt that the companies were expending too much on providing benefits, etc., to their employees—specially higher-paid employees. In order to place a curb thereon, **the Finance Act, 1963** (13 of 1963), **inserted sub-clause (*iii*) in section 40(*c*) of the 1961 Act** banning allowance of any expenditure on providing remuneration, benefit or amenity (with certain exceptions) to an Indian citizen employee in excess of ₹ 5,000 per month for any period of his employment after 28-2-1963. This prevailed only for one year.

The Finance Act, 1964 (5 of 1964), **substituted** a new **sub-clause (*iii*)** in place of the old, which left remuneration out of its operation. This provision had application to any expenditure incurred after 29-2-1964, which resulted, directly or indirectly, in the provision of any benefit or amenity or perquisite, whether convertible into money or not (with certain exceptions) to an employee—citizen as well as foreigner—in excess of one-fifth of the amount of salary payable to him for the relevant period. The new sub-clause (*iii*) was made effective for and from assessment year 1964-65. By **the Finance Act, 1965** (10 of 1965), the application of that clause (*iii*) was restricted, for and from assessment year 1965-66, to employees whose income chargeable under the head "Salaries" exceeded ₹ 7,500 for the year.

Section 40(*c*)(*iii*) of the 1961 Act remained operative **up to assessment year 1968-69**. It was **omitted** by **the Finance Act, 1968** (19 of 1968), **with effect from 1-4-1969**. It may be noted that that Finance Act brought in **section 40(*a*)(*v*) of the 1961 Act** which had application in the case of all—company as well as non-company—assessees and which remained operative **for assessment years 1969-70 to 1971-72**. **For and from assessment year 1972-73**, **section 40(*a*)(*v*) of the 1961 Act** was **omitted** and the provisions, in a modified and broadened form bringing within its sweep salary to employees in India, were enacted in **section 40A(5) of the 1961 Act**, which held the field for assessment years 1972-73 to 1988-89.

Analysis of omitted section 40(*c*)(*iii*) of 1961 Act.—Sub-clause (*iii*) of section 40(*c*) of the 1961 Act, which was **added** by **the Finance Act, 1963** (13 of 1963), **with effect from the 1-4-1963**, read as follows:—

> "(*iii*) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to an employee who is a citizen of India, to the extent such expenditure exceeds the amount calculated at the rate of five thousand rupees per month for any period of his employment after the 28-2-1963:
>
> *Provided* that in computing the aforesaid expenditure, any payments by way of gratuity or any sums comprised in the transferred balance of an employee participating in a recognised provident fund referred to in clause (*vii*) of sub-section (1) of section 17, or the amount of any compensation referred to in clause (*i*) or any payment referred to in clause (*ii*) of sub-section (3) of that section shall not be taken into account."

The following sub-clause was substituted, in place of the above, by **the Finance Act, 1964** (5 of 1964), **with effect from the 1-4-1964**:—

"(*iii*) any expenditure incurred after the 29-2-1964, which results directly or indirectly in the provision of any benefit or amenity or perquisite, whether convertible into money or not, to an employee (including any sum paid by the company in respect of any obligation which but for such payment would have been payable by such employee), to the extent such expenditure exceeds one-fifth of the amount of salary payable to the employee for any period of his employment after the aforesaid date:

Provided that in computing the aforesaid expenditure any payment by way of gratuity or the value of any travel concession or assistance referred to in clause (5) of section 10 or passage moneys or the value of any free or concessional passage referred to in sub-clause (*i*) *or any payment of tax referred to in sub-clause (vii)* of clause (6) of that section or any sum referred to in clause (*vii*) of sub-section (1) of section 17 or in clause (*v*) of sub-section (2) of that section or the amount of any compensation referred to in clause (*i*) or any payment referred to in clause (*ii*) of sub-section (3) of that section or any payment referred to in clause (*iv*) or clause (*v*) *or any expenditure referred to in clause (ix)* of sub-section (1) of section 36 shall not be taken into account."

In the above proviso, the words printed in italics (underlined) and the following further **proviso**, were **added** by **the Finance Act, 1965** (10 of 1965), **with effect from 1-4-1965**:—

"*Provided further* that nothing in this sub-clause shall apply to any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite to an employee whose income chargeable under the head 'Salaries' is seven thousand five hundred rupees or less."

Section 40(*c*)(*iii*) of the 1961 Act, as introduced by the Finance Act, 1963 (13 of 1963), held the field between 1-3-1963 and 29-2-1964, and thereafter the 1964-substituted provisions came into effect [*CIT v. Best & Co. P. Ltd.,* (1979) 119 ITR 830 (Mad)]. **But** according to Delhi High Court in *Addl. CIT v. Delhi Cloth & General Mills Co. Ltd.*, (1983) 144 ITR 275 (Del), section 40(*c*)(*iii*) of the 1961 Act, as substituted by the Finance Act, 1964 (5 of 1964), was held applicable for assessment year 1964-65 irrespective of the period constituting the relevant previous year.

As a result of the substitution of section 40(*c*)(*iii*) of the 1961 Act by the Finance Act, 1964 (5 of 1964), the word 'remuneration' was dropped from the relevant phrase giving an indication that the Legislature did not intend to include cash emoluments in any of the words 'benefit, amenity or perquisite'. *Secondly*, by the said amendment of 1964, the Legislature also added the words 'whether convertible into money or not'. *Thirdly*, it is also pertinent to note that, in section 40(*c*)(*i*) of the 1961 Act, the word 'remuneration' was retained along with the other words 'benefit or amenity' even after the aforesaid amendment of section 40(*c*)(*iii*) of the 1961 Act. The use of the words 'whether convertible into money or not' confined or restricted the application of section 40(*c*)(*iii*) of the 1961 Act to cases of distribution or payments in kind and not in cash [*CIT v. New India Industries Ltd.,* (1993) 201 ITR 208, 219-20, 223 (Guj)]. The expression 'benefit' or 'amenity' or 'perquisite' occurring in section 40(*c*)(*iii*) of the 1961 Act, as substituted by the Finance Act, 1964 (5 of 1964), must be read in the context in which the words are used [*CIT v. Duncan Bros. & Co. Ltd.,* (1983) 140 ITR 335, 342 (Cal)].

In the facts of *Peass Industrial Engineers Pvt. Ltd. v. CIT*, (1995) 211 ITR 348, 352 (Guj), the employee of the foreign company, which has entered into a collaboration agreement with the assessee-company, deputed to assist the assessee has been held to be an employee of the assessee-company and that the provisions of section 40(*c*)(*iii*) of the 1961 Act, for assessment year 1968-69, and those of section 40(*a*)(*v*) of the 1961 Act, for assessment year 1969-70, were attracted.

In *CIT v. Britannia Industries Co. Ltd.*, (1982) 135 ITR 35 (Cal), it was held that the value of the perquisite of free car provided to an employee should be taken in the hands of the employer-assessee, for the purpose of section 40(*c*)(*iii*) of the 1961 Act, at the same figure as it was taken in the hands of the employee. Also see, *CIT v. Nuchem Plastics Ltd.,* (1989) 179 ITR 196 (Punj). The above decision of the Calcutta High Court cannot be read as an authority that in all cases for the purposes of section 40(*c*)(*iii*) of the 1961 Act, the value of the perquisite in the hands of the employee, computed in accordance with relevant rules, must be taken. In order to disallow an expenditure incurred by a company in the provision of any benefit, etc., to an employee, it is not necessary that the value of the perquisite, etc., in the hands of the employees computed in accordance with relevant rules must exceed one-fifth of the salary. For that purpose, it is the entire expenditure incurred by the employer that has to be taken into account [*Bombay Burmah Trading Corpn. Ltd. v. CIT,* (1984) 145 ITR 793 (Bom), **followed in** *CIT v. Bennet Coleman & Co. Ltd.*, (1996) 217 ITR 216, 220 (Bom); *Bombay Burmah Trading Corporation Ltd. v. CIT,* (1991) 188 ITR 122 (Bom), **SLP granted**: (1994) 207 ITR (St.) 29 (SC)].

In *CIT v. Shree Krishna Gyanoday Sugar Ltd.*, (1990) 186 ITR 541, 543 (Cal), **following** *CIT v. Ashoka Marketing Ltd.*, (1990) 181 ITR 493 (Cal), a case relating to the then section 40(*a*)(*v*) or 40A(5) of the 1961 Act, it has been held that perquisites in terms of rule 3 of the Income-tax Rules, 1962, would not constitute the

LexisNexis

ceiling in the hands of the assessee-company for the purposes of disallowance under section 40(*c*)(*iii*) of the 1961 Act.

In *CIT v. Duncan Bros. & Co. Ltd.,* (1983) 140 ITR 335, 342 (Cal), medical insurance policies were taken out by the assessee-company on the individual life of its employees and premia was paid. It was held that the premia so paid did not result directly or indirectly in the provision of any benefit, amenity or perquisite to the employees within the meaning of the then section 40(*c*)(*iii*) of the 1961 Act and could not be taken into account in computing the amount disallowable under that section. Also see, *Simon Carves India Ltd. v. CIT,* (1983) 141 ITR 712 (Cal); *CIT v. Alkali & Chemical Corpn. of India Ltd.,* (1986) 158 ITR 58 (Cal).

Similarly, expenditure incurred on repairs of the flats let out to assessee's employees cannot be said to have conferred any benefit, etc., to the employees within the meaning of the then section 40(*c*)(*iii*) of the 1961 Act [*CIT v. Davidson of India Pr. Ltd.,* (1984) 148 ITR 544 (Cal)]. Also see, *CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 169 ITR 324 (AP); *CIT v. Johnson Pumps* (*India*) *Ltd.,* (1988) 172 ITR 333 (Cal). In *CIT v. Simon Carves* (*I.*) *Ltd.*, (1990) 184 ITR 301 (Cal), the expenses incurred by the assessee for the maintenance of bungalows taken on rent for the use by the employees for their residence were held not to result in the provision of any "benefit or amenity or perquisite" to such employees within the meaning of section 40(*c*)(*iii*) of the 1961 Act.

Similarly, amounts paid as bonus and medical expenses of employees were held not perquisites within the meaning of section 40(*c*)(*iii*) of the 1961 Act [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 169 ITR 324 (AP)]. So also, depreciation in respect of furniture provided by the assessee and in respect of building owned by the assessee could not be disallowed under section 40(*c*)(*iii*) of the 1961 Act [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 169 ITR 324 (AP)]. **But**, expenses incurred on replacement of crockery and cutlery to the employees were held to be a 'perquisite' within the meaning of section 40(*c*)(*iii*) of the 1961 Act [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 169 ITR 324 (AP)].

In *CIT v. Kores India Pr. Ltd.*, (1989) 176 ITR 500 (Bom), the cash payments made by the assessee-company to its employees in the form of car allowance, *ex gratia* payments, insurance premium, house rent allowance, etc., were held not to be covered by the expression 'benefit or amenity or perquisite, whether convertible into money or not' occurring in section 40(*c*)(*iii*) of the 1961 Act. Also see, *CIT v. Crompton Greaves Ltd.,* (1990) Tax LR 292 (Bom); *CIT v. Vulcan Laval Ltd.,* (1991) 188 ITR 453 (Bom). Similarly, in *CIT v. Automobile Products of India Ltd.*, (1991) 190 ITR 647, 648 (Bom), it has been held that cash allowances such as entertainment allowance, car allowance and house rent allowance were not to be covered by the expression 'benefit or amenity or perquisite' employed in section 40(*c*)(*iii*) of the 1961 Act. Also see, *CIT v. Alembic Distributors Ltd.,* (1991) 191 ITR 58, 59 (Bom); *CIT v. Mafatlal Gagalbhai & Co. Pvt. Ltd.,* (1991) 192 ITR 169, 170 (Bom); *CIT v. Bombay Dyeing & Manufacturing Co. Ltd.,* (1992) 193 ITR 250, 251 (Bom); *CIT v. New India Industries Ltd.,* (1993) 201 ITR 208, 224 (Guj); *CIT v. Mafatlal Fine Spg. & Mfg. Co. Ltd.,* (1993) 112 CTR (Bom) 14, 15; *CIT v. Atul Drug House Ltd.,* (1993) 112 CTR (Bom) 393, 394; *CIT v. Birla Bros.* (*P.*) *Ltd.,* (1993) 68 Taxman 291, 293 (Cal).

The words 'seven thousand five hundred rupees or less' in the 2nd proviso to section 40(*c*)(*iii*) of the 1961 Act would include a *nil* amount as well and these could not be understood to mean from Re. 1 to ₹ 7,500. The benefit of the above proviso is also to be given in a case where no part of the amount paid is chargeable under the head 'Salaries'. In that view of the matter, the value of the perquisite paid to the employees of the assessee's overseas branches [*Bombay Burmah Trading Corpn. Ltd. v. CIT,* (1984) 145 ITR 793 (Bom); *Bombay Burmah Trading Corporation Ltd. v. CIT,* (1991) 188 ITR 122 (Bom), **affirmed in** *CIT v. Bombay Burmah Trading Corporation*, (2000) 242 ITR 298, 300 (SC), where, **following** *CIT v. Continental Construction Ltd.*, (1998) 230 ITR 485 (SC), **followed in** *CIT v. Modi Industries Ltd.*, (2010) 327 ITR 570 (Del), it has been held that the provisions of section 40(*c*)(*iii*)/40(*a*)(*v*) of the 1961 Act did not apply in the case of employees of the assessee in its overseas branches]; or perquisite given to a foreign technician whose salary income was exempt under section 10(6)(*vii*) of the 1961 Act [*CIT v. Borosil Glass Works Ltd.,* (1986) 161 ITR 286 (Bom); *CIT v. Indopol Ltd.,* (1988) 169 ITR 367 (Bom)], could not be disallowed. This view finds support in *CIT v. Brakes India Ltd.*, (1993) 201 ITR 647, 649-50 (SC), **affirming on this point** *Addl. CIT v. Brakes India Ltd.,* (1979) 118 ITR 820 (Mad), a case concerning section 40(*c*)(*iii*) of the 1961 Act]. Also see, *CIT v. Bombay Burmah Trading Co.,* SLP (Civil) Nos. 7901-7904 of 1994: (1994) 207 ITR (St.) 29 (SC).

The term "salary", occurring in section 40(*c*)(*iii*) of the 1961 Act, could not be construed in a restricted or unrealistic manner. All payments or rewards [such as, bonus, commission allowance and special allowances, prizes and *ex gratia* payments] given to the employees for work done by them or in appreciation of good work done which had brought profit and prosperity to the employer concerned, and aiming at to induce them to do such good work in future, form part and come within the scope of "salary" to the employee [*CIT v. Kores India Pr. Ltd.,* (1989) 176 ITR 500, 502-03 (Bom)]. Personal allowance does not form part of 'salary' under rule 2(*h*) of Part A of the Fourth Schedule to the 1961 Act and such personal allowance cannot form part of 'salary' for

the purpose of computing the disallowance under section 40(*c*)(*iii*) of the 1961 Act [*CIT v. Champarun Sugar Works Ltd.,* (1997) 225 ITR 863, 866-67 (All)].

It is to be noted that the entire **sub-clause (*iii*)** has been **omitted** by **the Finance Act, 1968** (19 of 1968), **with effect from 1-4-1969**.

Analysis of omitted section 40(*a*)(*v*) of 1961 Act.—In the place of the then section 40(*c*)(*iii*), **section 40(*a*)(*v*) of the 1961 Act** was **inserted** by **the Finance Act, 1968** (19 of 1968) and it was **omitted** by **the Finance (No. 2) Act, 1971** (32 of 1971). Thus, the provisions remained in operation for assessment years 1969-70 to 1971-72.

The abovesaid provision was introduced with a view to check the deductible expenditure incurred by assessees (including companies) in providing amenities, benefits and perquisites to their higher paid employees. The said section was indeed an improvement upon section 40(*c*)(*iii*) of the 1961 Act [operative for assessment years 1963-64 to 1968-69] which preceded it [*CIT v. Mafatlal Gangabhai & Co.* (*P.*) *Ltd.,* (1996) 219 ITR 644, 649 (SC)]. Section 40A(5) of the 1961 Act [operative for assessment years 1972-73 to 1988-89] was yet a further improvement of the said section 40(*a*)(*v*) of the 1961 Act.

In this regard, the following *Circular No. 80, dated 4-3-1972:* (1972) 84 ITR (St.) 4, **as corrected by** *Circular No. 84, dated 23-5-1972*: (1972) 84 ITR (St.) 94 was relevant:—

"*Benefit, amenity or perquisite allowed to employees by companies—Restrictions imposed by section 40*(*c*)(*iii*) *as substituted* (*sic.*) *by section 40*(*a*)(*v*) *of the Income-tax, Act, 1961.*—Under section 40(*c*)(*iii*) of the Income-tax Act, 1961, any expenditure incurred by a company after 29-2-1964, which results directly in the provision of any benefit or amenity or perquisite, whether convertible in money or not, to an employee (including any sum paid by the company in respect of any obligation which but for such payment would have been payable by such employee) would be admissible as a deduction in computing the company's income, only to the extent of 1/5th of the amount of salary payable to the employee. Section 40(*c*)(*iii*) was replaced by section 40(*a*)(*v*) with effect from assessment year 1969-70 and was applicable to all assessee-employers, not restricted to companies only.

2. The question for consideration is whether the benefits given to the employees in the form of provision of medical facilities or reimbursement of medical expenses, electricity, gas, gardener, rent-free accommodation, motor-car and bonus or commission should form part of the 'salary' or whether they fall in the category of 'perquisite, amenity or benefit'. For the purpose of section 40(*c*)(*iii*)/40(*a*)(*v*), the term 'salary' has to be taken as per the definition given in rule 2(*h*) of Part A of the Fourth Schedule to the Income-tax Act, 1961. According to that definition the term 'salary' includes dearness allowance and perquisites.

3. All payments in the form of benefits or amenities such as reimbursement of medical expenses, provision of electricity, water, gas at the residence of the employees, payment of club bills of employees, provision of domestic servants, gardeners, etc., would be part of 'perquisite' which would be restricted to one-fifth in the assessment of the employer. The list of perquisites given above is only illustrative and by no means exhaustive.

4. As regards the payment of bonus, the Board are advised that the payment of bonus will be treated as salary in the following types of cases:—

(*a*) Payment of bonus made under a service agreement between the employer and the employee;

(*b*) Bonus paid pursuant to requirement of Payment of Bonus Act, 1965. In such a case the service agreement may be treated to have been modified to that extent;

(*c*) Where the bonus is paid in accordance with the decision of a trade association; and

(*d*) Bonus paid under an award by a Labour Tribunal where the award is binding on the employer and the employees.

If the bonus is paid gratuitously without there being any legal or contractual obligation, the payment is in the nature of a perquisite and has, among other perquisites, to be linked to 1/5th of the salary for allowance under section 40(*c*)(*iii*)/40(*a*)(*v*) of the 1961 Act.

As regards payment of commission to the employees, the question whether it forms part of 'salary' or 'perquisite' has to be decided on the facts of each case. If the terms and conditions of service are such that commission is paid not as a bounty or benefit but is paid as part and parcel of the remuneration for services rendered by the employee, such payment may partake of the nature of salary[1] rather than as a benefit or perquisite. If, however, on the terms and conditions of service either there is no obligation for the employer to pay the commission or it is a matter purely in the discretion of the employer, such payment should be treated as a benefit by way of addition to salary rather than in lieu of salary.

1. This view finds support in *Gestetner Duplicators Pr. Ltd. v. CIT,* (1979) 117 ITR 1 (SC).

LexisNexis

These instructions are issued in **supersession** of Board's Circular No. 62, dated 29-9-1971 [2][F. No. 13A/103/69-IT (A-II)] and in **modification** of Board's Circular No. 32, dated 29-10-1969 [3][F. No. 10/93/68-IT (A-II)] and may please be brought to the notice of all the Income-tax Officers working in your charge."

In *CIT v. Vickers Sperry of India Ltd.*, (1993) 201 ITR 637, 639 (Bom), the Tribunal was held justified in holding, on the basis of the departmental circular No. 32, dated 29-10-1969, that rent-free accommodation and cash house rent allowance provided by the assessee-company to its employees under the terms of the contract of employment were not perquisites within the meaning of the then section 40(*a*)(*v*) of the 1961 Act.

In *CIT v. Indian Engineering & Commercial Corporation P. Ltd.*, (1993) 201 ITR 723, 728-29 (SC), although their Lordships have extracted (without giving circular number and date) the penultimate paragraph of the departmental circular No. 80, dated 4-3-1972, they thought it not necessary to make any comment on the said portion of the circular.

"Such" employee in the latter part of section 40(a)(v) of 1961 Act.—In *CIT v. Travancore Tea Estates Co. Ltd.*, (1980) 122 ITR 557 (Ker), the Kerala High Court took the view that the adjective "such" in the expression "such employee" in the latter part of section 40(*a*)(*v*) referred to the employee referred to in the earlier part of that section, implying the employee who had had some benefit or amenity arising out of the expenditure in question. In that case, the assessee-company incurred expenditure on the maintenance and upkeep of its building provided free of charge to its employees. As no benefit had accrued to the employee by this expenditure of the company, it was held that the expenditure was not hit by section 40(*a*)(*v*).

The *Travancore Tea Estates* case [122 ITR 557 (Ker)] has been **overruled** by a Full Bench of the Kerala High Court in *CIT v. Forbes, Ewart and Figgis P. Ltd.*, (1982) 138 ITR 1 (Ker—FB), **SLP granted**: (1984) 146 ITR (St.) 7-8 (SC), where it was held that "such employee" in the second limb of section 40(*a*)(*v*) of the 1961 Act may be any employee, not necessarily the one who had had gained the benefit. In that view of the matter, the expenditure incurred by the assessee on the maintenance of its building provided free of charge to its employees was held hit by section 40(*a*)(*v*) of the 1961 Act.

The above view of the Kerala Full Bench [138 ITR 1 (Ker—FB)] has been **affirmed** by the Supreme Court in *C.W.S.* (*India*) *Ltd. v. CIT*, (1994) 208 ITR 649, 655-57 (SC) holding that the mere use of the word 'such' in the second limb of section 40(*a*)(*v*) of the 1961 Act should not have the effect of driving the court to place an interpretation upon the first and second limbs which is not only discriminatory but is highly incongruous. While literal construction may be the general rule in construing taxing enactments, it does not mean that it should be adopted even if it leads to a discriminatory or incongruous result. Interpretation of statutes cannot be a mechanical exercise. The object of all the rules of interpretation is to give effect to the object of the enactment having regard to the language used. It is a well-recognised rule of interpretation of statutes that where a literal interpretation leads to an absurd or unintended result, the language of the statute can be modified to accord with the intention of Parliament and to avoid absurdity. In that view of the matter, the expression 'such employee' in the second limb of section 40(*a*)(*v*) of the 1961 Act does not mean only an employee referred to in the first limb of that section 40(*a*)(*v*) of the 1961 Act.

It may be noted that section 40A(5)(*a*) of the 1961 Act does not employ the adjective "such". Instead, it uses, in its both sub-clauses (*i*) and (*ii*), the expression "an employee". In other words, so far as section 40A(5) of the 1961 Act is concerned, the aforesaid controversy does not and cannot arise for the reason that the second part of section 40A(5)(*a*)(*ii*) of the 1961 Act does not use the words 'such employee' but uses the words 'an employee'. It is not without significance that while substantially repeating the provision in section 40(*a*)(*v*) of the 1961 Act in section 40A(5)(*a*)(*ii*) of the 1961 Act, Parliament has taken care to substitute the word 'such' with the word 'an' [*C.W.S.* (*India*) *Ltd. v. CIT,* (1994) 208 ITR 649, 657 (SC)].

Limitation on allowability of salary placed [omitted s. 40A(5) of 1961 Act].—Section 40A(5) of the 1961 Act was **inserted** (**w. e. f. 1-4-1972**) by **the Finance (No. 2) Act, 1971** (32 of 1971) and remained operative **up to assessment year 1988-89**. Under that section, expenditure incurred by an assessee on payment of salary to an employee was not to be allowed as deduction in computing the taxable profits to the extent it exceeded an amount calculated at the rate of ₹ 7,500 [(**up to assessment year 1984-85**) ₹ 5,000] for each month or part thereof comprised in the period of his employment in India. Similarly, expenditure incurred by the assessee on payment of salary to a former employee, *i.e.*, an individual who ceases or ceased to be the employee of the assessee during the previous year or any earlier previous year, was not to be allowed as deduction in computing the taxable profits to the extent it exceeded ₹ 90,000 [(**up to assessment year 1984-85**) ₹ 60,000] for the year.

The ceiling fixed under section 40A(5) of the 1961 Act, for the purpose of disallowance of expenditure incurred by the assessee in paying remuneration to the employees, is in respect of remuneration paid to each

2. For the text of the Circular, see, (1971) 81 ITR (St.) 47.
3. For the text of the Circular, see, (1971) 81 ITR (St.) 47-48.

employee separately, and there cannot be any cumulative disallowance by clubbing the allowance paid to a number of employees [*Mihir Textiles Ltd. v. CIT,* (1997) 225 ITR 327, 334 (Guj)].

On a perusal of **section 40A(5)(*c*)(*i*) of the 1961 Act**, it was apparent that limits were fixed under the said section for deductions which could be claimed in respect of payments to an employee as also a former employee. The section itself indicated that an employee who retired during a particular previous year would be a former employee. Therefore, it was possible for a person to be an employee for a part of the relevant previous year, *i.e.*, up to the date of his retirement. For that period, he was to be treated as an employee and all payments made to him as an employee would be allowed as a deduction within the permissible monthly limit. After that period, when such an employee retired, he was to be treated as a former employee and payments made to him as a former employee again ought to be deductible within the permissible limit. Any other construction of the said section under which such an employee was treated only as an 'employee' or as a 'former employee' in the year in question would render one part of the said section or the other nugatory [*Hindustan Motors Ltd. v. CIT*, (1985) 156 ITR 223, 227 (Cal), **overruled, on this point, in** *Mercantile Bank Ltd. v. CIT*, (2006) 283 ITR 84 (SC)]. In that case, the assessee-company paid to its employee, who retired with effect from 1st September, 1973, a sum of ₹ 22,000 as salary for 5 months and a sum of ₹ 61,600 on account of retirement benefits including gratuity. It was held that the sum of ₹ 22,000 was fully allowable being within the limit (5×5000) prescribed in the former part of section 40A(5)(*c*)(*i*) of the 1961 Act. Out of ₹ 61,600, a sum of ₹ 1,600 was hit by the latter part of section 40A(5)(*c*)(*i*) of the 1961 Act and could be disallowed. The Calcutta decision [156 ITR 223 (Cal)] has been **followed in** *Jeewanlal* (*1929*) *Ltd. v. CIT*, (1991) 187 ITR 709, 714-15 (Cal); *CIT v. Hindusthan Motors Ltd.*, (1991) 192 ITR 619, 628 (Cal).

Dissenting from *Hindustan Motors Ltd. v. CIT*, (1985) 156 ITR 223 (Cal) and *Jeewanlal* (*1929*) *Ltd. v. CIT*, (1991) 187 ITR 709 (Cal), it has been held, in *CIT v. Mercantile Bank Ltd.*, (1999) 237 ITR 676, 682-83 (Bom) that where an employee ceases to be an employee during the relevant previous year, the aggregate limit of ₹ 90,000 prescribed in section 40A(5)(*c*)(*i*) of the 1961 Act applies. Therefore, the status of the person on the last date of the relevant previous year is crucial. In other words, the maximum allowable deduction is only ₹ 90,000. Under section 40A(5)(*c*)(*i*) of the 1961 Act, the expression 'employee' comes within the definition of the expression 'former employee'. As a former employee, the terminal benefits by way of gratuity paid to him by the assessee come within the definition of the word 'salary' and, therefore, the total amount including his salary and gratuity cannot exceed ₹ 90,000. In fact, the figure of ₹ 7,500 in the case of an employee in service and the figure of ₹ 90,000 in the case of a former employee read with the meaning of the word 'salary', as given in section 17(1) of the 1961 Act, clearly shows that salary for the purposes of disallowance under section 40A(5) of the 1961 Act includes terminal benefits like gratuity. This is particularly in view of section 17(1)(*iii*) of the 1961 Act. The Bombay decision [237 ITR 676 (Bom)] has been **affirmed, on this point, in** *Mercantile Bank Ltd. v. CIT*, (2006) 283 ITR 84 (SC) and **followed in** *Dorr-Oliver* (*India*) *Ltd. v. CIT*, (2009) 316 ITR 409 (Bom).

The **above controversy** has been **set at rest** by the Supreme Court in *Mercantile Bank Ltd. v. CIT*, (2006) 283 ITR 84 (SC). It has been held that under section 40A(5) of the 1961 Act, only one limit is prescribed for deduction on account of salary, whether paid to an employee in service or a retired employee, in any one previous year. Section 40A(5)(*c*)(*ii*) of the 1961 Act speaks of an 'amount' indicating that the employer is only entitled to deduction of one amount. Section 40A(5)(*c*)(*i*) of the 1961 Act also speaks of an employee as being not only one who has ceased to be in employment, but one who ceases to be in employment. In respect of the latter, it is assumed that the employee served for a period but ceases to be so employed during the previous year in question. In such a case, the section expressly provides for a limit on the deduction of ₹ 60,000. In terms of section 17 of the 1961 Act, there is only one limit for all salary whatever it may be comprised of whether wages or terminal benefits. The use of the word 'aggregate' in section 40A(5) of the 1961 Act been uncalled for as section 40A(5) of the 1961 Act speaks of an 'amount' and 'salary' indicating a single payment and the word 'aggregate' might be appropriate in relation to section 40A(6) of the 1961 Act [*Mercantile Bank Ltd. v. CIT*, (2006) 283 ITR 84, 90, 90-91, 91, 92 (SC), **overruling** *Hindustan Motors Ltd. v. CIT*, (1985) 156 ITR 223 (Cal) and **affirming** *CIT v. Mercantile Bank Ltd.*, (1999) 237 ITR 676 (Bom)]. Thus, the two separate limits could not be applied for computing disallowance under section 40A(5) of the 1961 Act *qua* an employee who retires and *qua* an employee who ceases to be in the employment during the previous year [*CIT v. Citibank N.A.*, (2003) 264 ITR 18, 20-21 (Bom)].

In *CIT v. Hindustan Petroleum Corporation Ltd.*, (1991) 187 ITR 1, 13-14 (Bom), the assessee, whose previous year consisted of 15 months, was held entitled to the limit of the allowances of expenditure under section 40A(5)(*c*)(*i*) of the 1961 Act in the case of a former employee to the extent of ₹ 75,000 (60,000 × 15/12) for assessment year 1978-79 even though that section fixed a limit of ₹ 60,000 without reference to the period during which the person concerned remained the former employee of the assessee.

Where the limitations of section 40A(5) of 1961 Act had no application.—It was further provided that the limitations under section 40A(5) of the 1961 Act were not to apply in the following cases:—

(*i*) Payments to an employee in respect of any period of his employment outside India.

Where a person, who was employed by the assessee in India, sent to a foreign country in connection with the assessee's business there, it could not be said that during the period he was in foreign country, he was employed outside India so as to attract the exception [*McGaw-Ravindra Laboratories* (*India*) *Ltd. v. CIT,* (1994) 210 ITR 1002, 1007-08 (Guj)].

(*ii*) Payments to foreign technicians who are entitled to exemption from tax on their remuneration under section 10(6)(*vii*) or section 10(6)(*viia*) of the 1961 Act.

Following *CIT v. Lucas TVS Ltd.*, (1997) 226 ITR 281 (Mad), it has been held that the ceiling provided under section 40A(5) of the 1961 Act is not applicable to the extent of remuneration that is exempt under section 10(6)(*vii*) of the 1961 Act or to the extent of the tax payable to the employees by the employer which is exempt under section 10(6)(*vii*) of the 1961 Act and to the extent to which it is exempt, the remuneration should be excluded altogether for the purpose of determining the ceiling under section 40A(5) of the 1961 Act [*CIT v. Indo National Ltd.*, (1999) 239 ITR 526, 527-28 (Mad)]. In other words, it is not the entire remuneration paid to the foreign technicians which is not to be taken into account for the purposes of section 40A(5) of the 1961 Act, but only that portion of such remuneration which is exempt under section 10(6)(*vii*) or 10(6)(*viia*) of the 1961 Act is to be excluded for the purpose of determining the ceiling under section 40A(5) of the 1961 Act [*Lucas TVS Ltd. v. CIT*, (1999) 239 ITR 534, 535-36 (Mad)]. Also see, *CIT v. Seshasayee Industries Ltd.*, (2000) 242 ITR 691, 694 (Mad).

(*iii*) Payments to any employee whose income chargeable under the head "Salaries" does not exceed ₹ 7,500. This may also include a case where the entire salary income of an employee is exempt [see, *Addl. CIT v. Brakes India Ltd.,* (1979) 118 ITR 820 (Mad), **affirmed, on this point, in** *CIT v. Brakes India Ltd.*, (1993) 201 ITR 647 (SC); *CIT v. Coromandel Fertilisers Ltd.,* (1985) 156 ITR 283 (AP), **SLP granted**: (1991) 187 ITR (St.) 35 (SC); *CIT v. Borosil Glass Works Ltd.,* (1986) 161 ITR 286 (Bom); *Inaroo Ltd. v. CIT,* (1993) 204 ITR 312, 315 (Bom)].

"Salary", defined.—For the purposes of section 40A(5) of the 1961 Act, "salary", as defined in *Explanation 2(a)(1)* to section 40A(5) of the 1961 Act, was defined broadly on the lines of the provisions of section 17(1) of the 1961 Act subject to certain modifications. The expression "salary", for the above purpose, **included** wages, any annuity or pension, any gratuity, any fees, commission[4] or profits in lieu of, or in addition to, any salary or wages; any advance of salary and the annual accretion to the balance to the credit of an employee participating in a recognised provident fund to the extent it is chargeable to tax. It **did not**, however, **include** perquisites and the sums transferred from the account of the employee in an unrecognised provident fund to a recognised provident fund.

LexisNexis

'Salary', here, did not include the gratuity which is exempt under section 10(10) of the 1961 Act. In other words, gratuity in excess of exemption under section 10(10) of the 1961 Act alone was required to be considered for disallowance for the purpose of section 40A(5) of the 1961 Act [*CIT v. Hindustan Petroleum Corporation Ltd.,* (1991) 187 ITR 1, 15-16 (Bom), **followed in** *CIT v. John Wyeth & Bros. Ltd.,* (1998) 143 Taxation 395, 396 (Bom)].

In *CIT v. Colgate Palmolive* (*India*) *Pvt. Ltd.*, (1994) 210 ITR 770, 781, 782 (Bom), it has been held that in the context of section 40A(5) of the 1961 Act, 'salary' could not be considered as including a one-time payment in the nature of retirement gratuity. Therefore, since the payment of gratuity at the time of retirement, could not be looked upon as a periodic payment, it was not covered by the provisions of either section 40(*c*) or section 40A(5) of the 1961 Act. The ceiling prescribed under the above two sections on allowable expenditure would not apply to such payment. Also see, *Sapt Textile Produces* (*India*) *Ltd. v. CIT,* (1996) 217 ITR 378, 380 (Bom); *CIT v. Fenner* (*India*) *Ltd.,* (1998) Tax LR 555, 558 (Mad) = (2000) 241 ITR 645, 651 (Mad); *CIT v. Macneill Magore Ltd.,* (1998) 232 ITR 945, 948 (Cal). **Following this view**, in *CIT v. Century Spng. & Mfg. Co. Ltd.*, (1994) 210 ITR 783, 785-86 (Bom), the Tribunal was held justified in holding that the amount of gratuity exempt under section 10(10) of the 1961 Act should be excluded and the excess of gratuity alone should be taken for the purposes of the disallowance under section 40A(5) of the 1961 Act. Similar view has also been taken in *CIT v. Birla Cotton Spng. & Wvg. Mills Ltd.*, (1992) 104 CTR (Cal) 406, 408, **SLP dismissed**: (1993) 204 ITR (St.) 7-8 (SC), where it has been held that in calculating the salary and perquisites for the purpose of section 40A(5) of the 1961 Act, the amount of gratuity exempt under section 10(10) of the 1961 Act should be excluded. Also see, *CIT v. Bharat Sugar Mills Ltd.,* (1992) 107 CTR (Cal) 306, 308; *Scindia Steam Navigation Co. Ltd. v. CIT,* (1995) 211 ITR 747, 751 (Bom); *Fenner* (*India*) *Ltd. v. CIT*, (2000) 241 ITR 797, 801 (Mad).

In view of the above judicial pronouncements, the **contrary view,** taken by the Calcutta High Court in *Indian Oxygen Ltd. v. CIT*, (1987) 164 ITR 466, 478 (Cal) to the effect that the Tribunal was right in confirming the

4. Refer, *Hira Lall & Sons v. CIT,* (1991) 190 ITR 408, 410-11 (Del).

treatment of gratuity exempt under section 10(10) of the 1961 Act as 'salary' for the purpose of disallowance under sections 40(*c*) and 40A(5) of the 1961 Act, **is not a correct view on the point**.

In *CIT v. Citibank N.A.*, (2003) 264 ITR 18, 20 (Bom), it has been held that the word 'salary' in section 40A(5)(*a*)(*i*) of the 1961 Act would cover retirement benefits like pension as also encashment of earned leave. Thus, the payment of leave salary to retiring employees constituted 'salary' as defined in *Explanation 2* to section 40A(5) of the 1961 Act [*CIT v. Alembic Glass Industries Ltd.*, (2005) 279 ITR 331, 339 (Guj)].

For the purpose of the predecessor section 40(*a*)(*v*) and/or section 40(*c*)(*iii*) of the 1961 Act, the expression "salary" included dearness allowance, if the terms of employment so provided, but excluded all other allowances and perquisites. Here, bonus was held to be a part of "salary" [*CIT v. India Radiators Ltd.,* (1976) 105 ITR 680 (Mad). **Contra:** *CIT v. B. Ghosal*, (1980) 125 ITR 744 (Ker); *CIT v. Mysore Commercial Union Ltd.*, (1980) 126 ITR 340 (Karn)]. Thus, for the purposes of section 40A(5) of the 1961 Act, bonus has been held to constitute 'salary' [*Jeewanlal* (*1929*) *Ltd. v. CIT,* (1991) 187 ITR 709, 713-14 (Cal)]. Also see, *CIT v. New India Industries Ltd,* (1993) 201 ITR 208, 226 (Guj).

Cash allowances received by an employee from the employer in his capacity as an employee would be part of the 'salary' paid to the employee for the purpose of computing the disallowance under section 40A(5) of the 1961 Act [*CIT v. Tinplate Co. of India Ltd.,* (1994) 207 ITR 729, 731-32 (Cal)]. Thus, house rent allowance paid to a managing director [*CIT v. Toshiba Anand Lamps Ltd.,* (1984) 145 ITR 563 (Ker); *CIT v. Mahavir Plantations Ltd.,* (1995) 213 ITR 485, 487 (Ker)]; or car allowance paid to the employee for the purpose of repairs to the car [*Travancore Tea Estates Co. Ltd. v. CIT,* (1985) 153 ITR 444, 455 (Ker); *Travancore Tea Estates Co. Ltd. v. CIT,* (1985) 154 ITR 745 (Ker)], do constitute 'salary' within the contemplation of section 40A(5)(*a*)(*i*) of the 1961 Act.

In *I.E.L. Ltd. v. CIT*, (1993) 204 ITR 386, 397 (Cal), it has been held that reimbursement of medical/ hospitalisation expenses and house rent allowance paid in cash should be taken as part of 'salary' for the purposes of section 40A(5)/40(*c*) of the 1961 Act. This view has been **followed in** *Indian Oxygen Ltd. v. CIT,* (1994) 210 ITR 274, 283 (Cal); *CIT v. Mafatlal Gangabhai & Co.* (*P.*) *Ltd.*, (1996) 219 ITR 644 (SC); *Sundaram Clayton Ltd. v. CIT*, (1999) 239 ITR 416 (Mad); *Sundaram Finance Ltd. v. CIT*, (2001) 250 ITR 86, 88 (Mad); *CIT v. Saraspur Mills Ltd.*, (2002) 254 ITR 522, 525 (Guj); *CIT v. Nutan Mills Ltd.*, (2002) 254 ITR 519, 521 (Guj); *EID Parry* (*India*) *Ltd. v. CIT*, (2002) 257 ITR 253, 256-57 (Mad); *CIT v. Gujarat Steel Tubes Ltd.*, (2002) 258 ITR 235, 237 (Guj); *Southern Switchgear Ltd. v. CIT*, (2002) 125 Taxman 44, 45 (Mad); *Rane* (*Madras*) *Ltd. v. CIT*, (2003) 259 ITR 307, 309 (Mad); *Ethnor Ltd. v. CIT*, (2003) 260 ITR 401, 414 (Bom); *CIT v. British Bank of Middle East*, (2004) 265 ITR 31, 34 (Bom). Thus, in *CIT v. Sundaram Fastners Ltd.*, (2000) 244 ITR 741, 742 (Mad), the Tribunal was held not correct in holding that the house rent allowance and medical reimbursement should not be taken into account as a part of the salary in reckoning the disallowance under section 40A(5) of the 1961 Act.

LexisNexis

Further, for the purposes of section 40A(5) of the 1961 Act, "salary", as defined in *Explanation 2(a)(2)* to section 40A(5) of the 1961 Act, was defined broadly on the lines of the provisions of section 17(3) of the 1961 Act subject to modifications that the reference to "assessee" shall be construed as reference to "employee or former employee" and the references to "his employer or former employer" and "an employer or a former employer" shall be construed as references to "the assessee".

In *J.K. Helene Curtis Ltd. v. CIT*, (1999) 236 ITR 403, 405 (Bom), the Tribunal was held right in holding that the amount of ₹ 1,00,000 paid to one JK at the time of his leaving the assessee-company was 'profit in lieu of salary' under section 17(3)(*i*) of the 1961 Act and thereby disallowing the same under section 40A(5) of the 1961 Act. So much so, compensation paid for premature retirement has been held to amount to 'profits in lieu of salary' and, therefore, the same was 'salary' attracting the limits of section 40A(5) of the 1961 Act.

Limitation on perquisites.—Section 40A(5) of the 1961 Act further imposed certain restrictions on the deductible amount of expenditure which was incurred for providing any perquisites, whether convertible into money or not, to an employee and the amount of expenditure or allowance (such as depreciation allowance) in respect of assets used by an employee for his own purpose or benefit. The aggregate of the expenditure or allowance under these heads that could be allowed as deduction in computing the taxable profits was limited to 20% of the amount of salary payable or an amount calculated at the rate of ₹ 1,000 for each month or part thereof comprised in the period of employment of the employee in India during the relevant previous year, whichever was less. Thus, there may be justification in disallowing the deduction of the value of perquisites in excess of the 1/5th of the salary paid to the employee [*Beco Engineering Co. Ltd. v. CIT,* (1998) 143 Taxation 333, 338 (Punj)]. For this purpose, the expression "perquisite" was defined to mean:—

(*i*) the value of rent-free accommodation provided to the employee by the assessee;

(*ii*) the value of any concession in the matter of rent respecting any accommodation provided to the employee by the assessee;

(*iii*) the value of any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessee;

(*iv*) any sum paid by the assessee in respect of any obligation which, but for such payment, would have been payable by the employee; and

(*v*) any sum paid by the assessee whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund, to effect an assurance on the life of the employee or to effect a contract for an annuity.

Interpreting the provisions of section 40(*a*)(*v*) of the 1961 Act, it was held that in order to attract the latter part of that section it was necessary that the employer should have incurred an expenditure or should have been granted an allowance in respect of any of its assets for use by its employees. Where an employer allowed his employees free residence in the quarters and in doing so incurred no expenditure at all, and the position of the employees in residing in these quarters was that of the licensees of the assessee, the fair annual rent calculated on a notional basis could not be treated as an expenditure or an allowance for the purposes of disallowance under section 40(*a*)(*v*) of the 1961 Act [*CIT v. Hind Lamps Ltd.,* (1980) 122 ITR 451 (All)]. The **position was changed** with the enactment of section 40A(5) of the 1961 Act. There, the definition of the expression "perquisite" expressly took in "rent-free accommodation provided to the employee by the assessee". Therefore, rent-free accommodation, as "perquisite", attracted section 40A(5)(*a*) of the 1961 Act. Thus, the provision of accommodation to the employee of the assessee in the premises belonging to the assessee amounted to a 'perquisite' as defined in *Explanation 2*(*b*)(*ii*) to section 40A(5) of the 1961 Act [*CIT v. Empire Dyeing & Manufacturing Co. Ltd.,* (1991) 192 ITR 245, 247 (Bom)].

In other words, a reading of the provisions of section 40A(5) of the 1961 Act makes it clear that all expenditure incurred by the assessee which results directly or indirectly in the provision of any perquisite to an employee or use of any asset by an employee is to be taken into account for computing the value of disallowance and even rent free accommodation provided to the employee is treated to be a perquisite [see, *Cawnpore Textiles Ltd. v. CIT*, (2005) 276 ITR 612, 620 (All)].

Regard being had to the object of the provision, it was evident that the control was on the amount expended on the asset which was used by the employee for his own benefit to the extent he used it for his personal purposes. If such use by the employee was to the extent of 1/3rd, it was only the 1/3rd of the expenses that would call for application of the limit of section 40A(5)(*c*)(*ii*) of the 1961 Act [*CIT v. Forbes, Ewart and Figgis* (*P.*) *Ltd.,* (1982) 138 ITR 1, 13 (Ker—FB). The Kerala decision [138 ITR 1 (Ker)] has been **followed in** *CIT v. Malayalam Plantations Ltd.*, (1987) 168 ITR 63 (Ker); *Harrisons Malayalam Ltd. v. CIT*, (1990) 183 ITR 585 (Ker); *Harrisons Malayalam Ltd. v. CIT*, (1995) 124 CTR (Ker) 179, 180. It is pertinent to note that Kerala Full Bench decision [138 ITR 1 (Ker—FB)] has been **affirmed** by the Supreme Court in *C.W.S.* (*India*) *Ltd. v. CIT*, (1994) 208 ITR 649, 657 (SC) on the aspect of interpretation of the expression 'such employee' as employed in the second limb of the then section 40(*a*)(*v*) of the 1961 Act, which expression finds a place in a modified form 'an employee' in section 40A(5)(*a*)(*ii*) of the 1961 Act. In the said case [208 ITR 649 (SC)], the Supreme Court has also **affirmed** the decision of the Kerala High Court in *Periakaramalai Tea & Produce Co. Ltd. v. CIT*, (1993) 199 ITR 100 (Ker) on the point that the Tribunal was right in confirming the order of the first appellate authority holding that the entire expenditure incurred on the maintenance of bungalows and 1/3rd of the expenditure incurred on the maintenance of motor cars were includible in the computation of disallowance under section 40A(5) of the 1961 Act.

Where the employer's asset is used by the employee for his own purposes, the provisions of section 40A(5) of the 1961 Act attracted, the fact that the assessee-employer collected fair rent (at the rate of the municipal value) could not be a fetter in applying such provisions. In that view of the matter, the entire expenditure incurred by the assessee-employer for the maintenance of the building given for the residence of the employees and the depreciation thereon could be taken into account for the purposes of disallowance under section 40(*a*)(*v*)/40A(5) of the 1961 Act, notwithstanding collection of fair rent from the employees [*Harrisons & Crossfield* (*India*) *Ltd. v. CIT,* (1990) 183 ITR 614, 617-18 (Ker); *Harrisons Malayalam Ltd. v. CIT,* (1990) 183 ITR 622 (Ker); *Malayalam Plantations* (*India*) *Ltd. v. CIT,* (1990) 184 ITR 505 (Ker); *CIT v. Travancore Tea Estates Co. Ltd.,* (1990) 184 ITR 529 (Ker), **SLP granted**: (1993) 204 ITR (St.) 11 (SC)]. Also see, *Harisson Malayalam Ltd. v. CIT,* SLP (Civil) Nos. 12085-12088 of 1985: (1990) 186 ITR (St.) 72 (SC); *Periakaramalai Tea & Produce Co. Ltd. v. CIT,* SLP (Civil) No. 16301 of 1985: (1991) 187 ITR (St.) 154 (SC); *Malayalam Plantations* (*I.*) *Ltd. v. CIT,* SLP (Civil) No. 309 of 1986: (1991) 187 ITR (St.) 158 (SC). In the facts of *CIT v. Vazir Sultan Tobacco Co. Ltd.*, (1988) 173 ITR 290 (AP), the buildings owned by the assessee and allowed to be occupied by some high-paid employees were treated as the business assets of the assessee for the purposes of section 40A(5) of the 1961 Act.

Though depreciation on furniture, flat, air-conditioners and refrigerators could not be treated as an expenditure resulting in the provision of any perquisite, it was liable to be considered as an allowance in respect

of the assets of the assessee used by the employee. In that view of the matter, it would fall within the purview of section 40A(5)(*a*)(*ii*) of the 1961 Act and the limit specified in section 40A(5)(*c*)(*ii*) of the 1961 Act shall apply [*CIT v. Birla Consultants Ltd.,* (1994) 206 ITR 458, 462 (Bom), **applying** *CIT v. Yorkshire Insurance Co. Ltd.,* (1986) 162 ITR 565, 568 (Bom)]. This is so because the expression 'allowance' in the then section 40(*a*)(*v*) and section 40A(5)(*a*)(*ii*) of the 1961 Act takes in depreciation allowance and the ceiling on expenditure provided under these provisions applies also to depreciation allowance on all assets belonging to the employer-assessee used by an employee [*C.W.S.* (*India*) *Ltd. v. CIT,* (1994) 208 ITR 649, 657 (SC); *Cawnpore Textiles Ltd. v. CIT*, (2005) 276 ITR 612, 620 (All)]. **However**, their Lordships of the Supreme Court declined to go into the question whether repairs to assets of the assessee used by an employee is not to be included in the expenditure referred to in the said provisions as such question was neither referred to the High Court nor answered by it.

In *South India Corporation Agencies P. Ltd. v. CIT*, (1998) 147 CTR (Mad) 476, 482-83 = (1999) 239 ITR 305, 311-12 (Mad), the expenditure incurred by the company on the house used by the Deputy Chairman towards electricity charges, depreciation and repairs have been held to be included in arriving at the amount to be disallowed under section 40A(5) of the 1961 Act. However, the expenditure by way of property tax cannot be a subject-matter of ceiling under section 40A(5) of the 1961 Act.

In *CIT v. T.V. Sundaram Iyengar & Sons*, (1998) 148 CTR (Mad) 9, 15-16 = (1999) 235 ITR 491, 498-99 (Mad), it has been held that the expenditure incurred towards rates and taxes paid in respect of the buildings and vehicles owned by the company, maintenance of vehicles and personal accident insurance premium cannot be treated as perquisites for the purposes of disallowance under section 40(*c*)/40A(5) of the 1961 Act. However, expenses like salary paid to watchmen and depreciation allowance on assets used by the directors/employees are to be subjected to the ceiling provided in section 40(*c*)/40A(5) of the 1961 Act. Also see, *CIT v. T.V. Sundaram Iyengar & Sons,* (1998) 148 CTR (Mad) 17, 20 = (2001) 247 ITR 286, 288-89 (Mad).

In *CIT v. Warner Hindustan Ltd.*, (1984) 145 ITR 24 (AP), it was found by the Tribunal as a fact that the employee, when departing on leave, handed over possession of the house to the assessee-company. It was held that the perquisite value of the rent-free accommodation during the period of leave of the employee could not be considered for the purpose of disallowance under section 40A(5) of the 1961 Act. **But** the expenditure incurred by the assessee in the maintenance of its bungalows in which its employees had been permitted to reside free of rent and the depreciation on such bungalows are to be treated as 'perquisites' for the purpose of disallowance under section 40A(5)(*a*)(*ii*) of the 1961 Act [*Travancore Tea Estates Co. Ltd. v. CIT,* (1985) 154 ITR 745 (Ker)].

In *Mather & Platt* (*India*) *Ltd. v. CIT*, (1993) 109 CTR (Cal) 434, 437-38, it has been held that the Tribunal was right in holding that in computing disallowance under section 40A(5) of the 1961 Act, in the case of one of the employees of the assessee, who occupied a flat owned by the assessee for a part of the previous year, the entire amount of depreciation allowed to the assessee should be taken into account and not the depreciation proportionate to the period of occupation by the employee concerned.

Items (*iv*) and (*v*) above indicate that the payment made by the assessee on behalf of its employee either under an obligation or voluntarily must finally enure to the benefit of the employee and he must have a right therein [*CIT v. Amco Batteries Ltd.,* (1984) 150 ITR 48 (Karn)]. In that case, the assessee took accident insurance policy in relation to personal accident or death by accident of some of its employees and paid premia thereon. Under the terms of the policy, the insured was the assessee-company and not the employees. The insured amount was payable to the assessee-company and the employees had no right to claim the amount payable under the policy. It was held that the premia paid could not be treated as a perquisite for the purposes of section 40A(5) of the 1961 Act. Also see, *CIT v. Bharat Ram Charat Ram Pr. Ltd.,* (1986) 157 ITR 199 (Del); *CIT v. J.B. Advani & Co.* (*Mysore*) (*Pr.*) *Ltd.,* (1987) 163 ITR 638 (Karn); *CIT v. Motor Industries Co. Ltd.,* (1988) 173 ITR 374, 386 (Karn); *CIT v. Amco Batteries Ltd.,* (1993) 203 ITR 614, 617 (Karn).

A bare perusal of item (*v*) made it clear that it did not refer to all payments made out of all or any fund. It only referred to payment made by the assessee to effect an assurance on the life of the employee or to effect a contract for an annuity, and not to any other payments. Even such payments are not included in 'perquisite' if the same are made out of recognised provident fund or approved superannuation fund, for the purpose of section 40A(5) of the 1961 Act [*Mihir Textiles Ltd. v. CIT,* (1997) 225 ITR 327, 339 (Guj)].

In *CIT v. Tata Oil Mills Co. Ltd.*, (1990) 182 ITR 130 (Bom), amounts were paid by the assessee-company for the purchase of deferred annuity policies upon the lives of its directors. It was held that the amounts so paid were not 'perquisite' as the directors had no present right to the said amounts.

In *CIT v. Grindlays Bank Plc.*, (2002) 254 ITR 289, 290, 291 (Cal), it has been held that the interest paid by the assessee-bank to its employees has to be included for the purpose of computing the excess amount paid to the employees to be disallowed in terms of section 40A(5) of the 1961 Act.

In *Citibank N.A. v. CIT*, (2003) 262 ITR 47, 50, 54 (Bom), the Tribunal was held right in law in holding that the provisions of section 40A(5) of the 1961 Act should be applied only on that part of the expenditure by way

LexisNexis

of salaries and perquisites, etc., apportioned under the head "Profits and gains of business or profession" and not in respect of such expenditure apportioned under the head "Interest on securities". Also see, *CIT v. Deutsche Bank A.G.*, (2003) 177 Taxation 3, 10 (Bom).

Perquisites, how to be valued?—Section 40A of the 1961 Act represents a complete scheme and it is to be enforced notwithstanding anything to the contrary contained in any other provision of the 1961 Act. Section 40A(5) of the 1961 Act dealt with the question of ascertainment of actual expenses incurred by the assessee-employer for certain types of employees contemplated by that section. Expenditure naturally means actual expenditure under the concerned heads. In this provision, the concept of the value of perquisites is totally absent and rightly so because while finding out the expenses actually incurred by the employer on certain amenities made available to the employees, the cost of such amenities as incurred by the employer can be easily ascertained on factual basis. The amount of these incurred expenses would naturally be within the personal knowledge of the employer. Even as per section 106 of the Evidence Act, the burden will be on the employer to point out as to what amount of actual expenditure he had incurred on the concerned benefits made available to the employee as contemplated by section 40A(5)(*a*) of the 1961 Act. For ascertaining the same, the focus of attention is on the employer-assessee and not on the employee who is not an assessee so far as the aforesaid provision is concerned. It is for this reason that rule 3 of the Rules which deals with an entirely different topic and which focuses its attention not on the employer-assessee but on the employee-assessee gets completely ruled out so far as the applicability of section 40A(5) of the 1961 Act is concerned [*CIT v. Rajesh Textile Mills Ltd.,* (1988) 173 ITR 179, 190 (Guj)]. In that case, it was held that the perquisites in respect of the furnished accommodation given by the assessee to its managing directors should not be worked out on the basis of the relevant provisions of rule 3 of the Income-tax Rules, 1962. In taking the above view, the Gujarat High Court has **not followed** the Calcutta High Court decision in *CIT v. Britannia Industries Co. Ltd.*, (1982) 135 ITR 35 (Cal), where the Calcutta High Court was concerned with the provisions of section 40(*c*)(*iii*) of the 1961 Act. **But later**, even the Calcutta High Court has also taken a similar view in *CIT v. Ashoka Marketing Ltd.*, (1990) 181 ITR 493, 497-99 (Cal) to the effect that the formula laid down in rule 3 of the 1962 Rules cannot be applied for computation of the value of the perquisite provided by the employer in the form of rent-free accommodation provided to the executives. In that case, it was held that the disallowance under the then section 40(*a*)(*v*) or 40A(5) of the 1961 Act should be on the basis of the actual expenditure incurred by the assessee for providing accommodation to the employees and not on the lines of the formula laid down in rule 3. This Calcutta decision has been **followed in** *CIT v. Shree Krishna Gyanoday Sugar Ltd.*, (1990) 186 ITR 541, 543 (Cal).

In the judgments of *CIT v. Malayalam Plantations* (*India*) *Ltd.*, (1990) 186 ITR 322, 327-28 (Ker); *CIT v. Electro Steel Castings Ltd.,* (1992) 193 ITR 103, 108 (Ori); *CIT v. Shriram Refrigeration Industries Ltd.,* (1992) 197 ITR 431, 439 (Del); *C.W.S.* (*India*) *Ltd. v. CIT,* (1992) 198 ITR 660, 664 (Ker); *CIT v. Coramandel Fertilisers Ltd.,* (1996) 220 ITR 298, 301-02 (AP); *CIT v. Malayalam Plantations* (*India*) *Ltd.,* (1997) 224 ITR 126, 132 (Ker), it has consistently been held that the value of perquisites for the purpose of disallowance under section 40A(5) of the 1961 Act could not be on the basis of rule 3 of the 1962 Rules or, in other words, it is impermissible to bring in the provisions of rule 3 of the 1962 Rules to determine the permissible ceiling limit under section 40(*c*) or 40A(5) of the 1961 Act. Only the actual expenditure incurred by the assessee (whether on house rent, cars, etc.) belonging to the asssessee and used by the employees and directors has to be taken into account for the purposes of section 40(*c*) or section 40A(5) of the 1961 Act [see, *Wheels India Ltd. v. CIT,* (1996) 218 ITR 293, 294, 298 (Mad), **followed in** *Brakes India Ltd. v. CIT,* (1997) 224 ITR 138, 140 (Mad); *Brakes India Ltd. v. CIT,* (1996) 88 Taxman 473, 474 (Mad); *CIT v. Madura Coats Ltd.*, (1999) 239 ITR 50, 52, 60 (Mad); *CIT v. South India Corporation Pvt. Ltd.*, (2001) 250 ITR 318, 321 (Mad); *CIT v. Porritts & Spencer* (*Asia*) *Ltd.*, (2002) 255 ITR 189, 193 (Punj); *CIT v. Madura Mills Co. Ltd.*, (2004) 188 CTR (Mad) 66, 67. Thus, in *CIT v. Empire Dyeing & Manufacturing Co. Ltd.*, (1991) 192 ITR 245, 248 (Bom), it has been held that the value of the perquisite would have to be taken as the amount actually spent by the assessee as expenditure on the flat occupied by its employees such as taxes, maintenance of the flat, society charges, etc., and 5/12ths of the depreciation allowed to the assessee in respect of the flat as the same was occupied by the employee for 5 months only.

However, a **contrary view** has been taken in *Porrits and Spencer* (*Asia*) *Ltd. v. CIT*, (1989) 180 ITR 211, 220 (Punj), **following** *CIT v. Nuchem Plastics Ltd.*, (1989) 179 ITR 196 (Punj), to the effect that in computing the disallowance under section 40A(5) of the 1961 Act, the provisions of rule 3(*c*)(*ii*) [relating to valuation of perquisite in the nature of providing motor car for use by the employee] of the Income-tax Rules, 1962, should be invoked. The Calcutta view [135 ITR 35 (Cal)] and the Punjab view [179 ITR 196 (Punj)] have been **followed in** *Geoffrey Manners & Co. Ltd. v. CIT*, (1996) 221 ITR 695, 711-12 (Bom), **dissenting from** *CIT v. Rajesh Textile Mills Ltd.,* (1988) 173 ITR 179 (Guj) and *CIT v. Electro Steel Castings Ltd.,* (1992) 193 ITR 103 (Ori). Another Punjab view [180 ITR 211 (Punj)] has been **followed in** *CIT v. Porrits & Spencer* (*Asia*) *Ltd.*, (2000) 241 ITR 126, 128 (Punj); *CIT v. Lakhani Footwear Ltd.*, (2001) 248 ITR 701, 702, 703 (Punj). Also see, *American Express International Banking Corporation v. CIT,* (1998) 143 Taxation 404, 405-06 (Bom).

LexisNexis

The **above controversy has been set at rest** by the Supreme Court in *CIT v. British Bank of Middle East*, (2001) 251 ITR 217, 223-24 (SC), where it has been ruled that section 40A(5) of the 1961 Act and rule 3 of the 1962 Rules deal with different situations and different sets of assessees—one dealing with the employer-assessee and the other employee-assessee. Rule 3 of the 1962 Rules deals with valuation for the purposes of computing the income of the employees chargeable under the head "Salaries" whereas section 40A(5) of the 1961 Act deals with the computation of the income under the head "Profits and gains of business or profession". Section 40A(5) of the 1961 Act was enacted to curb extravagant expenditure. It does not contemplate deduction of the notional value of perquisites assessed in the hands of the employees. It contemplates the deduction of actual expenditure or on estimate basis where the details of the actual expenditure are not furnished. In that view of the matter, it has been held that the Tribunal was not justified in law in holding that the value of the free car provided to the employees for the purpose of working out the disallowance under section 40A(5) of the 1961 Act in the case of the employer, *i.e.*, the assessee-company, should be the same as prescribed by rule 3(*c*) of the 1962 Rules in the case of the employee, for the assessment years 1975-76 and 1976-77.

In taking the above view, the Supreme Court has **approved** the Gujarat view [173 ITR 179 (Guj)] and has **overruled** the Calcutta view taken in *CIT v. Britannia Industries Co. Ltd.*, (1982) 135 ITR 35 (Cal) and the Bombay view taken in *Geoffrey Manners & Co. Ltd. v. CIT*, (1996) 221 ITR 695 (Bom). Further, in view of the above Supreme Court ruling, the **contrary view** taken by the Punjab High Court and Orissa High Court [179 ITR 196 (Punj), 180 ITR 211 (Punj) and 193 ITR 103 (Ori)] should be regarded as **impliedly overruled**.

The above Supreme Court ruling [251 ITR 217 (SC)] has been **followed in** *American Express International Banking Corporation v. CIT*, (2002) 258 ITR 601, 619 (Bom); *CIT v. British Bank of Middle East*, (2004) 265 ITR 31, 34 (Bom); *CIT v. Willard India Ltd.*, (2008) 302 ITR 221 (All) and has been **applied in** *Atlas Cycle Industries Ltd. v. CIT*, (2004) 270 ITR 108 (Punj). Also see, *Beco Engineering Co. Ltd. v. CIT*, (2005) 184 Taxation 611 (Punj).

Illustrative cases, whether 'perquisite' or not.—The following were **held not perquisites** within the meaning of section 40A(5) of the 1961 Act:—

(1) In *CIT v. Motor Industries Co. Ltd.*, (1988) 173 ITR 374, 383 (Karn), it has been observed that each and every amount spent on buildings cannot be treated as spent on repairs. The term "repairs" has a special meaning. What is necessary for the upkeep and maintenance of a building which necessarily includes periodical colour/whitewashing and painting can undoubtedly be treated as repairs. But, the amounts lavishly or even unnecessarily spent just to satisfy the ego or the eccentricities of an employee cannot be treated as an amount spent on repairs. The question whether the expenditure on repairs can be considered as "perquisite" for the purposes of section 40A(5) of the 1961 Act has to be decided keeping in view the aforestated and other relevant principles.

Thus, cost of repairs to the buildings taken on lease by the assessee or on the buildings owned by the assessee and allotted to its employees [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 173 ITR 290 (AP); *Vazir Sultan Tobacco Co. Ltd. v. CIT,* (1990) 184 ITR 70, 73 (AP); *CIT v. Mercantile Bank Ltd.*, (1999) 237 ITR 676, 683 (Bom)]; or expenditure on repairs and maintenance of the building given rent-free to the employees to be used by them [*CIT v. Oil India Ltd.,* (1992) 196 ITR 366, 375 (Cal)]. Also see, *CIT v. Oil India Ltd.,* (1992) 198 ITR 701, 707 (Cal) held not to be 'perquisite'. In this regard, a **contrary view** has been taken in *Lubrizol India Ltd. v. CIT,* (1991) 187 ITR 25, 29 (Bom); *Ceat Tyres of India Ltd. v. CIT,* (1994) 121 CTR (Bom) 80, 82; *CIT v. Banque Nationale De Paris*, (1999) 237 ITR 278, 279 (Bom); *Mercantile Bank Ltd. v. CIT*, (2001) 252 ITR 225, 226 (Bom), **SLP granted**: (2001) 248 ITR (St.) 259 (SC); *CIT v. Porritts & Spencer* (*Asia*) *Ltd.*, (2002) 255 ITR 189, 191-92 (Punj); *CIT v. Emirates Commercial Bank Ltd.*, (2003) 262 ITR 55, 57 (Bom).

(2) Difference between the concessional rate of interest and the prevailing market rate of interest on the loans advanced to the employees [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 173 ITR 290 (AP)].

Notional interest on interest-free loans advanced by the assessee-company to its employees [*Indian Oxygen Ltd. v. CIT,* (1994) 210 ITR 274, 283-84 (Cal), **following** *CIT v. P.R.S. Oberoi,* (1990) 183 ITR 103, 108-09 (Cal)]. Non-charging of interest on the debit balances in the running accounts of the directors or on the amounts advanced as interest-free loans to the employee-directors by the assessee-company [*V.M. Salgaocar & Bros. Pvt. Ltd. v. CIT*: *CIT v. Shivanand V. Salgaocar*, (2000) 243 ITR 383, 386, 387, 402-03 (SC), **reversing** *CIT v. V.M. Salgaocar & Bros. Pvt. Ltd.,* (1992) 198 ITR 738, 742 (Karn)].

(3) Expenditure on account of sweeper, watchmen and gardener [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 173 ITR 290 (AP)].

LexisNexis

(4) Depreciation and property tax in respect of the buildings owned by the assessee and used as residential quarters of its employees [*CIT v. Motor Industries Co. Ltd.,* (1988) 173 ITR 374, 382-83 (Karn), **followed in** *CIT v. Motor Industries Co. Ltd.,* (1998) 229 ITR 137, 146 (Karn)].

Property tax in respect of the house in the occupation of the Deputy Chairman of the company cannot be a subject matter of ceiling under section 40A(5) of the 1961 Act [*South India Corporation Agencies P. Ltd. v. CIT*, (1999) 239 ITR 305, 312 (Mad)].

Municipal taxes and repairing charges incurred by the assessee for the premises occupied by the employees [*CIT v. Orient Paper & Industries Ltd.,* (1994) 207 ITR 589, 594-95 (Cal)].

(5) Difference between the fair market value at which the old cars, which were sold to the employees at their written down value, and the purchase price of such cars [*CIT v. Britannia Industries Ltd.,* (1992) 198 ITR 225, 228 (Cal)].

(6) Expenditure by way of premia paid to Calcutta Hospital & Nursing Home Benefit Association [*Indian Oxygen Ltd. v. CIT,* (1994) 210 ITR 274, 282 (Cal)].

The following were **held perquisites** within the meaning of section 40A(5) of the 1961 Act:—

(1) Expenditure incurred for replacement of crockery used by the employees in the buildings allotted to them by the assessee [*CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 173 ITR 290 (AP)].

(2) Maintenance expenditure incurred by the assessee-company for the car provided to its director [*CIT v. Sundaram Industries Ltd.*, (1999) 240 ITR 335, 338 (Mad), **following** *CWS* (*India*) *Ltd. v. CIT*, (1994) 208 ITR 649 (SC); *CIT v. Madura Coats Ltd.*, (2003) 263 ITR 241, 242-43 (Mad)].

(3) Total expenditure incurred by the assessee, including repairs and maintenance of accommodation, ground rent, municipal taxes and society charges in respect of the premises owned by the assessee and used for the purpose of residence of employees [*Citibank N.A. v. CIT*, (2003) 262 ITR 47, 51-52 (Bom), **followed in** *CIT v. British Bank of Middle East,* (2004) 265 ITR 31, 33-34 (Bom)].

Allowances in cash, whether included in "perquisites" or in "salary"?—According to **one view**, section 40A(5)(*a*)(*ii*) of the 1961 Act referred to any expenditure which resulted directly or indirectly in the provision of any perquisite (whether convertible into money or not) to an employee. This indicated that the expenditure should result in the provision of any perquisite which might be one that was convertible into money or not so convertible, *i.e.*, it was a provision of something in kind which might be capable of being converted into money or not, but not money itself. In that view of the matter, payment in cash by way of house rent allowance [*CIT v. Mysore Commercial Union Ltd.,* (1980) 126 ITR 340 (Karn)] was held not to be a "perquisite" for the purpose of section 40A(5) of the 1961 Act.

Interpreting section 40(*a*)(*v*) or section 40(*c*)(*iii*) of the 1961 Act, where the words, etc., employed were "any benefit or amenity or perquisite, whether convertible into money or not", it was held that the expression "whether convertible into money of not" implied that the benefit or amenity or perquisite spoken of in the section was something apart from money, such as, something in kind which may be convertible into money or not convertible. On this reasoning, bonus and/or commission paid in cash [*CIT v. Mysore Commercial Union Ltd.,* (1980) 126 ITR 340 (Karn); *CIT v. Indokem P. Ltd.,* (1981) 132 ITR 125 (Bom); *CIT v. Vulcan Laval Ltd.,* (1991) 188 ITR 453, 456 (Bom)], or leave allowance paid in cash [*CIT v. Manjushree Plantations Ltd.,* (1980) 125 ITR 150 (Mad)], or overseas allowance, managing allowance, devaluation allowance and transport allowance paid in cash [*CIT v. Kanan Devan Hills Produce Co. Ltd.,* (1979) 119 ITR 431 (Cal); *CIT v. Hindustan Motors Ltd.,* (1989) 175 ITR 411 (Cal)], or cash allowance [*CIT v. Orient Paper Mills Ltd.,* (1983) 139 ITR 763 (Cal)], or motor car allowance [*CIT v. Tecalemit* (*Hind*) *Ltd.,* (1982) 137 ITR 285 (Cal)], or house rent allowance, conveyance allowance, cash allowance for lunch or club entrance fees [*CIT v. Johnson Pumps* (*India*) *Ltd.,* (1988) 172 ITR 333 (Cal)], was held not to constitute "benefit, amenity or perquisite" so as to be hit by section 40(*a*)(*v*) or section 40(*c*)(*iii*) of the 1961 Act. Also see, *CIT v. New India Industries Ltd.,* (1993) 201 ITR 208, 224, 229 (Guj); *CIT v. Standard Mills Co. Ltd.,* (1998) 143 Taxation 398, 400 (Bom). It is pertinent to note that bonus, which comes within the ambit of section 17(3)(*ii*) of the 1961 Act, was specifically excluded by virtue of clause (*g*) of the 1st proviso to section 40(*a*)(*v*) of the 1961 Act [*CIT v. Hind Lamps Ltd.,* (1980) 122 ITR 451 (All)]. In *CIT v. Duncan Bros. & Co. Ltd.*, (1983) 140 ITR 335 (Cal), the employer had purchased medical insurance policy on individual life of its employees in order to avoid the risk of heavy expenditure in a particular year and paid premia thereon. It was held that the employees did not derive "benefit" thereby, and the amounts were not hit by section 40(*c*)(*iii*) of the 1961 Act which took in expenditure spoken of in sections 30 to 38 of the 1961 Act.

The **other view** has been taken by the Kerala High Court holding that no undue emphasis could be laid on the words "whether convertible into money or not" so as to give a very restricted meaning to the expression

"benefit, amenity or perquisite", a meaning which would not serve the eminent purpose of section 40(*a*)(*v*) of the 1961 Act. The expression "benefit, amenity or perquisite" might take in any benefit in kind and in service and might take in also cash. "Whether convertible into money or not" need not qualify the whole range. It only meant that it was immaterial whether the benefit, amenity or perquisite might or might not be convertible into money. In this view of the matter, the house rent allowance was held covered by section 40(*a*)(*v*) of the 1961 Act [*CIT v. Commonwealth Trust Ltd.,* (1982) 135 ITR 19, 28 (Ker—FB)].

Setting the above controversy at rest, the Supreme Court has, in *CIT v. Mafatlal Gangabhai & Co.* (*P.*) *Ltd.*, (1996) 219 ITR 644, 653-54 (SC), held that the language employed in the then section 40(*a*)(*v*) or 40A(5)(*a*)(*ii*) of the 1961 Act read with clause (*b*) of *Explanation 2* thereto was not capable of taking within its ambit cash payments made to the employees by the assessee. These cash payments would, of course, be taxed as salary paid to the employees and would be subject to the limits/ceiling, if any, in that behalf. But they could not be brought within the purview of the words "any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite"—more so because of the following words "whether convertible into money or not". Further, the words "any sum paid by the assessee in respect of any obligation which but for such payment would have been payable by such employee", as employed in the said section 40(*a*)(*v*) or section 40A(5)(*a*)(*ii*) of the 1961 Act read with clause (*b*)(*iv*) of *Explanation 2* thereto, contemplated a situation where the assessee made a payment (in cash) in respect of an obligation—obligation of the employee—which would have been payable by the employee if it was not paid by the assessee. The payment by the assessee contemplated by these words was not evidently a payment to the employee but to a third party, no doubt, on account of the employee. Even cash payment referred to in clause (*b*)(*v*) of *Explanation 2* to section 40A(5) of the 1961 Act was not to the employee, though undoubtedly for his benefit. Thus, cash payments by an assessee to his/its employees did not fall within the ambit of section 40(*a*)(*v*) or 40A(5)(*a*)(*ii*) of the 1961 Act, as the case might be.

In taking the above view, the Supreme Court [219 ITR 644, 654 (SC)] has **overruled** the view taken in *CIT v. Commonwealth Trust Ltd.*, (1982) 135 ITR 19 (Ker—FB); and has **approved** the view taken in *CIT v. Kanan Devan Hills Produce Co. Ltd.*, (1979) 119 ITR 431 (Cal); *CIT v. Manjushree Plantations Ltd.*, (1980) 125 ITR 150 (Mad); *CIT v. Mysore Commercial Union Ltd.*, (1980) 126 ITR 340 (Karn); *CIT v. Indokem Pvt. Ltd.*, (1981) 132 ITR 125 (Bom); *CIT v. Warner Hindustan Ltd.*, (1984) 145 ITR 24 (AP); *Instalment Supply Pvt. Ltd. v. CIT*, (1984) 149 ITR 457 (Del); *CIT v. Shriram Refrigeration Industries Ltd.*, (1992) 197 ITR 431 (Del) and *CIT v. New India Industries Ltd.*, (1993) 201 ITR 208 (Guj).

The above Supreme Court ruling [219 ITR 644 (SC)] has been **followed in** *Sukhjit Starch & Chemicals Ltd. v. CIT*, (1996) 221 ITR 308, 310 (Punj); *CIT v. Smithkline Beecham Consumer Brands Ltd.*, (1997) 226 ITR 764, 777 (Punj); *Commonwealth Trust Ltd. v. CIT*, (1997) 228 ITR 1, 5-6 (SC), **reversing on the point** *CIT v. Commonwealth Trust Ltd.,* (1982) 135 ITR 19 (Ker—FB); *Sundaram Clayton Ltd. v. CIT*, (1999) 239 ITR 416, 417 (Mad); *CIT v. Hindustan Everest Tools Ltd.*, (2004) 141 Taxman 309 (Del); *HMM Ltd. v. CIT*, (2009) 313 ITR 401 (Punj); *CIT v. Sir Shadi Lal Enterprises Ltd.*, (2009) 317 ITR 449 (All); and **distinguished in** *Ambica Mills Ltd. v. CIT*, (1998) 231 ITR 583, 596-97 (Guj).

In the facts of the following cases, allowances in cash were **held not included in 'perquisites'** as contemplated by section 40A(5)(*a*)(*ii*)/the then section 40(*a*)(*v*) of the 1961 Act:—

(1) Cash payments in pursuance of a contract of service [*CIT v. Jayanthi Films* (*Madurai*) *Pvt. Ltd.,* (1992) 196 ITR 802, 803 (Mad)]. Also see, *CIT v. Vulcan Laval Ltd.,* (1990) Tax LR 1130 (Bom); *CIT v. Surat Cotton Spng. & Wvg. Mills* (*P.*) *Ltd.,* (1991) Tax LR 23 (Bom); *CIT v. New India Assurance Co. Ltd.,* (1992) Tax LR 715 (Bom).

(2) Cash payment by way of gratuity to a director [*CIT v. J. Govindram Pr. Ltd.,* (1987) 163 ITR 528 (Bom)].

(3) Bonus paid to employees in cash [*CIT v. Singareni Collieries Co. Ltd.,* (1984) 150 ITR 67 (AP); *CIT v. Yorkshire Insurance Co. Ltd.,* (1986) 162 ITR 565 (Bom); *CIT v. Greaves Cotton & Co. Ltd.,* (1991) 191 ITR 367 (Bom); *CIT v. New India Industries Ltd.,* (1993) 201 ITR 208, 229 (Guj); *CIT v. Alembic Chemical Works Ltd,* (1994) 206 ITR 170, 174 (Guj); *New India Industries Ltd. v. CIT,* (1994) 207 ITR 1010, 1013 (Guj); *CIT v. Kamani Tubes Ltd.,* (1994) 207 ITR 298, 301 (Bom)] in excess of the upper limits fixed by the Payment of Bonus Act, 1965 [*CIT v. Blaze Advertising Pvt. Ltd.,* (1992) 101 CTR (Bom) 314, 315].

In *CIT v. Indian Engineering & Commercial Corporation P. Ltd.*, (1993) 201 ITR 723, 728 (SC), it has been ruled that payment of a certain cash amount by way of commission on sales, directly to an employee, cannot be said to fall within the words 'Where the assessee incurs any expenditure which results directly or indirectly' as employed in sections 40A(5)(*a*)(*i*) and 40A(5)(*a*)(*ii*) of the 1961 Act. In that view of the matter, the commission paid by the assessee to its directors/employees on the sales effected by the assessee was held not falling within the provisions of the then section 40(*a*)(*v*) or

40A(5) of the 1961 Act. **But** in *CIT v. Peico Electronics & Electricals Ltd.*, (1992) 107 CTR (Cal) 240, 243, it has been held that the Tribunal was right in holding that the commission payments of ₹ 70,667 to senior management staff were required to be taken into consideration for the purpose of section 40A(5) of the 1961 Act.

(4) Cash house rent allowance [*CIT v. Warner Hindustan Ltd.,* (1984) 145 ITR 24 (AP), **SLP dismissed**: (1990) 185 ITR (St.) 3 (SC); *CIT v. Warner Hindusthan Ltd.,* (1986) 160 ITR 217 (AP); *CIT v. General Marketing & Mfg. Co.,* (1987) 165 ITR 566 (Cal); *CIT v. Motor Industries Co. Ltd.,* (1988) 173 ITR 374, 386 (Karn); *CIT v. Andhra Pradesh State Financial Corporation,* (1989) 175 ITR 87 (AP); *Ruston & Hornsby* (*India*) *Ltd. v. CIT,* (1991) 191 ITR 75, 76 (Bom); *CIT v. Empire Dyeing & Manufacturing Co. Ltd.,* (1991) 192 ITR 245, 248 (Bom); *CIT v. Bombay Dyeing & Manufacturing Co. Ltd.,* (1992) 193 ITR 250, 251 (Bom); *Otis Elevator Co.* (*India*) *Ltd. v. CIT,* (1992) 195 ITR 682, 686 (Bom); *Kores* (*India*) *Ltd. v. CIT,* (1992) 196 ITR 749, 750 (Bom); *CIT v. Blaze Advertising Pvt. Ltd.,* (1992) 101 CTR (Bom) 314, 315; *CIT v. Dunlop India Ltd.*, (1992) 103 CTR (Cal) 422, 424; *CIT v. Surat Cotton Spng. & Wvg. Mills* (*P.*) *Ltd.,* (1993) 202 ITR 932, 935 (Bom); *Godfrey Phillips India Ltd. v. CIT,* (1994) 206 ITR 23, 28 (Bom); *CIT v. Vickers Sperry of India Ltd.,* (1995) 216 ITR 861, 862 (Bom); *Castrol Ltd. v. CIT,* (1997) 140 Taxation 331 (Bom); *Mahavir Spinning Mills Ltd. v. CIT*, (2008) 304 ITR 371, 374 (Punj)] in accordance with the service agreement [*CIT v. Mansants Chemicals* (*P.*) *Ltd.,* (1989) 177 ITR 204 (Bom); *CIT v. Otis Elevator Co.* (*I.*) *Ltd.,* (1990) Tax LR 33 (Bom)].

Rent assistance [*Ruston & Hornsby* (*India*) *Ltd. v. CIT,* (1991) 191 ITR 75, 76 (Bom); *CIT v. Surat Cotton Spng. & Wvg. Mills* (*P.*) *Ltd.,* (1993) 202 ITR 932, 935 (Bom)].

(5) Conveyance allowance [*CIT v. Warner Hindustan Ltd.,* (1984) 145 ITR 24 (AP), **SLP dismissed**: (1990) 185 ITR (St.) 3 (SC); *CIT v. Eastern Assam Tea Co. Ltd.,* (1984) 41 CTR (Cal) 361; *CIT v. Warner Hindusthan Ltd.,* (1986) 160 ITR 217 (AP); *CIT v. Andhra Pradesh State Financial Corporation,* (1989) 175 ITR 87 (AP); *CIT v. Empire Dyeing & Manufacturing Co. Ltd.,* (1991) 192 ITR 245, 248 (Bom); *Godfrey Phillips India Ltd. v. CIT,* (1994) 206 ITR 23, 28 (Bom)].

Car allowance [*CIT v. Motor Industries Co. Ltd.,* (1988) 173 ITR 374, 386 (Karn); *Ruston & Hornsby* (*India*) *Ltd. v. CIT,* (1991) 191 ITR 75, 76 (Bom); *CIT v. Greaves Cotton & Co. Ltd.,* (1991) 191 ITR 367 (Bom); *CIT v. Blaze Advertising Pvt. Ltd.,* (1992) 101 CTR (Bom) 314, 315; *CIT v. New India Industries Ltd.,* (1993) 201 ITR 208, 229 (Guj); *CIT v. Surat Cotton Spng. & Wvg. Mills* (*P.*) *Ltd.,* (1993) 202 ITR 932, 935 (Bom); *CIT v. Kamani Tubes Ltd.,* (1994) 207 ITR 298, 301 (Bom)].

Fuel bills [*Mahavir Spinning Mills Ltd. v. CIT*, (2008) 304 ITR 371, 374 (Punj)].

(6) Entertainment allowance [*CIT v. Bombay Dyeing & Manufacturing Co. Ltd.,* (1992) 193 ITR 250, 251 (Bom); *CIT v. Dunlop India Ltd.*, (1992) 103 CTR (Cal) 422, 424].

(7) Special duty allowance [*CIT v. Ahmedabad New Cotton Mills Co. Ltd.*, (2002) 253 ITR 762, 764 (Guj)].

(8) Telephone charges/expenses [*CIT v. Bombay Dyeing & Manufacturing Co. Ltd.,* (1992) 193 ITR 250, 251 (Bom); *CIT v. Dunlop India Ltd.*, (1992) 103 CTR (Cal) 422, 424; *CIT v. Ambica Mills Ltd.,* (1998) 147 CTR (Guj) 340, 343-44 = (1999) 236 ITR 921, 925 (Guj)].

(9) Cash paid to employee by way of marriage allowance [*Travancore Tea Estates Co. Ltd. v. CIT,* (1985) 153 ITR 444 (Ker); *Travancore Tea Estates Co. Ltd. v. CIT,* (1985) 154 ITR 745 (Ker)].

(10) Club (membership subscription) fees [*CIT v. Warner Hindustan Ltd.,* (1984) 145 ITR 24 (AP), **SLP dismissed**: (1990) 185 ITR (St.) 3 (SC); *CIT v. Warner Hindusthan Ltd.,* (1986) 160 ITR 217 (AP); *CIT v. Andhra Pradesh State Financial Corporation,* (1989) 175 ITR 87 (AP); *Otis Elevator Co.* (*India*) *Ltd. v. CIT,* (1992) 195 ITR 682, 686 (Bom); *Kores* (*India*) *Ltd. v. CIT,* (1992) 196 ITR 749, 750 (Bom); *Castrol Ltd. v. CIT,* (1997) 140 Taxation 331 (Bom); *CIT v. Mercantile Bank Ltd.*, (1999) 237 ITR 676, 683 (Bom); *Mercantile Credit Corporation Ltd. v. CIT*, (2000) 245 ITR 245, 249 (Mad); *American Express International Banking Corporation v. CIT*, (2002) 258 ITR 601, 619 (Bom); *CIT v. Citibank N.A.*, (2003) 264 ITR 18, 19 (Bom); *Apollo Tyres Ltd. v. Asst. CIT*, (2019) 416 ITR 523 (Ker)]. Reimbursement of club bills [*CIT v. Ashoka Marketing Ltd.,* (1990) 181 ITR 493, 496 (Cal)].

(11) Cash payment made by the assessee to its employees to reimburse them for the expenses incurred by way of salaries of gardener/servants and watch and ward employee [see, *CIT v. General Marketing & Mfg. Co.,* (1987) 165 ITR 566 (Cal); *CIT v. Eastern Assam Tea Co. Ltd.,* (1984) 41 CTR (Cal) 361; *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 234, 236-37 (Mad); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 238, 239-40 (Mad)].

LexisNexis

Reimbursement of electricity, gas and water expenses to the employees [see, *CIT v. Vickers Sperry of India Ltd.,* (1995) 216 ITR 861, 862 (Bom); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 234, 236-37 (Mad); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 238, 239-40 (Mad); *H.M.M. Ltd. v. CIT*, (2001) 252 ITR 842, 843, 844 (Punj); *Mahavir Spinning Mills Ltd. v. CIT*, (2008) 304 ITR 371, 374 (Punj)].

(12) Reimbursement of medical expenses incurred by an employee [*Indian Leaf Tobacco Development Co. Ltd. v. CIT,* (1982) 137 ITR 827 (Cal); *CIT v. Warner Hindustan Ltd.,* (1984) 145 ITR 24 (AP), **SLP dismissed**: (1990) 185 ITR (St.) 3 (SC); *CIT v. National & Grindlays Bank Ltd.,* (1984) 145 ITR 457 (Cal); *Instalment Supply Pr. Ltd. v. CIT,* (1984) 149 ITR 457 (Del); *CIT v. Warner Hindusthan Ltd.,* (1986) 160 ITR 217 (AP); *Alkali & Chemical Corporation of India Ltd. v. CIT,* (1986) 161 ITR 820 (Cal); *CIT v. Darjeeling Co. Ltd.,* (1986) Tax LR 483 (Cal); *Union Carbide India Ltd. v. CIT,* (1987) 165 ITR 558 (Cal); *CIT v. General Marketing & Mfg. Co.,* (1987) 165 ITR 566 (Cal); *CIT v. Escorts Ltd.,* (1987) 59 CTR (Del) 284; *CIT v. Mercantile Bank Ltd.,* (1988) 169 ITR 44 (Bom); *CIT v. Vazir Sultan Tobacco Co. Ltd.,* (1988) 173 ITR 290 (AP); *CIT v. Andhra Pradesh State Financial Corporation,* (1989) 175 ITR 87 (AP); *CIT v. Indian Press Exchange Ltd.,* (1989) 176 ITR 331 (Cal); *CIT v. Boehringer Knoll Ltd.,* (1989) 177 ITR 96 (Bom); *National and Grindlays Bank Ltd. v. CIT,* (1989) 180 ITR 275 (Cal); *CIT v. Ashoka Marketing Ltd.,* (1990) 181 ITR 493, 496 (Cal); *CIT v. Jay Engineering Works Ltd.,* (1990) 182 ITR 181 (Del); *CIT v. Indian Oxygen Ltd.,* (1990) 184 ITR 339, 341 (Cal); *Asbestos Cement Ltd. v. CIT,* (1991) 192 ITR 89, 90 (Bom); *CIT v. Indian Explosives Ltd.,* (1991) 192 ITR 144, 147 (Cal); *CIT v. Empire Dyeing & Manufacturing Co. Ltd.,* (1991) 192 ITR 245, 248 (Bom); *CIT v. J.K. Synthetics Ltd.,* (1992) 193 ITR 524, 529 (Del); *CIT v. Shriram Refrigeration Industries Ltd.,* (1992) 197 ITR 431, 438 (Del); *J.M.A. Industries Ltd. v. CIT,* (1993) 200 ITR 210, 213 (Del); *CIT v. National & Grindlays Bank Ltd.,* (1993) 202 ITR 559, 561 (Cal); *Dr. Beck & Co.* (*India*) *Ltd. v. CIT,* (1993) 202 ITR 922, 925 (Bom); *CIT v. Amco Batteries Ltd.,* (1993) 203 ITR 614, 617 (Karn); *CIT v. Western Electronics Ltd.,* (1993) 117 Taxation 435 (Del), **SLP granted**: (1994) 207 ITR (St.) 21 (SC); *Godfrey Phillips India Ltd. v. CIT,* (1994) 206 ITR 23, 28 (Bom); *Phaltan Sugar Works Ltd. v. CIT,* (1994) 208 ITR 989, 991 (Bom); *CIT v. National Engineering Industries Ltd.,* (1994) 208 ITR 1002, 1005 (Cal); *CIT v. Bennete Coleman & Co. Ltd.,* (1994) 73 Taxman 64, 65 (Bom); *Ceat Tyres of India Ltd. v. CIT,* (1994) 121 CTR (Bom) 80, 82; *Phaltan Sugar Works Ltd. v. CIT,* (1995) 215 ITR 582, 584 (Bom); *CIT v. Madras Rubber Factory Ltd.,* (1995) 216 ITR 277, 285-86 (Mad); *CIT v. Audco India Ltd.,* (1995) 123 CTR (Bom) 169, 171; *CIT v. Coca Cola Export Corporation,* (1995) 82 Taxman 454, 455 (Del); *CIT v. Woodcraft Products Ltd.,* (1996) 217 ITR 862, 863 (Cal); *Aspinwall & Co. Ltd. v. CIT,* (1996) 220 ITR 611, 615-16 (Ker); *CIT v. K.G. Khosla Compressors Ltd.,* (1996) 221 ITR 582, 584 (Del); *CIT v. Malayalam Plantations* (*India*) *Ltd.,* (1997) 224 ITR 126, 132-33 (Ker); *CIT v. Bharat Steel Tubes Ltd.,* (1997) 226 ITR 750, 752 (Del); *Castrol Ltd. v. CIT,* (1997) 140 Taxation 331 (Bom); *CIT v. Mahindra Ugine Steel Co. Ltd.,* (1998) 233 ITR 204, 205 (Bom); *CIT v. Ambica Mills Ltd.,* (1998) 147 CTR (Guj) 340, 343-44 = (1999) 236 ITR 921, 925 (Guj); *Colour Chem Ltd. v. CIT*, (1999) 238 ITR 171, 173 (Bom); *CIT v. Lucas Indian Service Ltd.*, (1999) 240 ITR 631, 632 (Mad); *CIT v. Tiam House Service Ltd.*, (2000) 243 ITR 695, 699 (Mad); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 234, 236-37 (Mad); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 238, 239-40 (Mad); *Mercantile Credit Corporation Ltd. v. CIT*, (2000) 245 ITR 245, 247 (Mad); *Sundaram Fasteners Ltd. v. CIT*, (2001) 247 ITR 219, 222 (Mad); *CIT v. Madras Rubber Factory Ltd.*, (2001) 248 ITR 814, 816 (Mad); *H.M.M. Ltd. v. CIT*, (2001) 252 ITR 842, 843, 844 (Punj); *CIT v. Arvind Mills Ltd.*, (2002) 254 ITR 529, 532-33 (Guj).

Medical expenses by way of premium for Group Medical Insurance Scheme [see, *H.M.M. Ltd. v. CIT*, (2001) 252 ITR 842, 843, 844 (Punj); *CIT v. Mihir Textiles Ltd.*, (2002) 256 ITR 528, 530 (Guj); *CIT v. Dharamsi Morarji Chemicals Co. Ltd.*, (2015) 373 ITR 545 (Bom)].

Medical benefits and group term insurance [*CIT v. Sarangpur Cotton Manufacturing Co. Ltd.*, (2002) 177 CTR (Guj) 467, 469].

In *CIT v. Aspinwall & Co. Ltd.*, (1990) 184 ITR 298 (Ker), the Tribunal directed the Income-tax Officer to exclude the medical expenses while making the disallowance under section 40A(5) of the 1961 Act, relying on a particular circular wherein another circular was referred to. The High Court remanded the matter to the Tribunal for considering afresh because another circular was not made available to the High Court.

(13) Personal accident insurance premium [*First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 234, 236-37 (Mad); *First Leasing Co. of India Ltd. v. CIT*, (2000) 244 ITR 238, 239-40 (Mad); *Sundaram*

Finance Ltd. v. CIT, (2001) 250 ITR 86, 88-89 (Mad); *CIT v. Mihir Textiles Ltd.*, (2002) 256 ITR 528, 530 (Guj)].

Entire expenses of the insurance premium paid on the insurance policy taken by the company in respect of managing directors [*CIT v. Gujarat Steel Tubes Ltd.*, (2002) 258 ITR 235, 237 (Guj)].

Although the above cash allowances have been held not to constitute 'perquisites', these may well come under 'salary' as contemplated by section 40A(5)(*a*)(*i*) of the 1961 Act.

Reference may also be made to *CIT v. Parke Davis India Ltd.,* SLP (Civil) No. 3103 of 1984: (1990) 186 ITR (St.) 31 (SC); *CIT v. Warner Hindustan Ltd.,* SLP (Civil) Nos. 9287-9289 of 1984: (1991) 189 ITR (St.) 118 (SC); *CIT v. Andhra Bank Ltd.,* SLP (Civil) Nos. 11655-11655A of 1985: (1992) 195 ITR (St.) 145-46 (SC); *CIT v. Coromandel Fertilizers Ltd.* SLP (Civil) No. 3483 of 1988: (1992) 195 ITR (St.) 146 (SC); *J.K. Synthetics Ltd v. CIT,* SLP (Civil) No. 2307 of 1993: (1993) 201 ITR (St.) 49 (SC); *CIT v. Atlas Cycle Industries,* SLP (Civil) No. 996 of 1994: (1994) 206 ITR (St.) 277 (SC); *CIT v. Andhra Bank,* SLP (Civil) Nos. 3755-3756 of 1994: (1994) 207 ITR (St.) 20-21 (SC); *CIT v. Jay Engineering Works Ltd.,* SLP (Civil) No. 13981 of 1994: (1995) 211 ITR (St.) 3-4 (SC); *CIT v. Colour Chemicals,* SLP (Civil) Nos. 1738-1740 of 1995: (1995) 212 ITR (St.) 365 (SC).

In *C.W.S.* (*India*) *Ltd. v. CIT*, (1992) 198 ITR 660, 667 (Ker), the matter was remanded to the Tribunal as there was no finding that the educational allowance, servants' allowance and leave travel allowance were 'perquisites'.

Salary and perquisites not to include certain payments.—It was specifically provided that the following items were not to be taken into account in computing the expenditure or allowance that was not deductible under the new provision:—

(*i*) the value of home leave travel concession to Indian citizen or passage money in case of foreign nationals, which is exempt from tax as the income of the employee under the provisions of sections 10(5) and 10(6)(*i*) of the 1961 Act;

(*ii*) employer's contribution to the employee's account in any recognised provident fund or an approved superannuation fund or for the employee's benefit to an approved gratuity fund under section 36(1)(*iv*) or 36(1)(*v*) of the 1961 Act;

(*iii*) expenditure incurred by a company for the purpose of promoting family planning amongst its employees under section 36(1)(*ix*) of the 1961 Act.

LexisNexis

In *CIT v. Chloride Industries Ltd.*, (2001) 251 ITR 730, 733 (Cal), it has been held that when section 10(5) of the 1961 Act itself provides that the exemption shall be subject to the limit prescribed in rule 2B of the 1962 Rules, the limit prescribed in that rule 2B of the 1962 Rules cannot be ignored for the purpose of disallowance under section 40A(5) of the 1961 Act. In that view of the matter, the Tribunal was held not right in law in holding that the entire travel concession or assistance received the employee has to be excluded from the purview of section 40A(5) of the 1961 Act.

The payment of gratuity to an employee made through an approved gratuity fund to which contribution may have been made by the assessee-employer and such contribution cannot be included in the computation of expenditure for its purpose [*Mihir Textiles Ltd. v. CIT,* (1997) 225 ITR 327, 340 (Guj)].

The premium of group insurance policy should not be considered as 'salary' or 'perquisite' for disallowance under section 40A(5) of the 1961 Act [*CIT v. Dharamsi Morarji Chemicals Co. Ltd.*, (2015) 373 ITR 545, 552 (Bom)].

Scope of the 1st proviso to section 40A(5)(*a*) of 1961 Act.—The **1st proviso to section 40A(5)(*a*) of the 1961 Act** referred to a class of assessees who were companies and who had incurred expenditure or had provided allowance referred to in sub-clauses (*i*) and (*ii*) of section 40A(5)(*a*) and sub-clauses (*i*) and (*ii*) of section 40(*c*) of the 1961 Act to an employee or a former employee, being a director or a person who had a substantial interest in the company or a relative of the director or of such person. As per the 1st proviso to section 40A(5)(*a*) of the 1961 Act, the ceiling of ₹ 1,02,000 [(up to assessment year 1984-85) ₹ 72,000] on the permissible deduction or of expenditure or allowances consisted of the aggregate of the following four types of expenses and allowances:—

(1) Any expenditure by the company which resulted in the provision of any remuneration or benefit or amenity to the director or to a person who had a substantial interest in the company or to a relative of the director or of such person, as the case might have been [**s. 40(*c*)(*i*) of the 1961 Act**].

(2) Any expenditure or allowances provided by the company in respect of any assets of the company used by any person referred to in (1) above either wholly or partly for his own purpose or benefit [**s. 40(*c*)(*ii*) of the 1961 Act**].

(3) When the assessee-company had incurred any expenditure which resulted directly or indirectly in the payment of any salary to an employee or a former employee if he fell in the category of an employee or ex-employee as referred to in the 1st proviso to section 40A(5)(*a*) [**s. 40A(5)(*a*)(*i*) of the 1961 Act**].

(4) Any expenditure or allowance provided for by the assessee-company in respect of any employee as contemplated by the first proviso to section 40A(5)(*a*) when such expenditure resulted in the provision of any perquisite to such an employee or allowance in respect of any assets of the assessee used by such an employee either wholly or partly for his own purpose or benefit [**s. 40A(5)(*a*)(*ii*) of the 1961 Act**].

If any assessee-company had incurred any of the aforesaid four types of expenditures and allowances *vis-a-vis* any specified class of employees, as mentioned in the **1st proviso to section 40A(5)(*a*) of the 1961 Act** then, in that eventuality, the expenditures and allowances provided for by such an assessee-company would be subject to an aggregate ceiling of ₹ 1,02,000 [(up to assessment year 1984-85) ₹ 72,000] per each such employee in any given assessment year.

It may be noted that whereas section 40A(5)(*a*) of the 1961 Act, main clause, read with section 40A(5)(*c*) of the 1961 Act prescribed two separate ceilings, one for salary and the other for perquisites, etc., the 1st proviso to section 40A(5)(*a*) of the 1961 Act places a consolidated single ceiling of ₹ 1,02,000 [(up to assessment year 1984-85) ₹ 72,000] in respect of the four types of expenditures, etc., enumerated above.

Whereas the first proviso to section 40A(5)(*a*) of the 1961 Act relates to directors, who are employees and prescribes the overall ceiling limit for them, section 40A(5)(*c*) of the 1961 Act applies to persons other than directors and prescribes the overall ceiling limit for them. Where the remuneration paid to a director of the assessee-company was in excess of ₹ 72,000 (operative up to assessment year 1984-85), the excess amount has to be disallowed by invoking the provisions of the first proviso to section 40A(5)(*a*) and not section 40A(5)(*c*) of the 1961 Act [*CIT v. Siya Ram Kumar Engineering Works* (*P.*) *Ltd.*, (2002) 254 ITR 358, 359, 360 (Del)]. This view has been **followed in** *CIT v. Jain Tube Co. Ltd.*, (2003) 132 Taxman 34, 34-35 (Del).

Wherever a case fell within the first proviso, the two separate ceilings of the general section would not have application and the case would be governed by one single consolidated ceiling of the first proviso [*CIT v. Bharat Vijay Mills Ltd.,* (1981) 128 ITR 633 (Guj)]. In that case, the Gujarat High Court had taken the view that the headwise limit prescribed under section 40A(5)(*c*) of the 1961 Act in relation to salary and perquisite falling under section 40A(5)(*a*) of the 1961 Act did not apply in respect of an employee who was also a director referred to in the first proviso to section 40A(5)(*a*) of the 1961 Act. In other words, the individual ceiling on different items of expenditure specified in section 40A(5)(*c*) of the 1961 Act were not applicable to cases covered by the first proviso to section 40A(5)(*a*) of the 1961 Act. The only limit applicable to such cases is the aggregate, *i.e.*, ₹ 1,02,000 specified in the said proviso itself and the items which were to be taken into account for this purpose were the four items mentioned therein [*CIT v. Hico Products Pvt. Ltd.,* (1993) 201 ITR 567, 574 (Bom), **followed in** *CIT v. Hico Products* (*P.*) *Ltd.,* (1993) 201 ITR 575, 576 (Bom), *Godfrey Phillips India Ltd. v. CIT,* (1994) 206 ITR 23, 29 (Bom), *Bralco Metal Industries Pvt. Ltd. v. CIT,* (1994) 206 ITR 477, 481 (Bom); *Somaiya Orgeno-Chemicals Ltd. v. CIT,* (1995) 216 ITR 291, 295 (Bom)]. That decision in *CIT v. Bharat Vijay Mills Ltd.*, (1981) 128 ITR 633 (Guj) has been **dissented from in** *Travancore Rayons Ltd. v. CIT*, (1986) 162 ITR 732 (Ker), holding that where the amounts paid to the managing director during the relevant accounting year was solely by way of salary and perquisite and no other amount was paid so as to attract the provisions of section 40(*c*) of the 1961 Act, the expenditure could be allowed only with reference to section 40A(5) and section 40(*c*) of the 1961 Act shall have no application. Thus, expenditure regarding the remuneration of the managing director has been held to be allowed only with reference to section 40A(5) and section 40(*c*) of the 1961 Act has no application [*Travancore Rayons Ltd. v. CIT,* (1988) 172 ITR 350, 351 (Ker)]. In that view of the matter, in the case of a director, who is also an employee of the company, section 40A(5) of the 1961 Act would be applicable [*CIT v. Amritsar Rayon and Silk Mills* (*P.*) *Ltd.,* (1989) 179 ITR 292, 295 (Punj)]. Also see, *CIT v. Warner Hindustan Ltd.,* (1984) 145 ITR 24 (AP); *CIT v. South India Viscose Ltd.,* (1987) 163 ITR 674 (Mad); *Kesaria Tea Co. Ltd. v. CIT,* (1991) 189 ITR 374, 376-77 (Ker). It is pertinent to note that the **contrary view** (as discussed above) taken in *Travancore Rayons Ltd. v. CIT*, (1986) 162 ITR 732 (Ker) is **no longer good law** as held in *CIT v. Continental Construction Ltd.*, (1998) 230 ITR 485, 493 (SC).

According to the Andhra Pradesh High Court, while applying the ceiling on the expenditure incurred upon and the remuneration paid to and perquisites provided to a director-employee, (1) the expenditure of the nature referred to in clauses (*i*), (*ii*), (*iii*) and (*iv*) of the second proviso to section 40A(5)(*a*) of the 1961 Act shall not be taken into account; and (2) the aggregate of the expenditure and allowance referred to in sub-clauses (*i*) and (*ii*) of section 40A(5)(*a*) of the 1961 Act and the expenditure and allowance referred to in sub-clauses (*i*) and (*ii*) of section 40(*c*) of the 1961 Act shall not exceed ₹ 72,000 or ₹ 1,02,000, as the case might have been. In all other respects, it is section 40(*c*) of the 1961 Act that applies to directors-employees [*CIT v. D.B.R. Mills,* (1988) 172 ITR 366, 371-72 (AP)].

Thus, on a plain reading of the first proviso, the maximum limit was ₹ 1,02,000 [(up to assessment year 1984-85) ₹ 72,000] [*CIT v. Patiala Flour Mills Co. P. Ltd.,* (1980) 123 ITR 7 (Punj); *CIT v. Patiala Flour Mills Co. P. Ltd.,* (1989) 180 ITR 75 (Punj)]. **But**, the applicability of this outer maximum ceiling (limit) did not mean that the inner ceiling for computing permissible expenditure and allowances as contemplated by section 40A(5)(*c*) of the 1961 Act could not be pressed into service or gets ruled out. Thus, both these ceilings—inner ceiling and outer ceiling—could harmoniously co-exist. *For example*, if the employer-company in a given year had spent ₹ 1,50,000 on his employee-director by providing him with salary of ₹ 1,00,000 per year and perquisites of ₹ 50,000 per year. Then, as far as perquisites are concerned, the inner ceiling of ₹ 12,000 per year would operate by mandate of section 40A(5)(*a*)(*ii*) read with section 40A(5)(*c*)(*ii*) of the 1961 Act, for the simple reason that one-fifth of the salary would be ₹ 20,000 and would be in excess of the permissible limit of ₹ 12,000 as per the provision of section 40A(5)(*a*)(*ii*) read with section 40A(5)(*c*)(*ii*) of the 1961 Act. The outer limit as laid down by the first proviso to section 40A(5)(*a*) of the 1961 Act would be ₹ 72,000. Deducting ₹ 12,000 from the outer limit of ₹ 72,000, the balance of only ₹ 60,000 would be covered by the permissible expenditure under sub-head of salary. Even there, if the Income-tax Officer in his discretion held that the salary was excessive, the permissible expenditure on salary of director might get still reduced below ₹ 60,000. Thus, permissible expenditure by way of salary of such director would be at the highest ₹ 60,000 and the permissible expenditure of perquisites would be ₹ 12,000 and that is how, total of ₹ 72,000 would be worked out as total permissible expenditure on such director-employee, on the combined operation of the aforesaid various provisions of section 40A of the 1961 Act [*CIT v. Rajesh Textile Mills Ltd.,* (1988) 173 ITR 179, 195-96 (Guj)].

The first proviso applies even to a case where the employee was a director for the entire year concerned [*International Instruments P. Ltd. v. CIT,* (1981) 130 ITR 315 (Karn), **followed in** *CIT v. International Instruments P. Ltd.*, (1983) 144 ITR 936 (Karn), holding that section 40A(5) applied to the remuneration paid to a director of the assessee-company. Also see, *CIT v. Mysodet Pvt. Ltd.,* (1998) 233 ITR 674, 677 (Karn)].

In *CIT v. Travancore Chemical Mfg. Co.*, (1982) 133 ITR 818 (Ker), **SLP dismissed**: (1982) 137 ITR (St.) 13 (SC), the two managing directors of the assessee-company were held to be employees of the company and the remuneration paid to them was held subject to restrictions of section 40A(5) of the 1961 Act. The application of the first proviso to section 40A(5)(*a*) of the 1961 Act was not raised or considered. Also see, *Travancore Chemical & Manufacturing Co. Ltd. v. CIT,* (1997) 226 ITR 429, 432, 439, 441 (Ker).

In *International Instruments Pvt. Ltd. v. CIT*, (1994) 205 ITR 483, 484 (Karn), **SLP dismissed**: (1992) 194 ITR (St.) 237 (SC), the disallowance under section 40A(5) of the 1961 Act of ₹ 12,000 out of remuneration paid to managing director and ₹ 14,492 out of remuneration paid to director was held not right in law.

Which provision was appropriate in case of director-*cum*-employee?—Section 40(*c*) of the 1961 Act made special provisions applicable, in case of company-assessee, to remuneration, etc., to a director or a person having substantial interest in the company or a relative of the director or of such person. Section 40(*a*)(*v*) of the 1961 Act, operative for assessment years 1969-70 to 1971-72, enacted general provisions applicable to company as well as non-company assessees in relation to benefit or amenity or perquisite to employees. It may be that a director, etc., is also an employee of the assessee-company. In such a case, the question may arise as to which of the above two provisions—section 40(*c*) or section 40(*a*)(*v*) of the 1961 Act—is applicable? The Gujarat High Court has taken the view that such a case is to be governed by section 40(*c*) and not section 40(*a*)(*v*) of the 1961 Act. In arriving at such conclusion, their Lordships relied on the well-settled principle of interpretation that where there is a general enactment [section 40(*a*)(*v*) of the 1961 Act] as well as a special enactment [section 40(*c*) of the 1961 Act] in respect of the same head in a statute, the special enactment will override the general enactment [*Addl. CIT v. Tarun Commercial Mills Ltd.,* (1978) 113 ITR 745 (Guj), **followed in** *Saurashtra Cement and Chemical Industries Ltd. v. CIT,* (1980) 123 ITR 669 (Guj) and *CIT v. Ahmedabad Kaiser-i-Hind Mills Co. Ltd.,* (1983) 141 ITR 472 (Guj); *CIT v. Maneklal Harilal Spng. & Mfg. Co. Ltd.,* (1983) 141 ITR 129 (Guj)].

Following the aforestated view, the Calcutta High Court has held that the case of the directors of a company, who are also employees of the company, will be governed by the provisions of section 40(*c*) of the 1961 Act and not those of section 40A(5) of the 1961 Act [*CIT v. Indian Molasses Co.* (*P.*) *Ltd.,* (1989) 176 ITR 473, 478 (Cal)]. Also see, *CIT v. Hico Products Pvt. Ltd.,* (1993) 201 ITR 567, 575 (Bom); *Scindia Steam Navigation Co. Ltd. v. CIT,* (1995) 211 ITR 747, 751 (Bom); *CIT v. Westerwork Engineers Ltd.,* (1995) 124 CTR (Bom) 174, 175; *CIT v. Sales Magnesite* (*Pvt.*) *Ltd.,* (1995) 214 ITR 1, 3-4 (Bom); *CIT v. Chowgule & Co. Pvt. Ltd.,* (1995) 214 ITR 523, 525 (Bom); *CIT v. Parke Davis* (*India*) *Ltd.,* (1995) 214 ITR 587, 588 (Bom); *CIT v. J&J Dechane Laboratories* (*P.*) *Ltd.,* (1996) 222 ITR 11, 12-13 (AP); *CIT v. Godfray Phillips India Ltd.,* (1997) 224 ITR 727, 728 (Bom); *CIT v. Marshall Produce Brokers Co. Pvt. Ltd.,* (1997) 138 Taxation 750 (Bom); *CIT v. Dodsal Pvt. Ltd.,* (1997) 138 Taxation 754, 755 (Bom); *CIT v. Steel Tubes of India Ltd.,* (1997) 140 Taxation 239, 240 (MP); *CIT v. Bombay Tyres International Ltd.,* (1997) 140 Taxation 332 (Bom); *CIT v. Vidyut Engineering & Tech. Pvt. Ltd.,* (1997) 140 Taxation 335 (Bom); *CIT v. Pentax Engineering Pvt. Ltd.,* (1997) 140 Taxation 336 (Bom); *CIT v. Hickson & Dadajee Ltd.,* (1997) 141 Taxation 395, 396 (Bom); *CIT v. Mafatlal*

Dyes & Chemicals Ltd., (1997) 141 Taxation 549, 550-51 (Bom); *CIT v. Consolidated Pneumatic Tools Co.* (*India*) *Ltd.,* (1997) 141 Taxation 616, 617 (Bom); *CIT v. Mahindra Socier Ltd.,* (1997) 141 Taxation 630, 631 (Bom); *CIT v. Hindustan Lever Ltd.,* (1997) 141 Taxation 758 (Bom); *CIT v. Fit Tight Nuts & Bolts Ltd.,* (1997) Tax LR 517, 518 (Bom); *CIT v. R.K. Swamy Advertising Associates* (*P.*) *Ltd.,* (1997) Tax LR 911, 912 (Mad); *CIT v. Orwo Ltd.,* (1998) 143 Taxation 396, 397 (Bom); *CIT v. R.H. Windsor* (*I*) *Ltd.,* (1998) 143 Taxation 401, 402 (Bom); *Maharashtra Small Scale Industries Development Corporation Ltd. v. CIT,* (1997) Tax LR 544 (Bom); *CIT v. I.A. & I.C. Pvt. Ltd.*, (1999) 239 ITR 1, 2 (Bom); *CIT v. Mahindra & Mahindra Ltd.*, (1999) 239 ITR 937, 938-39 (Bom), **SLP granted**: (1998) 234 ITR (St.) 29 (SC); *CIT v. Trade Wings Ltd.*, (2000) 241 ITR 198, 199, 203 (Bom); *CIT v. Indian Organic Chemicals Ltd.*, (1999) 153 Taxation 242, 243 (Bom); *CIT v. Indian Hotels Co. Ltd.*, (2002) 168 Taxation 213, 214-15 (Bom); *Mentha & Allied Products P. Ltd. v. CIT*, (2007) 293 ITR 49 (All). **However**, the Punjab High Court has, in *CIT v. Amritsar Rayon and Silk Mills* (*P.*) *Ltd.*, (1989) 179 ITR 292 (Punj), **dissented from** *Addl. CIT v. Tarun Commercial Mills Ltd.*, (1978) 113 ITR 745 (Guj).

At the same time, section 40(*c*) of the 1961 Act does not envisage the case of an employee-director who is posted out of India. Such a case is dealt with only by section 40A(5)(*b*) of the 1961 Act. This being so, at least *qua* employee-directors employed outside India, section 40A(5)(*b*) of the 1961 Act is a specific provision and section 40(*c*) of the 1961 Act has to be regarded as a general provision. On the principle that, if there is a general provision and there is also a special provision, then it is the special provision which will prevail, the only conclusion to which one can come is that the case of remuneration to employee-directors posted outside India would fall under the provisions of section 40A(5) and not section 40(*c*) of the 1961 Act [*Continental Construction Ltd. v. CIT,* (1990) 185 ITR 178, 228 (Del)]. This Delhi decision [185 ITR 178 (Del)] has been **followed in** *CIT v. Western Electronics Ltd.*, (1993) 117 Taxation 435, 436 (Del); *CIT v. Weston Electronics Ltd.*, (1993) 117 Taxation 354, 355 (Del). **Affirming** the Delhi decision [185 ITR 178 (Del)], the Supreme Court has, in *CIT v. Continental Construction Co.*, (1998) 230 ITR 485, 495 (SC), held that any expenditure covered by section 40A(5)(*b*)(*i*) of the 1961 Act [which concerns any expenditure or allowance in relation to any employee in respect of any period of his employment outside India] in respect of an employee-director shall not be taken into account for the purposes of calculating the aggregate of expenditure under the first proviso to section 40A(5)(*a*) of the 1961 Act for the application of the ceiling limit prescribed there. Thus, **following** the above Supreme Court ruling [230 ITR 485 (SC)], it has been held that the Tribunal was not right in law in holding that proportionate salary of employees of the assessee for the period of their stay outside India in the ordinary course of their employment should not be excluded from the total salary while computing disallowance under section 40A(5) of the 1961 Act [*Colour Chem Ltd. v. CIT*, (1999) 238 ITR 171, 173 (Bom)].

In *CIT v. Indo Oceanic Shipping Co. Ltd.*, (2001) 247 ITR 247, 250, 258-59 (Bom), it has been held that the salary payable to the floating staff for the period of employment outside India should not be considered for the purpose of disallowance under section 40A(5)(*a*) of the 1961 Act. Similarly, in *South India Shipping Corporation Ltd. v. CIT*, (2001) 250 ITR 624, 628-29 (Mad), it has been held that as the Tribunal has found that expenditure in respect of which the assessee contended that section 40A(5)(*b*)(*i*) of the 1961 Act is applicable is expenditure incurred on the floating staff, the expenditure is required to be excluded from section 40A(5)(*a*) of the 1961 Act. However, the expenditure incurred on shore staff during the period spent by them outside India is not to be so excluded.

In *Krishnakeshsav Laboratories Ltd. v. CIT*, (2002) 254 ITR 149, 151 (Guj), it has been held that by virtue of the exception enacted in section 40A(5)(*b*)(*i*) of the 1961 Act, the amount of salary paid to an employee during his period of employment outside India cannot be disallowed or cannot be subject to the ceiling prescribed under section 40A(5)(*a*) of the 1961 Act.

In *CIT v. Indian Engineering & Commercial Corporation P. Ltd.*, (1993) 201 ITR 723, 728 (SC), it has been observed that in case of directors who were also employees, both section 40(*c*) and section 40A(5) of the 1961 Act would be attracted—the higher of the two ceilings was to be applied. Also see, *Bombay Forgings Pvt. Ltd. v. CIT,* (1994) 206 ITR 562, 566 (Bom); *CIT v. Colgate Palmolive* (*India*) *Pvt. Ltd.,* (1994) 210 ITR 770, 778 (Bom); *Ceat Tyres of India Ltd. v. CIT,* (1994) 121 CTR (Bom) 80, 82; *Sapt Textile Produces* (*India*) *Ltd. v. CIT,* (1996) 217 ITR 378, 380 (Bom); *CIT v. Synpol Products Pvt. Ltd.,* (1996) 217 ITR 154, 156-57 (Guj); *CIT v. Lucas TVS Ltd.,* (1997) 226 ITR 281, 290 (Mad); *CIT v. Continental Construction Ltd.,* (1998) 230 ITR 485, 492 (SC); *CIT v. Premier Cotton Mills Ltd.*, (1999) 240 ITR 434, 437 (Mad); *T.P. Sokkalal Ramsait Factory* (*P.*) *Ltd. v. CIT*, (2000) 244 ITR 369, 371 (Mad); *Super Spinning Mills Ltd. v. CIT*, (2004) 265 ITR 233, 238 (Mad); *CIT v. Ruby Coach Building Pvt. Ltd.*, (1999) 152 Taxation 450 (Bom); *CIT v. Moti Electric Industries* (*P.*) *Ltd.*, (2002) 125 Taxman 590, 591 (Del); *CIT v. Autometer Ltd.*, (2004) 187 CTR (Del) 547, 549; *Gayways Publicity (P.) Ltd. v. CIT*, (2010) 2 taxmann.com 114 (Del).

In *CIT v. R.K. Swamy Advertising Associates* (*P.*) *Ltd.*, (1998) 232 ITR 440, 442-43 (Mad), it has been held that the disallowance towards remuneration paid to the managing director of the assessee-company should be

regulated in terms of section 40(*c*) of the 1961 Act and not as per section 40A(5) of the 1961 Act, for assessment years 1975-76 and 1976-77.

Disallowance on estimated basis, held not justified.—Where the statement of facts recorded by the Tribunal in the reference to the High Court indicated that the claim for expenses towards salary, allowances and house rent paid to employees and value of perquisites was within the prescribed limits of section 40A(5) of the 1961 Act, the Tribunal was held not justified in reversing the order of the first appellate authority and restoring the order of the Assessing Officer in respect of making disallowance of ₹ 50,000 made under section 40A(5) of the 1961 Act on estimated basis [*B & A Plantations & Industries Ltd. v. CIT*, (2001) 251 ITR 455, 459-60, 461 (Gauh)].

NO DOUBLE DEDUCTION IN CASE OF BANKING COMPANIES [Omitted s. 40(*d*) of 1961 Act]

Provisions.—Section 20(1) of the 1961 Act [operative up to assessment year 1988-89] provided for apportionment of the general expenses in the case of a banking concern into those incurred in respect of collection, etc., of interest on securities and those related to the other business, and for allowing the same respectively, under respective heads of income. Section 20(2) of the 1961 Act provided that expenses deducted under section 20(1) of the 1961 Act shall not form part of the deductions by way of general business expenditure. **Section 40(*d*) of the 1961 Act**, **operative up to assessment year 1988-89**, again repeated or assured the same provisions contained in section 20(2) of the 1961 Act.

PROVISION FOR GRATUITY

Provision for gratuity, law up to assessment year 1972-73.—Every businessman would like to make an estimate of the amount that may be payable as gratuity to his employees likely to retire in the coming years. By way of a shock-absorber, he may create a provision therefor from year to year. The question is whether transfers to such fund would be permissible deductions as business expenditure? It was held that the provision for payment of such gratuity, if ascertained by actuarial (or scientific) calculations in which all contingencies are taken into consideration, is a liability *in praesenti* and the amount so set apart is a permissible business expenditure, under section 37(1) of the 1961 Act, in the year concerned for assessees following mercantile system of accounting [*Madho Mahesh Sugar Mills Pr. Ltd. v. CIT*, (1973) 92 ITR 503 (All); *Delhi Flour Mills Co. Ltd. v. CIT*, (1974) 95 ITR 151 (Del); *India United Mills Ltd. v. CIT*, (1975) 98 ITR 426 (Bom); *CIT v. Indian Metal & Metallurgical Corporation*, (1964) 51 ITR 240 (Mad); *CIT v. Laxmi Sugar & Oil Mills Ltd.*, (1978) 114 ITR 684 (All); *Tata Iron & Steel Co. Ltd. v. D.V. Bapat, ITO*, (1975) 101 ITR 292 (Bom); *CIT v. Ballarpur Industries Ltd.*, (1979) 119 ITR 817 (Bom); *CIT v. Standard Furniture Co. Ltd.*, (1979) 116 ITR 751 (Ker—FB); *CIT v. Pratap Cashew Co. P. Ltd.*, (1979) 116 ITR 733 (Ker); *CIT v. Andhra Prabha P. Ltd.*, (1980) 123 ITR 760 (Mad), **affirmed in** *CIT v. Andhra Prabha Pr. Ltd.*, (1986) 158 ITR 416 (SC); *L.H. Sugar Factories & Oil Mills v. CIT*, (1980) 124 ITR 58 (All); *CIT v. Sri Ranilakshmi Ginning Spng. & Wvg. Mills P. Ltd.*, (1981) 132 ITR 360 (Mad), **SLP dismissed**: (1991) 187 ITR (St.) 71 (SC); *Nagri Mills Co. Ltd. v. CIT*, (1981) 131 ITR 257 (Guj); *CIT v. Chamarchi Tea, Textile & Engineering Industries Ltd.*, (1982) 137 ITR 281 (Cal); *L.H. Sugar Factories & Oil Mills Pr. Ltd. v. CIT*, (1982) 137 ITR 277 (All); *CIT v. Coimbatore Cotton Mills Ltd.*, (1983) 140 ITR 562 (Mad), **SLP granted**: (1990) 186 ITR (St.) 35-36 (SC); *CIT v. Mettur Spng. Mills*, (1983) 140 ITR 991 (Mad), **SLP dismissed**: (1991) 187 ITR (St.) 70 (SC); *CIT v. Sitalakshmi Mills Ltd.*, (1983) 141 ITR 415 (Mad), **SLP granted**: (1991) 191 ITR (St.) 76 (SC); *CIT v. Hindustan Times Ltd.*, (1983) 144 ITR 670 (Del); *CIT v. Vijaya Productions Pr. Ltd.*, SLP (Civil) No. 9956 of 1981: (1984) 146 ITR (St.) 5 (SC); *Balanoor Tea & Rubber Co. Ltd. v. State of Karnataka*, (1984) 148 ITR 736 (Karn); *CIT v. Bajraj Textiles Mills Ltd.*, (1984) 39 CTR (Mad) 270; *CIT v. Lucas TVS Ltd.*, (1985) 153 ITR 239 (Mad); *CIT v. S.A.E.* (*I*) *Pr. Ltd.*, (1985) 153 ITR 269 (Mad), **SLP dismissed**: (1992) 193 ITR (St.) 29 (SC); *CIT v. Mittal Steel Re-rolling & Allied Industries Pr. Ltd.*, (1985) 155 ITR 1 (Ker); *CIT v. Remington Rand India Ltd.*, (1986) 159 ITR 922 (Cal); *Kil Kotagiri Tea & Coffee Estates Co. Ltd. v. CAgIT*, (1986) 161 ITR 497 (Mad); *CIT v. Canning Mitra Phoenix Pr. Ltd.*, (1986) 162 ITR 836 (SC); *CIT v. Pearey Lal & Sons Pr. Ltd.*, (1986) 162 ITR 838 (SC); *CIT v. Perfect Pottery Co.* (*M.B.*) *Ltd.*, (1987) 163 ITR 529 (MP); *CIT v. South India Viscose Ltd.*, (1987) 163 ITR 674 (Mad), **SLP dismissed**: (1992) 193 ITR (St.) 2 (SC); *CIT v. Travancore Rayons Ltd.*, (1987) 164 ITR 134 (Ker); *CIT v. John Fleming & Co. Ltd.*, SLP (Civil) No. 7562 of 1979: (1987) 164 ITR (St.) 151 (SC); *CIT v. Victor Gasket Industries Ltd.*, SLP (Civil) No. 307 of 1979: (1987) 164 ITR (St.) 151 (SC); *CIT v. Guest Keen Williams Ltd.*, (1987) 166 ITR 405 (Cal); *CIT v. Steel Rolling Mills of Bengal Ltd.*, (1988) 169 ITR 430 (Cal); *CIT v. Orient Paper Mills Ltd.*, (1988) 171 ITR 181 (Cal); *CIT v. Gabriel India Ltd.*, (1989) 179 ITR 54 (Bom); *CIT v. Camlin Pvt. Ltd.*, (1989) 180 ITR 638 (Bom); *CIT v. International Clearing & Shipping Agency*, SLP (Civil) No. 531 of 1984: (1990) 181 ITR (St.) 20 (SC); *CIT v. Ashoka Marketing Ltd.*, (1990) 181 ITR 493 (Cal); *CIT v. Small Tools Manufacturing Co. of India Ltd.*, (1990) 186 ITR 266 (Cal); *CIT v. Polychem Ltd.*, SLP (Civil) No. 2170 of 1985: (1990) 186 ITR (St.) 75 (SC); *CIT v. Prakash Cotton Mills Pvt. Ltd.*, (1991) 188 ITR 713, 714 (Bom); *CIT v. Coromandel Engineering Co. Ltd.*, SLP (Civil) No. 6368 of 1984: (1991) 189 ITR

(St.) 114-15 (SC); *Kesoram Industries & Cotton Mills Ltd. v. CIT*, (1991) 191 ITR 518, 525-26 (Cal); *CIT v. T. Maneklal Mfg. Co. Ltd.*, (1991) 192 ITR 268, 271 (Bom); *CIT v. State Bank of Hyderabad*, SLP (Civil) No. 14886 of 1985: (1992) 193 ITR (St.) 11-12 (SC); *CIT v. Dalmia Dadri Cement Ltd.*, (1992) 195 ITR 290, 310 (Del); *CIT v. Dunlop India Ltd.*, (1992) 197 ITR 34, 41 (Cal); *CIT v. Metal Box India Ltd.*, (1992) 63 Taxman 160, 161 (Cal); *CIT v. Dalmia Dadri Cement Ltd.*, (1992) 103 CTR (Del) 97; *CIT v. Jiyajeerao Cotton Mills Ltd.*, (1992) 103 CTR (Cal) 426, 428; *CIT v. Soorajmul Nagarmull*, (1992) 107 CTR (Cal) 134, 136; *CIT v. Garware Synthetic Bristles*, (1994) 205 ITR 426 (SC); *J.K. Chemicals Ltd. v. CIT*, (1994) 207 ITR 725, 727 (Bom); *CIT v. Kelvinator of India Ltd.*, (1994) 210 ITR 933, 939, 941 (Del); *CIT v. Hindusthan Pilkington Glass Works Ltd.*, (1994) 73 Taxman 631, 634-35 (Cal); *CIT v. V.S. Dempo & Co. Pvt. Ltd.*, (1994) 122 CTR (Bom) 288, 289; *CIT v. V.S. Dempo & Co. Pvt. Ltd.*, (1996) 131 CTR (Bom) 203, 204-05; *CIT v. Electric Construction & Equipment Co. Ltd.*, (1996) 133 Taxation 411, 412 (Del); *CIT v. Sudarsan Trading Co. Ltd.*, (1996) Tax LR 245, 246 (Mad) *CIT v. Uma Trading Co.*, (1998) 231 ITR 272 (SC); *CIT v. Ghaziabad Engineering Co.* (*P.*) *Ltd.*, (2001) 249 ITR 244, 252-53 (Del); *CIT v. Kanpur Textiles Ltd.,* (2005) 143 Taxman 274, 283 (All) = (2005) 276 ITR 140 (All). Also see, *Metal Box Co. of India Ltd. v. Their Workmen*, (1969) 73 ITR 53 (SC); *Southern Railway of Peru Ltd. v. Owen*, (1957) 32 ITR 737 (HL). Provision for gratuity made on the basis of the notification issued by the State Government also held deductible [*CIT v. Rohtak & Hissar District Electric Supply Co.* (*P.*) *Ltd.*, (1990) 88 CTR (Del) 230, 232]. The provision is held deductible even though such valuation was made after the close of the accounting year [*Ishwar Industries Ltd. v. CIT*, (1984) 149 ITR 301 (Del), **SLP granted**: (1990) 186 ITR (St.) 75 (SC)]. Further, statutory gratuity liability held allowable even though no provision was made therefor [*CIT v. Shyam Nagar Tin Factory Pr. Ltd.*, (1984) 150 ITR 617 (Cal); *CIT v. Woolcombers India Ltd.*, (1984) 41 CTR (Cal) 63; *CIT v. Calcutta Electric Supply Corporation Ltd.*, (1987) 166 ITR 797 (Cal)].

Provision for payment of gratuity even on actuarial valuation is allowable to the extent the liability in that regard pertains to the relevant accounting year. Accumulation for a number of years and claim in a year of the assessee's choice is not possible [*Mysore Tobacco Co. Ltd. v. CIT*, (1978) 115 ITR 698 (Karn); *CIT v. High Land Produce Co. Ltd.*, (1976) 102 ITR 803 (Ker), **affirmed in** *CIT v. High Land Produce Co. Ltd.*, (1986) 158 ITR 419 (SC); *Dalmia Dadri Cement Ltd. v. CIT*, (1980) 126 ITR 851 (Del), **SLP dismissed**: (1983) 144 ITR (St.) 11 (SC); *CIT v. Travancore Timbers & Products*, (1984) 149 ITR 450 (Ker), **SLP dismissed**: (1986) 161 ITR (St.) 131 (SC)]. In this view of the matter, any provision based on actuarial basis made in the year in which the statutory liability for payment of gratuity first came into force is allowable even though such provision relates to earlier years including that year [*CIT v. Eastern Spng. Mills Ltd.*, (1980) 126 ITR 686 (Cal), **followed in** *CIT v. Ramdutt Ramkissendass*, (1988) 172 ITR 142 (Cal); *CIT v. Binani Metal Works Ltd.*, (1989) 175 ITR 182 (Cal); *CIT v. Bally Jute Co. Ltd.*, (1990) 182 ITR 428 (Cal); *CIT v. Bharat Starch & Chemicals Ltd.*, (1989) Tax LR 358 (Cal); and *CIT v. Indian Oxygen Ltd.*, (1990) 184 ITR 339, 341 (Cal); *CIT v. Carborandum Universal Ltd.*, (1995) 216 ITR 360, 361, 365 (Mad)]. **But** in any year subsequent to the first year of statutory liability, provision on actuarial basis is allowable only to the extent to which it pertains to that particular year [*Mysore Tabacco Co. Ltd. v. CIT*, (1978) 115 ITR 698 (Karn)]. Thus, liability for gratuity can be allowed only in the year in which that liability has accrued and not in any other year [*Karvalves Ltd. v. CIT*, (1992) 197 ITR 95, 106 (Ker), **SLP granted**: (1992) 193 ITR (St.) 105 (SC)]. Also see, *CIT v. Kanpur Textiles Ltd.,* (2005) 143 Taxman 274, 283 (All) = (2005) 276 ITR 140 (All).

If, however, one or more employees have retired in a particular year, provision may be made as per the rules for the amount to be payable to them and the claim for allowance will be allowed since the liability had accrued during the year [*Seshasayee Bros. (Travancore) P. Ltd. v. CIT*, (1971) 82 ITR 442 (Ker)]. **But** provision for gratuity does not represent an accrued liability for the year in which a notice of termination of the services is issued [*CIT v. Nagpal Optical Co.*, (2001) 248 ITR 665, 667-68 (Del)].

A claim in respect of a liability already incurred during an earlier year cannot be made in a later year [*CIT v. Kerala Nut Food Co.*, (1978) 111 ITR 252 (Ker); *CIT v. Mittal Steel Re-rolling & Allied Industries (P.) Ltd.*, (1985) 155 ITR 1 (Ker); *CIT v. Commonwealth Trust Ltd.*, (1988) 169 ITR 134, 138 (Ker), **SLP granted**: (1990) 183 ITR (St.) 156 (SC)]. The department, accordingly, issued *Circular No. 47, dated 21-9-1970*: (1970) 78 ITR (St.) 13, directing allowance of such provision. Later, by *Circular No. 146, dated 26-9-1974*: (1975) 101 ITR (St.) 46, those instructions were **withdrawn** in view of the decision in *Bombay Dyeing & Mfg. Co. Ltd. v. CWT*, (1974) 93 ITR 603 (SC) **confirming** decision of *Standard Mills Co. Ltd. v. CWT*, (1967) 63 ITR 470 (SC). The later-issued *Circular No. 146, dated 26-9-1974* was held to be **unwarranted and untenable** in *Tata Iron & Steel Co. Ltd. v. D.V. Bapat, ITO*, (1975) 101 ITR 292 (Bom). Also see, *L. Madanlal (Aluminium) Pr. Ltd. v. ITO*, (1978) 115 ITR 293 (Cal); *Birpara Tea Co. v. ITO*, (1980) 126 ITR 704 (Cal). It may be noted that section 36(1)(*v*) of the 1961 Act does not come in the way of allowability of such a provision [*CIT v. Andhra Pradha P. Ltd.*, (1980) 123 ITR 760, 767 (Mad), **affirmed in** *CIT v. Andhra Prabha Pr. Ltd.*, (1986) 158 ITR 416 (SC); *Nagri Mills Co. Ltd. v. CIT*, (1981) 131 ITR 257 (Guj); *Addl. CIT v. Madho Mahesh Sugar Mills*, (1978) 114 ITR 432 (All); *Addl. CIT v. Rup Chemicals Pr. Ltd.*, (1978) CTR (All) 188]. The said *Circular No.*

LexisNexis

146, dated 26-9-1974, providing that any allowance of gratuity liability towards an unapproved gratuity fund under section 37(1) of the 1961 Act shall not be made, is in **direct conflict with the law laid down by the Supreme Court** in *Metal Box Co. of India Ltd. v. Their Workmen*, (1969) 73 ITR 53 (SC). Therefore, the said circular has to be ignored in making the assessments up to and including the assessment year 1972-73 [*CBDT v. Chloride India Ltd.*, (1997) 225 ITR 129, 132-33 (Cal)].

Gratuity liability payable under an award was held deductible even though no trust was created [*CIT v. Saran Engineering Co. Ltd.*, (1991) 187 ITR 637, 638 (All)].

Incremental gratuity liability payable to the employees in respect of the business that was retained was held to be an admissible deduction [*CIT v. Sarada Binding Works*, (1985) 152 ITR 520 (Mad)]. In the facts of *CIT v. Carborandum Universal Ltd.*, (1995) 216 ITR 360, 361, 365 (Mad), provision for incremental liability (₹ 1,74,314) to pay gratuity to the employees was held allowable in the assessment year 1972-73.

Amount withheld by the vendee towards the vendor's statutory liability for gratuity held deductible in the hands of the vendor [*Co-operative Tea Society Ltd. v. CIT*, (1985) 154 ITR 405 (Ker)].

In *CIT v. Indian Express (Madurai) Pr. Ltd.*, (1983) 140 ITR 705 (Mad), it was held that claim for deduction in respect of provision for gratuity on valid grounds may be entertained by the Tribunal even as an additional ground.

Tribunal was held justified in remitting the matter to the Income-tax Officer for considering as to whether the provision for gratuity was based on scientific basis [*V.D. Swami & Co. Pr. Ltd. v. CIT*, (1984) 146 ITR 425 (Mad), **SLP dismissed**: (1991) 187 ITR (St.) 68 (SC); *CIT v. Madras Rubber Factory Ltd.*, (1984) 149 ITR 411 (Mad)]. Also see, *CIT v. Dalmia Dadri Cement Ltd.*, (2003) 263 ITR 364, 367-68 (Del).

Where, without setting aside the AAC's order, the Tribunal directed fresh working of gratuity figures after excluding future increments, deduction of the amount as originally allowed by the AAC was held allowable even though the fresh working gave a figure in excess of such originally allowed figure [*Travancore Rayons Ltd. v. CIT*, (1991) 191 ITR 121, 125-26 (Ker)].

Provision made for future payment of gratuity, if not based on any legal or scientific basis [*Official Liquidator v. CIT*, (1971) 81 ITR 528 (Bom); *L.H. Sugar Factories and Oil Mills v. CIT*, (1980) 124 ITR 58 (All); *Sheveroy Estates Ltd. v. Govt. of Tamil Nadu*, (1981) 132 ITR 214 (Mad)]; or claim for an *ad hoc* sum not based on any actuarial valuation [*CIT v. McDowell & Co. Ltd.*, (1985) 156 ITR 162 (Mad), **SLP dismissed**: (1991) 187 ITR (St.) 46-47 (SC)], is not allowable. Similarly, no deduction is possible in respect of a non-statutory liability about gratuity unless proper book-entries are made thereabout or actual payment has been made [*Escorts (Agents) P. Ltd. v. CIT*, (1971) 80 ITR 61 (Del)]. Further, provision for gratuity made in a year prior to the statute creating the liability came into force held not allowable [*CIT v. Khandelwal Bros. Pr. Ltd.*, (1986) 158 ITR 207 (Cal)].

LexisNexis

Where the provisions of the Kerala Industrial Employees (Payment of Gratuity) Act, 1970, which was preceded by an Ordinance promulgated on 9-12-1969, made it obligatory for employers to set aside particular amounts for payment as gratuity to their employees in respect of the accounting year 1969-70 and for the earlier years in which the employees of the concerned employer had served, the assessee, whose business has been taken over on 15-10-1970, as a running concern by a firm consisting of himself and another as partners, was held not entitled to deduction in respect of the amount debited by him in the profit and loss account of the previous year ending 14-10-1970 (relevant to assessment year 1971-72). Such am entry could not and did not represent any disbursement of money by the assessee and, therefore, neither on the principles of mercantile system of accounting nor on the basis of the cash system of accounting could the assessee validly claim this amount as a deduction [*K.J. Francis v. CIT*, (1999) 236 ITR 308, 311 (SC)].

Claim for gratuity on actual claim basis cannot be allowed in a case where the gratuity provision has been allowed on actuarial basis [*Oriental General Industries Ltd. v. CIT*, (1993) 114 CTR (Cal) 237, 238-39].

Reference may also be made to *CIT v. William Goodacre* (*India*) *Ltd.*, SLP (Civil) No. 7772 of 1980: (1983) 141 ITR (St.) 51 (SC); *CIT v. Jayshree Tea & Industries Ltd.*, SLP (Civil) No. 17063 of 1993: (1993) 204 ITR (St.) 146-47 (SC); *CIT v. Modi Spinning & Weaving Mills Co. Ltd.*, SLP (Civil) No. 4987 of 1985: (1994) 207 ITR (St.) 12 (SC); *CIT v. Ganges Manufacturing Co.*, SLP (Civil) No. 16492 of 1994: (1994) 210 ITR (St.) 5 (SC); *CIT v. Hindustan National Glass Industries Ltd.*, CA No. 88 of 1995 arising out of SLP (Civil) No. 3935 of 1986: (1995) 212 ITR (St.) 56 (SC); *CIT v. New Asarwa Mills P. Ltd.*, CC No. 5956 of 1997: (1997) 227 ITR (St.) 55-56 (SC).

As to the allowability of gratuity **up to assessment year 1972-73**, the position has, thus, been summarised by the Supreme Court in *Shree Sajjan Mills Ltd. v. CIT*, (1985) 156 ITR 585, 599-600 (SC):—

(1) Payments of gratuity actually made to the employee on his retirement or termination of his services were expenditure incurred for the purpose of business in the year in which the payments were made and allowed under section 37 of the 1961 Act.

(2) Provision made for payment of gratuity which would become due and payable in the previous year was allowed as an expenditure of the previous year on accrued basis when mercantile system was followed by the assessee.

(3) Provision made by setting aside an advance sum every year to meet the contingent liability and gratuity as and when it accrued by way of provision for gratuity or by way of reserve or fund for gratuity was not allowed as an expenditure of the year in which such sum was set apart.

(4) Contribution made to an approved gratuity fund in the previous year was allowed as deduction under section 36(1)(*v*) of the 1961 Act.

(5) Provisions made in the profit and loss account for the estimated present value of the contingent liability property ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either under section 28 or section 37 of the 1961 Act.

DISALLOWANCE OF OTHER EXPENDITURES
[Omitted ss. 40A(6), 40A(8) & 40A(12) of 1961 Act]

Limitations on allowability of fees for services rendered by some *ex*-employees [omitted s. 40A(6) of 1961 Act].—Under **section 40A(6) of the 1961 Act**, **operative for assessment years 1972-73 to 1988-89**, expenditure incurred by an assessee on payment of fees for services rendered by a person who at any time during the 24 months immediately preceding the relevant previous year was his employee was not to be allowed deduction in computing the taxable profits of the assessee to the extent it exceeded ₹ 90,000 for any of the assessment years 1985-86 to 1988-89 [(₹ 60,000 for any of the assessment years 1972-73 to 1984-85)]. In a case where the assessee also incurred in relation to such person, any expenditure on payment of salary referred to in section 40A(5)(*a*)(*i*) of the 1961 Act, the deduction in respect of the expenditure on payment of fees and that on payment of salary was to be limited to ₹ 90,000 for any of the assessment years 1985-86 to 1988-89 [(₹ 60,000 for any of the assessment years 1972-73 to 1984-85)] in the aggregate.

Disallowance of 15% of interest paid on public deposits by non-banking and non-financial companies [omitted s. 40A(8) of 1961 Act].—*Statutory provision.*—**Section 40A(8) of the 1961 Act** made provisions for disallowance, **for assessment years 1976-77 to 1985-86**, of 15% of the expenditure incurred by a company [not being a *banking company* (as defined) or a *financial company* (as defined)] in respect of any *deposit* [as defined] received by such company.

The provisions of section 40A(8) of the 1961 Act are applicable for and from assessment year 1976-77 and it cannot be said that those provisions are to be applied only to expenditure incurred on or after 1-4-1976 [*Andhra Prabha* (*P.*) *Ltd. v. CIT,* (1998) 144 CTR (Mad) 12, 15-16].

Object of insertion.—As a result of the general policy of credit restraint and enforcement of selective controlled measures by the RBI, it was felt that non-banking non-financial companies had been increasingly resorting to acceptance of deposits from the public to meet their financial requirements. The levy of interest-tax under the Interest-tax Act, 1974, on the gross amount of interest received by scheduled banks on loans and advances made in India had the effect of increasing, on an average, the cost of borrowings from the scheduled banks by about 1%. The levy of this tax had, it was felt, made the acceptance of deposits by non-banking non-financial companies from the public all the more attractive. **The Finance Act, 1975** (25 of 1975), **inserted section 40A(8) of the 1961 Act** under which 15% of the interest paid by such companies on deposits received by them from the public was to be disallowed, for assessment years 1976-77 to 1985-86, in computing their total income.

Section 40A(8) not to exclude or override section 40A(2) of 1961 Act.—On a perusal of the provisions of section 40A(8) of the 1961 Act (operative for assessment years 1976-77 to 1985-86) and those of section 40A(2) of the 1961 Act, it is clear that these two sections have different objects to be achieved and both these can co-exist and may be applicable to the facts of a particular case [*CIT v. Sandika P. Ltd.*, (1989) 179 ITR 117, 120, 121 (Punj)]. In that case, the matter was remanded to the Tribunal to consider as to how much amount was unreasonable or excessive under section 40A(2) of the 1961 Act. It was made clear that 15% was to be disallowed under section 40A(8) of the 1961 Act even if nothing was found excessive or unreasonable.

'Deposit', defined.—The expression 'deposit' was defined in clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act **to mean** any deposit of money with, and **to include** any money borrowed by, a company. This definition is couched very widely which is evident from the word 'any' that precedes 'deposit'. The tenure or nature of the deposit is not relevant in finding out that it is a deposit or not. The nature of deposit, *viz.,* fixed deposit, call deposit, deposit in current account or savings account, is immaterial and irrelevant for determining whether it is a 'deposit' within the meaning of section 40A(8) of the 1961 Act or not. The decisive factor is the true relationship between the assessee-company and its creditors. No doubt, such deposit should not fall in any of the exclusions contained in sub-clauses (*i*) to (*ix*) of clause (*b*) of the said *Explanation* [*CIT v. Jhaveri Bros.*

LexisNexis

& Co. Pvt. Ltd., (1995) 214 ITR 374, 378 (Bom)]. Also see, *CIT v. Vockanardt Pvt. Ltd.,* (1995) 215 ITR 793, 797, 798 (Bom); *CIT v. Bhandari Machinery Co.* (*P.*) *Ltd.,* (1998) 231 ITR 294, 303 (Del).

A reading of section 40A(8) of the 1961 Act makes it absolutely clear that the word 'deposit' has not been qualified by any phrase limiting it to public or private deposit. The word 'deposit' is in respect of any deposits received by the company. Any deposits would definitely cover within its ambit all the deposits whether received from the public or shareholders or from the directors [*CIT v. Nath Roller Flour Mills* (*P.*) *Ltd.*, (2005) 273 ITR 432, 435-36 (All)].

It may be seen that the definition of 'deposit' has been given the widest amplitude so as to include any borrowing by a company. Borrowing is a genetic term. It should include deposits as well as loans and the distinction between deposits and loans was thus obliterated and furnished no saving from the mischief of the provision of section 40A(8) of the 1961 Act. On the one hand, the definition was inclusive and, on the other hand, it excluded certain specific types of loans as appearing in sub-clauses (*i*) to (*ix*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act. A saving could only be had of the exceptions contained in the aforesaid sub-clauses. These sub-clauses had to be looked into for any attempt to find place in the particular kind of loan transactions referred to in the sub-clauses as exceptions [*CIT v. Suman Tea & Plywood Industries* (*P.*) *Ltd.,* (1993) 204 ITR 719, 727 (Cal)]. Also see, *CIT v. Suman Tea & Plywood Industries* (*P.*) *Ltd.,* (1997) 226 ITR 34, 39-40 (Cal).

Where the assessee has not placed any material to show that the amount left with the company by the directors and shareholders was not meant for the use of the company, the very fact that the directors and shareholders allowed that amount to remain with the company for the whole year and chose to receive interest, would indicate that they did intend to leave the amount with the company as 'deposit' in respect of which they expected to, and did receive, interest [*CIT v. Kutty Flushdoor Furniture Co.* (*P.*) *Ltd.*, (2000) 243 ITR 174, 176 (Mad)]. In the facts of that case, the Tribunal was held not right in holding that the amounts left with the company by the directors and shareholders could not be considered as deposits so as to be brought within the meaning of *Explanation* (*b*) to section 40A(8) of the 1961 Act for the assessment years 1980-81 and 1982-83.

Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the sums received from the directors and shareholders of the assessee did not amount to 'deposits' within the meaning of section 40A(8) of the Act and that no disallowance of interest under section 40A(8) of the 1961 Act was called for is a question of law [*CIT v. Kalani Asbestos Cement Pvt. Ltd.,* (1989) 176 ITR 346 (MP)].

Security deposit from employees.—Under **sub-clause (*vi*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act**, the expression 'deposit' did not include any amount received by the company from an employee of the company by way of security deposit. In that view of the matter, no part of the interest paid on the security deposits made by the shop managers, who were the employees of the assessee, could be disallowed under section 40A(8) of the 1961 Act [*CIT v. Bata India Ltd.*, (1993) 201 ITR 884, 892 (Cal)].

Security or advance from purchasing agent, etc.—Under **sub-clause (*vii*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act**, the expression 'deposit' did not include any amount received by the company by way of security or as an advance from any purchasing agent, selling agent or other agent in the course of, or for the purpose of, the business of the company, or as advance against orders for the supply of goods or for the rendering of any service.

The above exclusionary provision could have no application to a case where the amount deposited with the assessee-company by a buying agent by way of security or advance had remained with the assessee-company even after such buying agency came to an end. No doubt, during the subsistence of the buying agency, the interest payable on such deposit would not be subjected to the cut of 15%, but the moment the buying agency would come to an end, the provisions of section 40A(8) of the 1961 Act would again be applied and the cut would be imposable. In that view of the matter, interest paid to the ex-buying agent on the deposit made by it was held to be hit by the provisions of section 40A(8) [*CIT v. Patiala Flour Mills Co. Ltd.,* (1989) 180 ITR 75, 81 (Punj)].

In *Ledo Tea Co. Ltd. v. CIT*, (2000) 241 ITR 605, 615 (Cal), it has been held that the findings to the effect that the persons who had advanced loan were not the purchasing agents, selling against or other agents within the meaning of *Explanation* (*b*)(*vii*) to section 40A(8) of the 1961 Act, were findings of fact so that the exclusionary provisions were not attracted.

Where the assessee-company did not lead any evidence and did not place on record any material to show that the interest paid by it to its agents was covered by *Explanation* (*b*)(*vii*) to section 40A(8) of the 1961 Act, the assessee-company could not claim any benefit under the exclusionary provisions of that *Explanation* [*CIT v. Jagdish Processors P. Ltd.*, (2001) 252 ITR 755, 757 (Guj)].

Loan secured by creation of a mortgage, charge, etc.—According to **sub-clause (*ix*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act**, 'deposit' did not include—

—any amount received by the company as a loan from any person where the loan was secured by the creation of a mortgage, charge or pledge of any assets of the company (in short, such loan referred to as 'relevant loan') and

—the amount of the relevant loan, together with the amount of any other prior debt or loan secured by the creation of a mortgage, charge or pledge of such assets, was not more than 75% of the price that such assets would ordinarily fetch on sale in the open market on the date of creation of the mortgage, charge or pledge for the relevant loan.

In order to attract this exclusionary provision, it was necessary to establish that the loan concerned was secured by the creation of a mortgage, charge or pledge of any assets of the company [*CIT v. Kohinoor Glass Factory P. Ltd.,* (1989) 175 ITR 237, 240 (AP)]. In the facts of that case, it was held that the case of the assessee did not fall within the exception contained in sub-clause (*ix*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act.

A bald assertion claiming the benefit of the exclusionary provision does not suffice for its acceptance unless the assessee indicates as to how the conditions precedent laid down in the exclusionary clause were satisfied [*ITC Ltd. v. CIT,* (1994) 205 ITR 126, 131-32 (Cal)].

But, as the creation of a floating charge can be made orally as held by the Supreme Court in *M.L. Abdul Jabbar Sahib v. H. Venkata Sastri & Sons*, AIR 1969 SC 1147 and *M.C. Chacko v. State Bank of Travancore*, AIR 1970 SC 504 and by the conduct of the parties, the creation of a valid charge can be inferred, the provisions of sub-clause (*ix*) of clause (*b*) of the *Explanation* to section 40A(8) of the 1961 Act were held attracted in a case even where the charge was not created by getting the same registered as per the provisions of the Indian Registration Act, 1908, and the interest on deposits was held not to be disallowed under section 40A(8) of the 1961 Act [*Combined Industrials Ltd. v. CIT,* (1998) 148 CTR (Mad) 553, 559-60]. This very case, as reported in 148 CTR (Mad) 553, has been reported under a different name as *L.G. Balakrishnan & Brothers Ltd. v. CIT*, (2000) 245 ITR 743, 750 (Mad). This Madras view [245 ITR 743 (Mad)] has been **followed in** *CIT v. L.G. Balakrishnan & Brothers Ltd.*, (2001) 247 ITR 131, 133 (Mad); *CIT v. Elgi Equipment Ltd.*, (2002) 176 CTR (Mad) 305, 306-07; *Super Spinning Mills Ltd. v. CIT*, (2004) 265 ITR 233, 236 (Mad).

Section 40A(8) of 1961 Act concerned with interest on deposits, and not with net interest.—Section 40A(8) of the 1961 Act referred to expenditure by way interest in respect of deposits received by the assessee-company and did not referred to the net expenditure on interest after setting off the interest income [*Andhra Prabha* (*P.*) *Ltd. v. CIT,* (1998) 144 CTR (Mad) 12, 16-17 = (1999) 238 ITR 525, 528 (Mad), **followed in** *CIT v. South India Corporation* (*Agencies*) *Ltd.,* (1998) 147 CTR (Mad) 492, 498 = (2000) 246 ITR 581, 587 (Mad)]. This view has been **followed in** *Indian Express* (*Madurai*) *Pvt. Ltd. v. CIT,* (2000) 244 ITR 341, 342-43 (Mad). Thus, applicability of section 40A(8) of the 1961 Act cannot be restricted only to net interest where disallowance under section 40A(8) of the 1961 Act is limited in respect of interest paid on deposits received by company [*CIT v. Farrukhabad Cold Storage* (*P.*) *Ltd.*, (2005) 148 Taxman 64, 67 (All)].

However, a **contrary view** has been taken in *CIT v. Wintex Mills Ltd.*, (2000) 245 ITR 266, 270 (Guj), where, **applying** the principle laid down by the Supreme Court in *Keshavji Ravji & Co. v. CIT*, (1990) 183 ITR 1 (SC), it has been held that the Tribunal was right in law in coming to the conclusion that under the provisions of section 40A(8) of the 1961 Act for the purpose of determining the disallowance, the net amount of interest has to be taken into account.

Illustrations under section 40A(8) of 1961 Act.—The provisions of section 40A(8) of the 1961 Act held attracted in respect of following interest payments:—

(1) Interest paid to friends and relatives of the directors and directors/shareholders on loans and borrowings/advances from them [*Agew Steel Manufacturers Pvt. Ltd. v. CIT,* (1994) 209 ITR 77, 79-80 (Guj); *New Haven Bearing* (*P.*) *Ltd. v. CIT*, (1999) 157 CTR (Guj) 429, 435] including interest paid on the amounts standing to the credit in their current accounts [*CIT v. Gandhi Metals Mills* (*P.*) *Ltd.*, (1993) 200 ITR 252, 257-58 (Raj); *CIT v. Jain Cables Pvt. Ltd.,* (1995) 214 ITR 190, 192 (Raj); *CIT v. Jhaveri Bros. & Co. Pvt. Ltd.,* (1995) 214 ITR 374, 378 (Bom); *CIT v. Khivaraj Motors Ltd.,* (1997) 227 ITR 473, 479-80 (Mad); *CIT v. Hari Finance & Trade* (*P.*) *Ltd.*, (2000) 243 ITR 465, 466-67 (Cal)]. Also see, *CIT v. Navjivan Roller & Pules Mills,* (2001) 251 ITR 661, 663, 670 (Guj), **followed in** *Parikh Enterprises* (*P.*) *Ltd. v. CIT,* (2002) 124 Taxman 468, 469-70 (Guj).

However, the Madhya Pradesh High Court has, relying on the Press Note issued under section 58A of the Companies Act, 1956, held that the sums received from the directors and shareholders, in running current accounts, by the assessee-company did not amount to 'deposits' within the meaning of section 40A(8) of the 1961 Act and, therefore, no disallowance of interest under section 40A(8) of the 1961 Act was called for [*CIT v. Kalani Asbestos Cement* (*P.*) *Ltd.,* (1997) 224 ITR 338, 341-42 (MP)]. Similarly, in *CIT v. Kalani Asbestos (P.) Ltd.*, (1989) 180 ITR 55 (MP), the interest was paid mainly to directors and shareholders on their current account. It was found by the Tribunal that such

LexisNexis

interest was not paid by the assessee in respect of any deposit received by it and, therefore, it was held that disallowance under section 40A(8) of the 1961 Act was not called for. The Tribunal was held justified in so holding. This view has been **followed in** *CIT v. Dadha Plantations* (*P.*) *Ltd.*, (2002) 258 ITR 639, 640 (Mad) so as to hold that no disallowance of interest was called for by invoking section 40A(8) of the 1961 Act as the interest payments were made to the shareholders and directors on the credit balances in their current accounts not in the capacity as deposit holder nor the amounts so lying could be regarded as deposit. Also see, *CIT v. Kakkar Complex Steels (P.) Ltd.*, (2009) 2 taxmann.com 138 (Punj).

(2) Interest paid on the amounts deposited with the company by the directors [*United Mercantile Co.* (*P.*) *Ltd. v. CIT,* (1997) 225 ITR 983, 986 (Ker); *CIT v. Bhandari Machinery Co.* (*P.*) *Ltd.,* (1998) 231 ITR 294, 303, 304 (Del)], their relatives and friends [*Daga & Co.* (*P.*) *Ltd. v. CIT,* (1997) 227 ITR 480, 489 (Cal)] and the shareholders [*CIT v. Rajakatra* (*P.*) *Ltd.,* (1993) 68 Taxman 266, 270 (Cal); *CIT v. Bhandari Machinery Co.* (*P.*) *Ltd.,* (1998) 231 ITR 294, 303, 304 (Del)].

(3) Interest paid on sums of moneys received from persons for allotment of shares but which continued to remain with the company without shares having been allotted [*J.J. Foams* (*P.*) *Ltd. v. CIT,* (1998) 229 ITR 590, 591 (Del)].

(4) Interest paid on amount borrowed in the form of public deposits [*Hindustan Cocoa Products Ltd. v. CIT*, (1999) 236 ITR 140, 142 (Bom)].

(5) Interest paid on amounts in capital accounts of the partners transferred to the company as a result of taking over of the business of the firm by the company [*CIT v. Vockanardt Pvt. Ltd.,* (1995) 215 ITR 793, 798 (Bom)]. Also see, *CIT v. Rockman Cycle Industries (P.) Ltd.*, (2007) 164 Taxman 83 (Punj).

Thus, the provisions were held applicable in respect of all and sundry and whenever the interest is paid. It was not restricted to deposits made by the directors or their relatives [see, *CIT v. Harish Sugar Co.* (*P.*) *Ltd.,* (2005) 279 ITR 589 (All)].

In *I.D.L. Chemicals v. CIT*, (2005) 275 ITR 218, 220-21 (AP), the Tribunal was correct in upholding the disallowance out of interest payable on the deposits accepted under the Companies (Acceptance of Deposits) Rules, 1975, by applying the provisions of section 40A(8) of the 1961 Act for the assessment years 1980-81 and 1981-82.

The provision of rule 3(*c*) of the Companies (Acceptance of Deposits) Rules, 1975 [as amended by the Companies (Acceptance of Deposits) (Amendment) Rules, 1981] was enforced on 1-4-1981, and in that view of the matter, the Tribunal was justified in allowing the amount of interest claimed by the assessee [*Jai Prakash Associates P. Ltd. v. CIT*, (2005) 277 ITR 193, 196 (All)].

Fixed deposits secured by a floating charge on specific assets of company amounts to secured fixed deposits and, therefore, interest paid on them cannot be disallowed [*CIT v. Dalmia Cement (Bharat) Ltd.*, (2013) 29 taxmann.com 227 (Del)].

Where deposits were primarily taken for payment of taxes, benefit of section 80V of the 1961 Act would be available to assessee on interest paid on said deposit and interest paid could not be disallowed under section 40A(8) of the 1961 Act for assessment year 1985-86 [*CIT v. Mafatlal Dyes and Chemicals Ltd.*, (2014) 49 taxmann.com 359 (Bom)].

No disallowance can be made, under section 40A(8) of the 1961 Act, in respect of interest paid by the Indian company on the mode of payment of consideration for the assets received by virtue of the scheme of amalgamation, because the assessee-company has neither incurred any interest in respect of any 'deposit received' nor on any 'money borrowed' [*CIT v. Commonwealth Trust India Ltd.*, (1999) 240 ITR 758, 760-61 (Ker)].

Financial companies were excluded.—In the facts of *CIT v. Kanoria Investments* (*P.*) *Ltd.*, (1998) 232 ITR 7, 10 (Cal), the Tribunal was held correct in law in holding that the assessee was a 'financial company' within the meaning of sub-clauses (*ii*) and (*iv*) of clause (*c*) of the *Explanation* to section 40A(8) of the 1961 Act and no disallowance under section 40A(8) of the 1961 Act could be made in its case.

In *Emcete & Sons Pvt. Ltd. v. CIT*, (2000) 242 ITR 350, 357 (Mad), quashing the impugned orders of the respondents [orders of CIT under section 264 of the 1961 Act and orders of ITO under section 154 of the 1961 Act] in the writ petitions, the respondents were directed to delete the disallowance of interest under section 40A(8)/58(2) of the 1961 Act that has been made in the concerned assessments. This was so because the assessee-petitioner has been held to a 'miscellaneous financial company' within the meaning of *Explanation* (*c*)(*vi*) to section 40A(8) of the 1961 Act.

Where the Tribunal has recorded a finding of fact to the effect that the principal business of the assessee was finance business so as to be covered by *Explanation* (*c*) to section 40A(8) of the 1961 Act, such finding cannot be interfered with by the High Court in the reference proceedings [*CIT v. Khattar & Co.* (*P.*) *Ltd.,* (2004) 265

LexisNexis

ITR 252, 253 (All)]. **However**, in *Barkha Investment & Trading Co. v. CIT*, (2006) 281 ITR 316, 337 (Guj), assessee-company derived income from the business of purchase and sale of shares. Assessee had placed on record the fact that it was treated and registered as an 'investment company' by the RBI in the light of provisions of NBFC (Reserve Bank) Directions, 1977. The Assessing Officer had held that section 40A(8) of the 1961 Act was not applicable as the assessee was a 'financial company'. However, Tribunal held that the assessee-company was not a financial company within the meaning of clause (*c*) of *Explanation* to section 40A(8) of the 1961 Act. On facts, the High Court said that the Tribunal had committed an error in law in not taking into consideration the factum of classification and registration of assessee by the RBI and further committed an error in law in brushing aside the past history of the assessment of the assessee as an 'investment company' without bringing any distinguishing material on record.

Chit fund company is not a 'financial company'.—In the facts of *Suman Savings & Investments Pvt. Ltd. v. CIT*, (1998) 229 ITR 727, 730 (AP), the assessee-chit fund company was held not to satisfy the requirement of a 'financial company' as defined in clause (*c*) of the *Explanation* to section 40A(8) of the 1961 Act.

Expenditure incurred in connection with certain proceedings under the 1961 Act [omitted s. 40A(12) of 1961 Act].—This **section 40A(12) of the 1961 Act** was **inserted** (**w. e. f. 1-4-1986**) by **the Finance Act, 1985** (32 of 1985). Thus, the Allahabad High Court, in *CIT v. Hind Lamps Ltd.*, (2003) 130 Taxman 586, 588-89 (All), **does not seem to be correct** in observing that the provisions of section 40A(12) of the 1961 Act can be applied for the assessment year 1987-88 and onwards and not to the assessment year 1986-87.

The provisions of section 40A(12) of the 1961 Act, *inter alia*, provide that no deduction shall be allowed in excess of ₹ 10,000 for any assessment year in respect of any expenditure incurred by an assessee by way of fees or other remuneration paid to any person (other than an employee of the assessee) for services (not being services by way of preparation of return of income) in connection with any proceedings under the Act before any income-tax authority. The use of the phrase 'any proceedings under the Act' indicate that the applicability of the section is very wide. Considering the nature of services rendered by the Chartered Accountants, the provision was attracted [see, *Coronation Flour Mills v. Asst. CIT*, (2009) 314 ITR 1, 7 (Guj)].

Section 40A(12) of the 1961 Act has been **omitted** (**w. e. f. 1-4-1993**) by **the Finance Act, 1992** (18 of 1992). Thus, section 40A(12) of the 1961 Act was operative for assessment years 1986-87 to 1992-93. As a result of the omission of section 40A(12), the restriction on the allowability of expenditure incurred in connection with certain proceedings as contemplated by section 40A(12) of the 1961 Act has gone and now, for and from assessment year 1993-94, the allowability of even such expenditure is to be tested under the provisions of section 37(1) of the 1961 Act.

LexisNexis

Omitted/Phased-out provisions of section 44AC of the 1961 Act

[1][**S. 44AC. * * * *]**

Provisions of section 44AC, as originally enacted, explained.—The scope and effect of **section 44AC, as originally inserted** by **the Finance Act, 1988** (26 of 1988), with effect from 1-4-1989, *i.e.*, for and from assessment year 1989-90, and other related provisions, have been elaborated in the following portion of the departmental **circular** No. 528, dated 16-12-1988, as follows:—

'New provision for computing profits and gains from business of trading in certain goods.—**24.1** The Finance Act, 1988 (26 of 1988), has introduced a new section 44AC in the Income-tax Act, 1961, which is a special provision for computing profits and gains in the case of persons engaged in the trading of (*i*) country liquor, (*ii*) timber obtained under a forest lease, (*iii*) timber obtained by any mode other than under a forest lease; and (*iv*) any other forest produce not being timber (hereinafter referred to as specified goods). The rates for working out the profit in respect of trading in each of these items for computing the income chargeable to tax under the head "Profits and gains of business or profession" have been enumerated in the section. Further, the Finance Act, 1988 (26 of 1988), has also introduced section 206C in the Income-tax Act which provides for "collection of tax" at source, at the time of purchase of any of the goods specified in section 44AC of the Income-tax Act.

24.2 The object of the introduction of the new provisions for working out the profits on a presumptive basis is to get over the problems being faced in assessing the income of and recovering the taxes in the cases of persons trading in country liquor, timber and forest produce. A large number of such persons either do not

---

1. Section 44AC has been omitted by the Finance Act, 1992 (18 of 1992), s. 21 (w. e. f. 1-4-1993).

Omitted section 44AC.—Section 44AC, prior to its omission by the Finance Act, 1992, with effect from 1st April, 1993, stood as follows:—

'[a]**[S. 44AC. Special provision for computing profits and gains from the business of trading in certain goods.—**(1) Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of an assessee, being a person other than a public sector company (hereafter in this section referred to as the buyer), obtaining in any sale by way of auction, tender or any other mode, conducted by any other person or his agent (hereafter in this section referred to as the seller),—

(*a*) any goods in the nature of alcoholic liquor for human consumption (other than Indian-made foreign liquor), a sum equal to forty per cent of the amount paid or payable by the buyer as the purchase price in respect of such goods shall be deemed to be the profits and gains of the buyer from the business of trading in such goods chargeable to tax under the head "Profits and gains of business or profession":

[b][*Provided* that nothing contained in this clause shall apply to a buyer where the goods are not obtained by him by way of auction and where the sale price of such goods to be sold by the buyer is fixed by or under any State Act.]

[c][*Explanation.*—For the purposes of this clause, "purchase price" means any amount (by whatever name called) paid or payable by the buyer to obtain the goods referred to in this clause, but shall not include the amount paid or payable by him towards the bid money in an auction, or, as the case may be, the highest accepted offer in case of tender or any other mode;]

(*b*) the right to receive any goods of the nature specified in column (2) of the Table below, or such goods, as the case may be, a sum equal to the percentage, specified in the corresponding entry in column (3) of the said Table, of the amount paid or payable by the buyer in respect of the sale of such right or as the purchase price in respect of such goods shall be deemed to be the profits and gains of the buyer from the business of trading in such goods chargeable to tax under the head "Profits and gains of business or profession".

Table

Sl. No.	*Nature of goods*	*Percentage*
(1)	(2)	(3)
(*i*)	Timber obtained under a forest lease	Thirty-five per cent
(*ii*)	Timber obtained by any mode other than under a forest lease	Fifteen per cent
(*iii*)	Any other forest produce not being timber	Thirty-five per cent

(2) For the removal of doubts, it is hereby declared that the provisions of sub-section (1) shall not apply to a buyer (other than a buyer who obtains any goods from any seller which is a public sector company) in the further sale of any goods obtained under or in pursuance of the sale under sub-section (1).

(3) In a case where the business carried on by the assessee does not consist exclusively of trading in goods to which this section applies and where separate accounts are not maintained or are not available, the amount of expenses attributable to such other business shall be an amount which bears to the total expenses of the business carried on by the assessee the same proportion as the turnover of such other business bears to the total turnover of the business carried on by the assessee.

Explanation.—For the purposes of this section, "seller" means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company or firm [d][or co-operative society].]'.

---

a. Section 44AC was inserted by the Finance Act, 1988 (26 of 1988), s. 15 (w. e. f. 1-4-1989).
b. Ins. by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989), s. 10 (w. e. f. 1-4-1989).
c. Ins. by the Finance Act, 1990 (12 of 1990), s. 14(*a*) (w. e. f. 1-4-1991).
d. Ins. by the Finance Act, 1990 (12 of 1990), s. 14(*b*) (w. e. f. 1-4-1991).

maintain any books of account or the books maintained are irregular and incomplete. Locating such persons after the contract or agreement became impossible in many cases. Further, in such cases, even if the assessment was completed, the Income-tax Department found it extremely difficult to collect the tax from them. Thus, assessment of income and recovery of taxes from such businessmen posed serious problems.

24.3 The presumptive rate of profit will be applied in the cases of all buyers (except a "public sector company") who purchase the specified goods and trade in the same. The provisions of the section will, however, apply only in respect of the goods obtained from a "seller", as defined in the *Explanation* below sub-section (3) of section 44AC of the Income-tax Act. "Seller", as per this *Explanation* means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company or firm[2]. A "buyer" who obtains goods in the course of a second sale except where such a sale is made by a "public sector company" will not come within the purview of the section. Thus, if 'A' buys logs of timber from 'B' who had purchased the same at an auction, the provisions of section 44AC of the Income-tax Act will apply only to 'B' and not to 'A'. However, if 'B' is a public sector company, then buyer 'A' will be liable to have his income determined on a presumptive basis in accordance with the provisions of section 44AC.

24.4 As mentioned above, the newly introduced section 44AC of the Income-tax Act applies only in the case of persons *engaged in the trading of goods* referred to therein. This provision will, therefore, not apply in cases where the goods purchased by a "buyer" are utilised for the purposes of manufacturing, processing or producing any article or thing. As the goods purchased have to be "traded in" as per these provisions, if the same are destroyed or lost subsequently, there would be no occasion for trading in such goods in such an eventuality. Hence, the tax collected under section 206C of the Income-tax Act would have to be refunded if such loss is proved. Proviso to sub-section (1) of section 206C of the Income-tax Act ensures that no tax will be collected at source from a buyer who purchases goods for the purposes of manufacturing, processing or producing any article or thing. If a buyer on an application made by him obtains a certificate from his Assessing Officer and furnishes the same to the seller, that the goods to be purchased are to be utilised in the carrying on of any of the activities referred to above, no tax will be collected under section 206C of the Income-tax Act. The manufacture and sale of country liquor is controlled and supervised by the State Excise authorities and liquor is retailed in the same commercial form as purchased. There will, therefore, be no occasion for a liquor contractor to obtain a certificate of the type referred to above. However, if a "buyer" of timber obtains the same for, say, making furniture, the provisions of section 44AC of the Income-tax Act will not apply and no collection of tax will be required to be made, on his obtaining the requisite certificate from his Assessing Officer. Similarly, if a buyer purchases timber as an actual user for construction of a house no collection of tax will be required to be made under section 206C of the Income-tax Act.

LexisNexis

24.5 The term "manufacturing" has been interpreted in several court decisions. It generally refers to "production of articles for use from raw, semi-raw or prepared materials by giving these materials new forms, qualities, properties or combinations, whether by hand labour or machinery". In the case of *Collector of Central Excise v. Kutty Flush Doors & Furniture Co. (P.) Ltd.* [AIR 1988 SC 1164 = (1988) 17 ECC 37 (SC)], a case arising under the Central Excises and Salt Act, 1944[3], the conversion of timber logs by sawing them into sizes and dried timber did not tantamount to any manufacture. The Supreme Court observed that "It may be worthwhile to note that 'manufacture' implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulation. But something more was necessary and there must be transformation; a new and different article must emerge having a distinct name, character or use". Thus, manufacture implies bringing in something new. In the case of forest produce, *biris* made from tendu leaves and tobacco brings into existence a new and different article. Consequently, a "buyer" who obtains tendu leaves for making *biris* and not for trading in such leaves will fall outside the purview of the new sections 44AC and 206C of the Income-tax Act.

24.6 The term "processing" has a wider meaning than the term "manufacture". Buyers carrying on the activity of processing will fall within the purview of section 206C(1) of the Income-tax Act. Though sawing of logs of timber into different sizes may not fall within the meaning of the term "manufacture", a view could be taken that it constitutes processing. But, mere cutting of timber into smaller sizes to make its marketability and packing easy would not constitute processing. The broad distinction between "manufacture" and "processing" is that manufacture involves bringing into existence of a new product; a product which is of a different chemical composition or whose integral structure is different. Processing could be said to be doing specific acts to something for changing its shape or size.

24.7 The presumptive rates of profits specified in respect of different commodities in section 44AC of the Income-tax Act for determining the income chargeable to tax will be applied to the amount paid or payable by

---

2. or co-operative society, as a result of the amendment of the *Explanation* to section 44AC by the Finance Act, 1990 (12 of 1990) (w. e. f. 1-4-1991).

3. With effect from 28-9-1996, the short title is 'the Central Excise Act, 1944', *vide* section 71 of the Finance (No. 2) Act, 1996 (33 of 1996).

the buyer as the purchase price in respect of such goods. The purchase price[4] for this purpose will be the cost of the commodity inclusive of any excise duty, sales tax, or any other levy, whatever its nomenclature, paid for by the buyer for obtaining the goods. Purchase price will not, however, include any freight or transportation charges. In the case of buyers of liquor, the purchase price will include the cost of the bottle, label, sealing charges, etc.

24.8 In a case where the business carried on by the assessee consists exclusively of trading in the items to which provisions of section 44AC of the Income-tax Act apply, the deemed rate of profit will be applicable only for determining income chargeable to tax under the head "Profits and gains of business or profession". No other item of expenditure incurred in the trading of any of the goods specified in the section will be allowable. However, where the business carried on by the assessee does not exclusively consist of trading in the commodities specified in section 44AC of the Income-tax Act and where separate accounts are not maintained or are not available, the amount of expenses attributable to the other business carried on by the assessee for the purpose of allowing these would be worked out on the basis of the same proportion as the turnover of such other business bears to the total turnover of the business.

24.9 In so far as the deductions under Chapter VI-A of the Income-tax Act are concerned, the same will be allowed from the income so determined under section 44AC of the Income-tax Act. For example, the income of a trader in *biri* leaves, who is an exporter, will be first determined in accordance with the provisions of section 44AC of the Income-tax Act and, thereafter, he would be eligible to claim the deduction under section 80HHC of the Income-tax Act, 1961.

24.10 As mentioned above, the "seller" referred to in section 44AC of the Income-tax Act has to collect tax at source from the buyer as required by the new provisions of section 206C of the Income-tax Act when any of the items specified in section 44AC are sold. The collection of tax at source has to be made at the time when the ''seller'' debits the amount payable by the ''buyer'' or at the time of receipt of such amount, whichever is earlier. The sum to be collected by the "seller" at source will be a percentage of the amount payable by the "buyer". The Table in sub-section (1) of section 206C of the Income-tax Act specifies the percentages to be collected at source by the "seller" in respect of the different commodities to which the section applies. If the total amount payable by a buyer to the "seller" is Rs. 100, the sum to be collected at source will be Rs. 10[5] in the case of "timber obtained by any mode other than under a forest lease". The collection of tax at source in respect of the commodities referred to above will not be 10 per cent.[6] of the amount of the presumptive rate of profit laid down in section 44AC of the Income-tax Act [*i.e.*, 10 per cent. of 15 per cent. of the amount payable by the "buyer"]. Collection shall also be made of surcharge for purposes of the Union calculated at the rate of 5 per cent.[7] of such collection.

LexisNexis

24.11 It has already been mentioned that no tax will be collected at source in cases where a buyer obtains a certificate from his Assessing Officer to the effect that the goods to be purchased will be utilised by him for manufacturing, processing or producing articles or things. The certificate to be issued by the Assessing Officer shall be valid for a period not exceeding one year from the date of certificate. The Assessing Officer will have the power to cancel the certificate at any time before the expiry of the specified period if it comes to his knowledge that the buyer is not utilising the specified items purchased for the purposes of manufacturing, processing or producing any articles or things. The certificate will be addressed to a particular "seller" and that "seller" will not collect tax at source from any purchase made by the buyer for such period as the certificate is valid. A "buyer" will, therefore, have to obtain separate certificate from the Assessing Officer for such "seller" from whom he would be making purchases. A single certificate should not bear the name of more than one "seller". The certificate should be issued by the Assessing Officer and accepted by the "seller" only if it is as per Form No. 27C of the Income-tax Rules, 1962, and not in any other manner.

24.12 There may be cases where for the purchase of any of the items specified in section 44AC, the "buyer" may have to pay the cost of the item *plus* excise duty to a particular "seller" and any other tax or payment towards the purchase of the same item to another. For example, in some States for the purchase of liquor, the retailer has to pay the cost of liquor *plus* excise duty to the State Excise Department. The sales tax is paid by this retailer for the liquor directly to the Sales Tax Authorities. For the price of the bottles, label and sealing charges the payments are made to the distilleries from where the liquor is lifted. In such cases, the

---

4. It may be noted that a new definition of the expression "purchases price" has been coined, for the purpose of section 44AC(1)(*a*), in the *Explanation* to that clause newly inserted by the Finance Act, 1990 (12 of 1990) (w. e. f. 1-4-1991).

5. Rs. 5, as a result of amendment of section 206C by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989) (w. e. f. 1-6-1988).

6. 5%, as a result of the aforesaid amendment.

7. 8% during the financial year 1989-90 as per section 2(6) of the Finance Act, 1989 (13 of 1989); in case of non-company assessee 8% (upto 14-1-1991) and 12% (w. e. f. 15-1-1991) and in case of a domestic company 8% (upto 14-10-1990) and 15% (w. e. f. 15-10-1990) during the financial year 1990-91 as per section 2(6) of the Finance Act, 1990 (12 of 1990), as amended by section 2(*b*) of the Taxation Laws (Amendment) Act, 1991 (2 of 1991); in case of non-company assessee 12% and in case of a domestic company 15% during the financial year 1991-92 as per section 2(6) of the Finance (No. 2) Act, 1991 (49 of 1991). Such rates have also varied in subsequent financial years.

State Excise Department will have to collect tax at source at 15 per cent. of the total of the cost of liquor *plus* excise duty *plus* sales tax inclusive of the cost of the bottles, label and sealing charges. This is because of the fact that cost to the buyer can be worked out only after taking into account all these amounts together.

24.13 The amount collected by the "seller" shall be deposited in the account of the Central Government within seven days of the date of collection. Further, the "seller" has to furnish to the "buyer" a certificate within 10 days of the date of collection of tax from him stating therein the tax collected, the rate at which the tax has been collected and such other particulars as have been prescribed in Form No. 27D of the Income-tax Rules, 1962.[8] Credit of the tax so collected will be given to the buyer at the time of his assessment. If a "seller" responsible for collecting the tax fails to do so he will still be liable to pay the tax to the credit of the Central Government within seven days of the date of collection which will be the date of debiting the account of the buyer or at the time of receipt of such amount, whichever is earlier. In addition, if the "seller" does not collect the tax or after collecting the same fails to pay it to the credit of the Central Government, he will be liable to pay simple interest at the rate of two per cent. per month or part thereof of the amount of such tax from the date on which such tax was collectible, to the date on which tax is actually paid.

24.14 The new section 276BB of the Income-tax Act provides for prosecution of a person who fails to pay to the credit of the Central Government, the tax collected by him as required under the provisions of section 206C of the Income-tax Act and punishment for a term which shall not be less than three months but which may extend to seven years and with fine.

24.15 The amendment relating to section 44AC of the Income-tax Act will come into force with effect from the 1-4-1989, and will, accordingly, apply in relation to assessment year 1989-90 and subsequent years. The provisions relating to collection of tax under section 206C of the Income-tax Act have come into force with effect from the 1-6-1988. [Sections 2, 15, 40 and 46 of the Finance Act, 1988]'.

Reference may also be made to *PIB Press Note, dated 23-6-1988*, reproduced at (1988) 172 ITR (St.) 21-24. This Press Note has been held not ambiguous or invalid [*Vishal Enterprises v. Union of India,* (1988) 174 ITR 548 (Karn)].

Legislative amendments.—I. *The Direct Tax Laws (Amendment) Act, 1989.*—By this Act, a new proviso has been inserted in section 44AC(1)(*a*). That new proviso provides that clause (*a*) relating to determination of profits in the trading of goods, in the nature of alcoholic liquor for human consumption (other than Indian made foreign liquor), at 40 per cent. of the purchase price, shall not apply where the goods are not obtained by way of auction and where the sale price of such goods to be sold by the buyer is fixed by or under any State Act.

The scope and effect of the newly inserted proviso to section 44AC(1)(*a*) as also of the amendments made in the allied provisions of section 206C have been elaborated in the following portion of the departmental circular No. 559, dated 4-5-1990, as follows:—

'10.1 *Amendments of sections 44AC and 206C relating to levy and collection of presumptive tax in the case of trading in certain goods to remove hardships and to remove the lacuna.*—Section 44AC was inserted in the Income-tax Act by the Finance Act, 1988 (26 of 1988), with effect from 1-4-1989. The purpose was to counteract tax evasion by liquor contractors and dealers in forest produce by providing presumptive rates of profits in the case of trading in these items, where such items are obtained by way of auction, tender or any other mode. The presumptive rates prescribed in the section are:

1	*Nature of goods*	*Rate of profit*
1.	Alcoholic liquor for human consumption (other than foreign liquor).	40% of the purchase price.
2.	Timber obtained under a forest lease.	35% of the purchase price.
3.	Timber obtained by any mode other than under a forest lease.	15% of the purchase price.
4.	Any other forest produce, not being timber.	35% of the purchase price.

10.2 It was, however, pointed out that in some of the States the contracts for sale of liquor are not given by auction or any similar mode, but licences to sell the liquor are issued to the contractors by the State Government more or less on a permanent basis. The licences are renewable every year automatically on payment of the prescribed fees. Both the purchase and sale prices are regulated by the State Government. Thus, indirectly, the entire profit in such cases is regulated by the State laws and this leaves little scope of manipulation for tax evasion. It was, therefore, pointed out that the application of the rate of presumptive profits operated very harshly in such cases. To remove this hardship, the Amending Act, 1989, has amended section 44AC to provide that the provision for the application of rate of presumptive profit would not apply in a case where the liquor is

8. The provisions of section 206C(5A), newly inserted by the Direct Tax Laws (Amendment) Act, 1989 (3 of 1989), are also apposite with effect from 1-4-1989.

LexisNexis

not obtained by the buyer by way of auction and where the sale price of such liquor to be sold by the buyer is fixed by or under any State Act.

10.3 Simultaneously with the insertion of section 44AC, another section 206C was also inserted in the Income-tax Act by the Finance Act, 1988 (26 of 1988), with effect from 1-6-1988, which provided for collection of tax by the seller of the goods referred to in section 44AC, at a fixed percentage of the purchase price of such goods. The rates of tax were provided in this section in respect of all the four items mentioned in section 44AC. In the case of timber obtained by any mode other than under a forest lease, the rate of tax prescribed in the section was 10% of the purchase price.

10.4 It was pointed out that the said rate of tax of 10% of purchase price prescribed in the case of timber obtained by any mode other than under a forest lease was too high and caused hardships in such cases. To avoid this hardship, the Amending Act, 1989, has amended section 206C to reduce the rate of collection of tax in such cases from 10% to 5%. This amendment has been made retrospectively with effect from 1-6-1988.

10.5 The provisions of section 206C relating to collection of tax at source are analogous to the provisions for deduction of tax at source in respect of certain incomes, which are contained in sections 192 to 195. Section 206 provides for furnishing of returns of tax deducted at source by the persons responsible to deduct such tax to the prescribed income-tax authorities. However, there was no provision in section 206C corresponding to section 206 requiring the persons collecting tax at source to furnish returns of such tax collected at source to the income-tax authorities. To remove this lacuna, the Amending Act, 1989, has inserted a new sub-section (5A) in section 206C to provide that every person collecting tax in accordance with the provisions of this section shall prepare half yearly returns for the periods ending 30th September and 31st March in each financial year and deliver to the prescribed income-tax authority such returns in such form and verified in such manner and setting forth such particulars and within such time as may be prescribed.'.

II. *The Finance Act, 1990.*—By this Act, a new *Explanation* has been inserted in section 44AC(1)(*a*) coining the definition of the expression "purchase price", for the purposes of that clause, so as to mean any amount paid or payable by a buyer to obtain alcoholic liquor for human consumption (other than Indian made foreign liquor) excluding the amount paid or payable towards the bid money in an auction or the highest accepted offer in case of a tender or any other mode.

As a result of the amendment of the *Explanation* below section 44AC(3), a co-operative society has also been taken within the definition of the expression "seller" contained in the *Explanation*.

The scope and effect of these amendments have also been elaborated in the following portion of the departmental **circular** No. 572, dated 3-8-1990, as follows:—

'Modification of special provisions for computing profits and gains from the business of trading in certain goods.—**21.** Under the existing provisions of section 44AC of the Income-tax Act, 1961, in the case of a trader of alcoholic liquor for human consumption (other than Indian made foreign liquor), forty per cent. of the purchase price paid or payable is deemed to be his income. As a result of different systems prevailing in different States, the term purchase price is being understood in different ways. Therefore, an *Explanation* has been inserted in clause (*a*) of sub-section (1) of section 44AC to provide that purchase price shall mean all amounts paid or payable to obtain country liquor, excluding the amount paid or payable towards the bid money in an auction or the highest accepted offer in a tender or any other mode.

21.1 At present, the provisions of section 44AC apply where the goods of the specified nature are sold by the Central Government, a State Government, any local authority, a statutory corporation or authority, a company or a firm. The *Explanation* below section 44AC has been amended to include co-operative societies within the meaning of the term "seller" in section 44AC.

21.2 These amendments will take effect from 1-4-1991, and will, accordingly, apply in relation to the assessment year 1991-92 and subsequent years. [*Section 14 of the Finance Act, 1990*]'.

Omission of section 44AC.—By section 21 of **the Finance Act, 1992** (18 of 1992), **section 44AC** has been **omitted**, with effect from 1-4-1993. In that view of the matter, the provisions of section 44AC shall apply only upto assessment year 1992-93. Thus, for and from assessment year 1993-94, even in cases contemplated by the omitted section 44AC, the assessments are to be done in accordance with the normal provisions of the Income-tax Act.

The scope and effect of the **omission of section 44AC**, as also of the amendments made in section 206C of the 1961 Act by **the Finance Act, 1992** (18 of 1992), have been elaborated in the following portion of the departmental **circular** No. 636, dated 31-8-1992:—

'Withdrawal of presumptive tax in respect of certain trades.—**34.** Under section 44AC of the Income-tax Act, for computing profits and gains of persons engaged in the trading of country liquor, timber obtained under forest lease, timber obtained by any other mode other than under a forest lease and any other forest produce not being

timber, a prescribed percentage of the purchase price is deemed to be the profit in respect of trading in such specified goods.

34.1 Having regard to the controversy on the interpretation of the provisions of section 44AC and the administrative difficulties in the implementation of this provision this section has been deleted through the Finance Act, 1992 (18 of 1992).

34.2 This amendment takes effect from 1-4-1993, and, accordingly, applies in relation to the assessment year 1993-94 and subsequent years.

34.3 However, section 206C providing for collection of tax at source in respect of these cases shall continue to remain in force with certain amendments consequential to the deletion of section 44AC of the Income-tax Act. The amended section takes effect from 1-4-1992. [*Sections 21 and 79*]'.

Provisions not invalid.—The provisions of sections 44AC and 206C are not beyond the legislative competence of Parliament as contained in Entry 82 of List I to the Seventh Schedule to the Constitution of India and are, therefore, valid [*T.K. Aboobacker v. Union of India,* (1989) 177 ITR 358 (Ker), **affirming**, *P. Kunhammed Kutty Haji v. Union of India,* (1989) 176 ITR 481 (Ker)]. In other words, Parliament was competent to enact sections 44AC and 206C. The tax levied under these sections is tax on income and not on purchases [*Sat Pal & Co. v. Excise & Taxation Commissioner,* (1990) 185 ITR 375, 388 (Punj)]. In *K.M. Joseph Binoy v. Union of India* [(1992) 194 ITR 449, 451 (Ker)], sections 44AC and 206C have been held to be valid. Also see, *Excise & Taxation Commissioner v. Sat Pal & Sons,* SLP (Civil) Nos. 23139-23149 of 1994 : (1995) 212 ITR (St.) 53 (SC).

In *A. Sanyasi Rao v. Government of Andhra Pradesh* [(1989) 178 ITR 31, 73 (AP)], their Lordships have summarised the conclusions as follows:

(*i*) Parliament was perfectly competent to enact sections 44AC and 206C;

(*ii*) Section 206C does not suffer from any constitutional infirmity and is perfectly valid;

(*iii*) Section 44AC is not an independent provision. It does not dispense with a regular assessment in accordance with the provisions of the Income-tax Act. Section 44AC is merely an adjunct to and explains the provisions in section 206C. A regular assessment has to be made in respect of an assessee dealing in specified goods in accordance with sections 28 to 43C. Read down in this manner, section 44AC also does not suffer from any constitutional infirmity;

(*iv*) It is competent for Parliament to adopt the purchase price as a measure for determining the income-tax. In this case, the purchase price is taken as a measure for the limited purpose of determining the quantum of tax to be collected under section 206C. Tax collected on specified goods will be given credit for in the year in which those goods are sold;

(*v*) In view of the clarification of the Central Board of Direct Taxes, communicated by the Chief Commissioner of Income-tax, Andhra Pradesh, Hyderabad, and also in view of the concession made by the Income-tax Department, it is directed that the expression "purchase price" in section 44AC and section 206C shall mean, in the State of Andhra Pradesh in respect of arrack, only the "issue price" as understood in the Andhra Pradesh Excise Act and the Rules made thereunder, now in force in this State. The true meaning and content of the expression "purchase price" is, however, different.....

(*vi*) The collection at source provided by section 206C is relatable to the purchase price and not to the income component of the purchase price.'.

Following the Andhra decision [178 ITR 31 (AP)], the Orissa High Court has taken the view that although section 44AC was violative of articles 14 and 19(1)(*g*) of the Constitution, that section 44AC need not be struck down but it should be read not as an independent provision but as an adjunct to and as explanatory to section 206C; and that it did not dispense with the regular assessment altogether with the result that after the tax is collected in the manner provided by section 206C, a regular assessment would be made where the profits and gains of business in the goods in question would be ascertained in accordance with sections 28 to 43C [*Sri Venkateswara Timber Depot v. Union of India,* (1991) 189 ITR 741, 755, 757, 759 (Ori)]. Also see, *K.M. Joseph Binoy v. Union of India,* (1992) 194 ITR 449 (Ker).

In *Union of India v. A. Sanyasi Rao* [(1993) 202 ITR 584, 585-86 (SC)], the Supreme Court has **suspended the operation of the Andhra Pradesh High Court judgment in** *A. Sanyasi Rao v. Government of A.P.* [(1989) 178 ITR 31 (AP)] because as a result of that Andhra judgment, the department was unable to complete assessments involving the application of section 44AC and the assessments were getting time-barred. The Department was allowed to complete the assessments of assessees involving cases under section 44AC irrespective of the observations in the judgment of the High Court of limited applicability of section 44AC. Also see, *Union of India v. Radhe Shyamdas,* SLP (Civil) Nos. 14502-14512 of 1991: (1993) 204 ITR (St.) 147 (SC).

Affirming the decisions of the Andhra Pradesh High Court in *A. Sanyasi Rao v. Government of Andhra Pradesh* [(1989) 178 ITR 31 (AP)] and of the Punjab and Haryana High Court in *Sat Pal & Co. v. Excise &*

LexisNexis

Taxation Commissioner [(1990) 185 ITR 375 (Punj)], the Supreme Court has, in *Union of India v. A. Sanyasi Rao* [(1996) 219 ITR 330, 356, 357-58 (SC)], held that section 44AC read with section 206C is not wholly hit by article 14 of the Constitution of India. However, the denial of relief provided by sections 28 to 43C to the particular businesses or trades dealt with in section 44AC calls for different consideration. It has not been shown as to why the persons carrying on business in the particular goods specified in section 44AC are denied the reliefs available to others. The denial of such reliefs to trades specified in section 44AC, available to other assessees, has no nexus to the object sought to be achieved by the Legislature. Therefore, to the extent the *non obstante clause* in section 44AC excluded the provisions of sections 28 to 43C (applicable to all assessees), the provisions are unreasonable. Thus, section 44AC is a valid piece of legislation and is an adjunct to and explanatory to section 206C. It does not dispense with the regular assessment, as provided in accordance with sections 28 to 43C. Also see, *Gondia Bidi Leaves Contractors Association v. Union of India*, (1998) 229 ITR 388, 389 (Bom); *Panchaman Traders v. CIT,* (2006) 283 ITR 50 (Ker), **affirmed in** *Panchaman Traders v. CIT*, (2010) 323 ITR 334 (Ker).

There is no conflict of decisions between *Ramjee Prasad Sahu v. Union of India* [(1993) 202 ITR 800 (Pat)] and *Union of India v. A. Sanyasi Rao :* (1996) 219 ITR 330 (SC) [*Bharat Prasad Choudhary : Shambhu Prasad v. Union of India,* (1998) 229 ITR 363, 365 (Pat)].

In *Harbilas & Co. v. Union of India* [WP No. 791 of 1988: (1988) 174 ITR (St.) 29 (SC)], the Supreme Court has, by an order dated 5-9-1988, directed the issue of rule *nisi* on a writ petition by certain liquor licensees in the State of Haryana challenging the *vires* of sections 44AC, 206C and 276BB of the Income-tax Act, 1961, where pursuant to the impugned sections, the Excise and Taxation Commissioner in the State ordered collection of income-tax at sources from the licensees. Also see, *Ranganatha Associates v. Union of India,* WP No. 1030 of 1988: (1988) 174 ITR (St.) 29 (SC).

In *R. Laxmichand & Co. v. Union of India* [(1990) 184 ITR 376 (Guj)], the High Court refused the petitioners' prayer for granting interim relief by restraining the respondents from deducting tax at source as provided under the provisions of sections 44AC and 206C.

The Supreme Court ruling [219 ITR 330 (SC)] has been **followed in** *Indrajit & Co. v. Girijan Co-operative Corporation Ltd.* [(1999) 107 Taxman 179, 180 (Bom)]; *P. Ramswamy & Co. v. Government of India* [(1999) 107 Taxman 292, 292-93 (Mad)]; *CIT v. Ram Sanehighat Contractor* [(2006) 154 Taxman 536 (All)]; *CIT v. Chanan Lal Jai Ram Dass & Co*. [(2006) 157 Taxman 483 (All)]; *CIT v. Shanta Prasad Resham Singh* [(2007) 158 Taxman 90 (All)].

In *State of Bihar v. CBDT* [(2011) 336 ITR 506 (Pat)], it has been held that the State Government had failed to discharge its statutory duty, as a result of which the Revenue was justified in taking steps to quantify the amount in accordance with the procedure prescribed by section 44AC.

***Vires* of a provision, when can be examined.—**Where pleas challenging the *vires* of a particular provision are properly raised and urged before a competent court, it would be appropriate for it to examine the question in a properly constituted action. However, where the party concerned does not bestir himself to raise a contention challenging the *vires* of a provision, it is not appropriate for the court concerned to have itself taken up such a question [*Bank of Baroda v. Rednam Nagachaya Devi,* (1990) 68 Comp Cas 165, 176 (SC)].

Right to receive—meaning of.—The expression 'right to receive', in section 44AC(1)(*b*), has to be construed having regard to the object of the provision and its place in the scheme of the Act. The provision is a special provision for computing the profits and gains from the business of trading in certain goods. One of the items of the goods specified is forest produce. The transfer of title in the forest produce from one person to another in the course of trade is, therefore, to be governed by this provision. It covers not only the actual sale of goods but also the right to receive the goods of the nature specified in the Table including forest produce. The word 'receive', therefore, in the context has to be construed as including the gathering of the forest produce from the forest as immediately after such gathering it is to be appropriated by the person who has been given the right to gather, as his own property. The words 'right to receive' have been used in the statutory provision to indicate the right to become the owner of the goods and not merely an instance of one person delivering goods to another without any intent to transfer the ownership therein. What is material is the transfer of title [*S. Khader Mohideen v. ITO*, (2001) 248 ITR 554, 556-57 (Mad)]. In that view of the matter, in the facts of that case, it has been held that the auction of the right to gather the forest produce was an auction in relation to the right to receive forest produce by going into the forest and gathering the produce, so as to rightly invoke the provisions of section 44AC.

Applicability of the proviso.—It may be noted that the **proviso to section 44AC** was **inserted** (w. e. f. 1-4-1989) by **the Direct Tax Laws (Amendment) Act, 1989** (3 of 1989). Two things are necessary for the application of the said proviso:

(*a*) that the goods were not obtained by way of auction; and

(*b*) that the sale price of such goods to be sold by the buyer was fixed by or under any State Act.

The territory of a proviso is to carve out an exception to the main enactment and exclude something which otherwise would have been within the section [see, *CIT v. Indo Mercantile Bank Ltd.,* (1959) 36 ITR 1, 7 (SC)]. On examining the fundamental provisions governing the grant of L-13 licences, for sale of country liquor, it has been held that L-13 licensees came within the purview of the said proviso and the provisions of section 206C and section 44AC(1) did not apply to them [*Gian Chand Ashok Kumar & Co. v. Union of India,* (1991) 187 ITR 188, 198, 202 (HP), **followed in**, *K.K. Mittal & Co. v. Union of India,* (1991) 187 ITR 208, 215-16 (Punj)].

In *CIT v. Virsa Singh & Co.* [(2008) 307 ITR 30 (Punj)], the assessee being an L-13 licensee was governed by the proviso to section 44AC.

'Seller'—meaning of.—Keeping in view the intention of the Legislature and the reasons for insertion of the provisions of section 44AC and 206C, it has been held that the State of Bihar would come within the meaning of the word 'seller' as envisaged under section 44AC and section 206C [*State of Bihar v. CIT,* (1993) 202 ITR 535, 553 (Pat), special leave petition dismissed by the Supreme Court : (1995) 211 ITR (St.) 9 (SC)].

In *S.K.G. Sugar Ltd.* : *Shiv Shankar Chemical Industries Ltd. v. CIT* [(1999) 236 ITR 338, 339, 340 (Pat)], it has been held that a wholesale dealer was also a 'seller' as required under sections 44AC and 206C. Therefore, wholesale dealers of liquor were held to be required to collect tax at source at the rate of 15 per cent. of the total purchase price, including excise duty, etc., *plus* surcharge of 12 per cent. on tax so collected with respect to the sales to retailers.

No *prima facie* adjustment possible.—In the garb of the *prima facie* adjustment permissible under the first proviso to section 143(1)(*a*), the Assessing Officer is not authorised to take recourse to section 44AC and to bring the profits computed under that provision to tax. Making of any such adjustment renders the intimation as *ab initio* void [*Pradeep Kumar Har Saran Lal v. Assessing Officer,* (1998) 229 ITR 46, 55 (All)].

LexisNexis

Erstwhile provisions of section 44AD of the 1961 Act

Introduction under 1961 Act.—*The Finance Act, 1994.*—By **the Finance Act, 1994** (32 of 1994), **section 44AD** has been **inserted** (**w. e. f. 1-4-1994**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 684, dated 10-6-1994*, as follows:—

'*Estimated Income Method for taxpayers engaged in the business of civil construction.*—**31.** The Estimated Income Method of assessment for certain categories of businesses is prevalent in several countries. The Tax Reforms Committee has also recommended gradual introduction of the Estimated Income Method in certain areas to facilitate better tax compliance. Accordingly, a new section 44AD has been inserted in the Income-tax Act with a view to providing for a method of estimating income from the business of civil construction or supply of labour for civil construction work. The new section is applicable to all assessees whose gross receipts from the abovementioned business do not exceed ₹ 40 lakhs. Gross receipts are the amount received from the clients for the contract and will not include the value of material supplied by the client. The income from the above mentioned business will be estimated at 8 per cent. of the gross receipts paid or payable to an assessee. A taxpayer can voluntarily declare a higher income in his return.

31.2 The expression "civil construction" will include the construction or repair of buildings, dams, bridges or other structures, or of roads or canals. It will also include the execution of any other works contract. It will, thus, include work related to electrical fittings, plumbing job, landscaping work, etc.

31.3 The rate of 8 per cent. is comprehensive. All deductions under sections 30 to 38 including depreciation, will be deemed to have been already allowed and no further deduction will be allowed under these sections. The written down value will be calculated, where necessary, as if depreciation as applicable has been allowed. In the case of firms, the normal deductions to the extent allowed under clause (*b*) of section 40 will be allowed.

31.4 The assessees who file the return, estimating income at 8 per cent. of gross receipts, or a higher income, will neither be required to maintain books of account under the provisions of section 44AA, nor required to get accounts audited under the provisions of section 44AB, in respect of their income from the business of civil construction. However, even such an assessee has to comply with the requirements of both sections 44AA and 44AB in respect of his businesses which are not covered by this scheme. For instance, a person may have gross receipts of ₹ 30 lakhs from civil construction business and of ₹ 25 lakhs from trading in scrap and ₹ 10 lakhs from garment manufacture. Although his total gross receipts are ₹ 65 lakhs, he will not be required to have his accounts audited, since his gross receipts after excluding those from the business of civil construction are still less than ₹ 40 lakhs, the limit provided in section 44AB.

31.5 The income from the business of civil construction, estimated in accordance with this provision, will be aggregated with other incomes of the assessee, from any other business or under other heads of income, in accordance with the normal provisions of the Income-tax Act. Accordingly, all deductions under Chapter VIA and rebate under Chapter VIII will be available to the assessee, if the conditions therein are fulfilled.

31.6 The scheme is optional. A system of rebuttal has been provided. A person can claim that his income in respect of the abovementioned business is lower than the specified estimate of income. In such a case, he must produce necessary evidence to prove his case. Such a case will be scrutinised for regular assessment under section 143(3).

31.7 This amendment takes from 1-4-1994, and will, accordingly, apply in relation to the assessment year 1994-95 and subsequent years. Accordingly, a person can file his return based on the estimated income method for the current assessment year also. [*Section 16*]'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1997.*— By **the Finance Act, 1997** (26 of 1997), the following **amendments** have been made—

—**proviso to section 44AD(2)** has been **inserted** (**w. r. e. f. 1-4-1994)**; and

—**section 44AD(5)** has been **omitted** (**w. r. e. f. 1-4-1997**).

For the scope and effect of the above amendments, reference may be made to paras. 24 to 24.2 of the *Departmental Circular No. 763, dated 18-2-1998*.

II. *The Income-tax (Second Amendment) Act, 1998.*—By **the Income-tax (Second Amendment) Act, 1998** (11 of 1999), **section 44AD(5)** has been **inserted** (**w. r. e. f. 1-4-1997**).

III. *The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 44AD(6)** has been **inserted** (**w. r. e. f. 1-4-1998**).

LexisNexis

For the scope and effect of the above insertion, reference may be made to paras. 26 to 26.3 of the *Departmental Circular No. 779, dated 14-9-1999*.

PROFITS AND GAINS OF CIVIL CONSTRUCTION BUSINESS, ETC.
[Operative between 1-4-1994 and 31-3-2011]

Section 44AD of 1961 Act is constitutionally valid.—Applying the ratio of the Supreme Court in *Union of India v. A. Sanyasi Rao*, (1996) 219 ITR 330 (SC), a case concerning the constitutional validity of the then section 44AC read with section 206C of the 1961 Act, it has been held that section 44AD of the 1961 Act cannot be said to be in any manner arbitrary or violative of article 14 of the Constitution of India. That section 44AD of the 1961 Act is constitutionally valid. That section does not dispense with a regular assessment as provided in accordance with sections 28 to 43C of the 1961 Act [*Manohar Ram Chandra Patil v. Union of India*, (2003) 260 ITR 87, 90 (Ori)].

Provisions of section 44AD(1) of 1961 Act were of overriding nature.—Section 44AD(1) of the 1961 Act overrides the provisions of sections 28 to 43C of the 1961 Act as that sub-section begins with a *non obstante* clause, namely, "Notwithstanding anything to the contrary contained in sections 28 to 43C".

Applicability of the provisions of section 44AD(1) of 1961 Act.—The provisions of **section 44AD(1)** of the 1961 Act were applicable, for assessment years 1994-95 to 2010-11, to an assessee engaged in the business of—

—civil construction [**includes** (*a*) the construction or repair of any building, bridge, dam or other structure or of any canal or road; (*b*) the execution of any works contract]; or

—supply of labour for civil construction.

Such assessee, hereinafter, referred to as an 'eligible assessee'.

Section 44AD of the 1961 Act inserted was to apply for the assessment years 1994-95 onwards, and it was not a mandatory requirement for the assessment year 1993-94 to assess the profit of civil construction at the rate prescribed therein, yet the rate could be applied at the discretion of the Income-tax authorities [*CIT v. Kailash Kacchawaha,* (2007) 293 ITR 449, 450 (Raj)].

Further, such eligible assessee's gross receipts paid or payable do not exceed an amount of ₹ 40 lakhs for the applicability of this provision.

LexisNexis

Sub-contractors are also covered.—The argument that section 44AD of the 1961 Act does not apply to sub-contracts and applies only to a contract cannot be accepted. The mere fact that in the matter of deduction at source, a distinction is made in section 194C of the 1961 Act between a contractor and a sub-contractor, does not enable the assessee to contend that section 44AD of the 1961 Act cannot apply to the case of a sub-contractor. The section speaks of any assessee engaged in the business of civil construction or supply of labour for civil construction and provides for a presumptive profit from such business. Whether a contractor or a sub-contractor, the assessee is admittedly engaged in the business of civil construction or supply of labour for civil construction within the meaning of section 44AD of the 1961 Act. On the wording of section 44AD of the 1961 Act, there is no doubt that a sub-contractor would also come squarely within the purview of that provision [*Manohar Ram Chandra Patil v. Union of India*, (2003) 260 ITR 87, 90 (Ori)].

Deemed profits and gains.—By virtue of the provisions of section 44AD(1) of the 1961 Act, in the case of an eligible assessee, higher of the following sum shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession":—

(*a*) a sum equal to 8% of the gross receipts paid or payable to the assessee in the previous year on account of such business; or

(*b*) a sum higher than the aforesaid sum as declared by the assessee in his return of income.

In *CIT v. K. Manickam*, (2002) 258 ITR 175, 178 (Mad), which was a case relating to assessment year 1992-93, it has been held that the order of the Tribunal deleting the addition of ₹ 2.5 lakhs, in the case of a building contractor, sustained by the first appellate authority was based on appreciation of evidence. In deleting such addition, the Tribunal incidentally referred to section 44AD of the 1961 Act to show that the profit margin shown by the assessee at 11.5% was more than 8% as fixed in section 44AD of the 1961 Act and did not rely on section 44AD of the 1961 Act which came into force subsequently from 1-4-1994 only.

Under section 44AD of the 1961 Act, when the books of account were not maintained the income had to be estimated only at 8% [*CGT v. A. Vajjiram & Bros.*, (2010) 326 ITR 551 (Mad)].

In *CIT v. Surinder Pal Anand*, (2011) 242 CTR (Punj) 61, it has been held that where an assessment is made under the provisions of section 44AD of the 1961 Act, the assessee is not under any obligation to explain individual entry of cash deposit in the bank until and unless such entry has no nexus with the gross receipts in question.

No deduction under sections 30 to 38 of 1961 Act to be allowed.—As per the provisions of **section 44AD(2)** of the 1961 Act, any deduction allowable under the provisions of sections 30 to 38 of the 1961 Act shall, for the purposes of section 44AD(1) of the 1961 Act, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed. Also see, *Shyam Bihari v. CIT*, (2012) 345 ITR 283 (Pat); *CIT v. Dolphin Builders (P.) Ltd.*, (2013) 356 ITR 420 (MP).

Thus, it is only with effect from 1-4-1994 that, by virtue of section 44AD(2) of the 1961 Act, Parliament has provided for a fictional assumption that the deduction shall be deemed to have been allowed. This provision clearly militates against the assumption sought to be raised on behalf of the Revenue in a case not falling within such statutory assumption [*CIT v. Chopra Bros. India* (*P.*) *Ltd.*, (2001) 252 ITR 412, 417 (Punj)].

In this regard, the following *Circular No. 737, dated 23-2-1996* was on the point:—

"*Admissibility of deduction on account of salary/interest to partners of firms opting for estimation of income under sections 44AD and 44AE.*—Sections 44AD and 44AE were inserted in the Income-tax Act, 1961, by the Finance Act, 1994, with effect from April 1, 1994. Section 44AD provides for a method of estimating income from the business of civil construction or supply of labour for civil construction work, where the gross receipts from the business do not exceed ₹ 40 lakhs. Section 44AE provides for a method of estimating income from the business of plying, hiring or leasing trucks owned by a taxpayer owning not more than 10 trucks. Both the schemes are optional.

2. Sub-sections (1) of sections 44AD and 44AE clearly provide that the income shall be estimated at the prescribed percentage/basis without regard to the provisions contained in sections 28 to 43C of the Act. In other words, the income estimated in accordance with sections 44AD and 44AE takes care of various deductions, etc., admissible under the aforesaid sections.

3. A doubt has been raised as to whether deduction(*s*) on account of salary/interest to the partners of a firm shall be admissible from the income estimated in accordance with sections 44AD and 44AE of the Act. The law is clear on this issue and no separate deduction is to be allowed under section 40(*b*) in such cases. The doubt has primarily arisen because of the erroneous clarification given in paras. 31.3 and 32.2 of the Explanatory Notes on provisions of the Finance Act, 1994 (Circular No. 684, dated 10th June, 1994). The relevant portion of the Explanatory Note reads as follows:—

> "In the case of firms, the normal deductions to the extent allowed under clause (*b*) of section 40 will be allowed.".

4. Clause (*b*) of section 40 lays down restriction on the deduction allowable on account of salary and interest to the partners and is not an enabling section for claiming deduction. The admissible deductions are specifically mentioned under sections 30 to 38 of the Income-tax Act. Hence, sections 44AD(2) and 44AE(3) only state this obvious position by way of clarification. However, in view of the *non obstante* clause in sub-section (1) of sections 44AD and 44AE, there is no ambiguity about the intention of the legislation is this matter and the provisions of the Act are quite clear. As already said above, the doubt has primarily arisen because of the error in the Explanatory Notes to the Finance Act, 1994. Therefore, for the sake of clarity and removal of doubts in this regard, the following lines are deleted from paras 31.3 and 32.2 of Circular No. 684, dated 10th June, 1994:—

> "In the case of firms, the normal deductions to the extent allowed under clause (*b*) of section 40 will be allowed.".'

The effect of the abovesaid circular No. 737 has been **nullified** as a result of the insertion (w. r. e. f. 1-4-1994) of a proviso to section 44AD(2) as also to section 44AE(3) by the Finance Act, 1997 (26 of 1997).

Thus, **proviso to section 44AD(2)** of the 1961 Act **inserted** (**w. r. e. f. 1-4-1994**) by **the Finance Act, 1997** (26 of 1997), specifically provides that the salary and interest paid to the partners of the assessee-firm shall be deducted while computing the income of such firm subject to the conditions and limits specified in section 40(*b*) of the 1961 Act. The provisions of this proviso are operative retrospectively for and from assessment year 1994-95.

Without noticing the fact that a new proviso has been inserted (w. r. e. f. 1-4-1994) by the Finance Act, 1997 (26 of 1997), the Kerala High Court has taken the view, in *Maliyekkal Construction Co. v. CIT*, (2003) 260 ITR 333, 336 (Ker), judgment rendered on 4-10-2002, that the assessee is not entitled to further deductions under section 40(*b*) of the 1961 Act.

In view of the insertion (w. r. e. f. 1-4-1994) of the proviso to section 44AD(2) of the 1961 Act by the Finance Act, 1997 (26 of 1997), the said circular No. 737 has been held to be clearly erroneous and the same was not permitted to stand. Therefore, the said circular No. 737 has been quashed [*A.S. Construction Co. v.*

LexisNexis

Union of India, (1998) 144 CTR (Raj) 69, 71 = (2001) 252 ITR 182, 183-84 (Raj); *Goswami & Bros. v. Union of India,* (1998) 96 Taxman 219, 221 (Raj) = (2001) 250 ITR 359, 361 (Raj)]. As the said circular No. 737 has lost its efficacy as a result of the retrospective amendments of sections 44AD and 44AE of the 1961 Act by the Finance Act, 1997 (26 of 1997), the assessments made on the basis of the said circular No. 737 could not stand and the same are liable to be vacated [*Ranjan Constructions v. CBDT,* (1998) 232 ITR 76, 78 (Ori)].

Still, in a case decided prior to the retrospective insertion (w. e. f. 1-4-1994) of the proviso to section 44AD(2) of the 1961 Act by the Finance Act, 1997 (26 of 1997), the Andhra Pradesh High Court has, dismissing the writ petitions, held that the later circular No. 737 in not extending the benefit of the earlier circular No. 684, dated 10-6-1994 has neither tried to deprive the assessee of any right nor has created any liability which was not already existing under the law then existent. Thus, if a wrong circular had been issued giving the impression that the assessee was entitled to the benefits of section 40(*b*) of the 1961 Act as well as section 44AD of the 1961 Act, it is the inherent right of the authorities to cure their own error. The later circular No. 737 of the Board has only attempted to do that and hence no exception can be taken to it. In that view of the matter, the later circular No. 737, dated 23-2-1996 was valid [*Venugopala Constructions v. ITO,* (1997) 227 ITR 164, 171-72 (AP)].

No doubt, the effect of any circular cannot be applied retrospectively so as to deprive the assessee of the benefit of the earlier circular [here, circular No. 684, dated 10-6-1994], which was applicable at the time of assessment. But, where at the time of assessment by the ITO, another circular [here, circular No. 737, dated 23-2-1996] is occupying the field, no grievance can be made that such a circular has been applied retrospectively [*Ambika Construction v. ITO,* (1998) 99 Taxman 561, 562-63 (Pat)].

In *Narinder Jain v. CBDT*, (1997) 143 CTR (Punj) 114, 116, in view of the retrospective amendment made in section 44AD of the 1961 Act by the Finance Act, 1997 (26 of 1997), with effect from 1-4-1994, the writ petition filed by the petitioner has been disposed of without expressing any opinion and relegated the petitioner to raise the point before the concerned authority (whether appellate or AO).

In *Atal Construction Co. v. Union of India*, (2001) 165 CTR (Raj) 125, 126, quashing the proceedings in pursuance of circular No. 737, dated 23-2-1996, the Assessing Officer was directed to start fresh proceeding as per the proviso to section 44AD(2) of the 1961 Act.

Where the Tribunal has held that deduction for salary and interest is separately allowable to the assessee-firm in view of the provisions contained in the proviso to section 44AD(2) of the 1961 Act even though its profit was computed by applying net profit rate as contemplated by section 44AD(1) of the 1961 Act, no question of law has been held to have arisen out of the order of the Tribunal [*CIT v. Heera Lal Bhat*, (2000) 158 CTR (Raj) 59, 60 = (2003) 184 CTR (Raj) 554, 554-55, **following** *CIT v. Jain Construction Co.*, (2000) 245 ITR 527, 537 (Raj)].

LexisNexis

Further, the contention that the proviso to section 44AD(2) of the 1961 Act has no application to the assessment completed under section 44AD(5) of the 1961 Act was not entertained because such contention was not raised before the Tribunal [*CIT v. Heera Lal Bhat*, (2000) 158 CTR (Raj) 59, 60 = (2003) 184 CTR (Raj) 554, 554-55].

Written down value deemed to be calculated on the basis of deemed allowance of depreciation.—Under **section 44AD(3)** of the 1961 Act, the written down value of any asset used for the purpose of the business referred to in section 44AD(1) of the 1961 Act shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

Sections 44AA and 44AB of 1961 Act not to apply.—Section 44AD(4) of the 1961 Act enacts that the provisions of sections 44AA and 44AB of the 1961 Act shall not apply in so far as they relate to the business referred to in section 44AD(1) of the 1961 Act and in computing the monetary limits under those sections, the gross receipts or, as the case may be, the income from the said business shall be excluded.

However, it is pertinent to note that with effect from 1-4-1998, the provisions of section 44AA(2)(*iii*) and section 44AB(*c*) of the 1961 Act make it obligatory to maintain books of account and to get such accounts audited even in case of a business referred to in section 44AD(1) of the 1961 Act if the assessee has claimed his income to be lower than the presumptive rate.

It seems difficult to reconcile the provisions of section 44AA(2)(*iii*), section 44AB(*c*), the proviso to section 44AD(1) and section 44AD(4) of the 1961 Act.

Provisions of section 44AD of 1961 Act not to apply in certain cases.—The provisions were not applicable in the following cases:—

(1) Gross receipts paid or payable to the eligible assessee exceed an amount of ₹ 40 lakhs [**proviso to s. 44AD(1)** of the 1961 Act]. Thus, section 44AD of the 1961 Act was not applicable since the gross receipts exceeded ₹ 40 lakhs. In the instant case, the Tribunal was not justified in adopting the

principle underlying section 44AD of the 1961 Act when the same was not applicable [*Shri Ram Jhanwar Lal v. ITO,* (2010) 321 ITR 400, 403 (Raj)]. Also see, *Awasthi Traders v. CIT*, (2016) 388 ITR 185, 193 (SC) = (2017) 297 CTR (SC) 451.

(2) **Between 1-4-1994 and 31-3-1997**, sections 44AD(1), (2), (3) and (4) of the 1961 Act shall not apply where the assessee claimed and produced evidence to prove that the profits and gains from the aforesaid business are lower than the profits and gains specified in section 44AD of the 1961 Act, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee and determine the sum payable by the assessee on the basis of assessment made under section 143(3) of the 1961 Act [**the then s. 44AD(5)** of the 1961 Act].

The said section 44AD(5) of the 1961 Act made the provisions of section 44AD(1) of the 1961 Act optional by saying that nothing contained in sub-sections (1) to (4) of section 44AD of the 1961 Act would apply, where the assessee claimed and produced evidence to prove that the profits and gains from the aforesaid business are lower than the profits and gains specified in section 44AD(1) of the 1961 Act, and there upon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee and determine the sum payable by the assessee on the basis of assessment made under section 143(3) of the 1961 Act [*Baghel Construction v. Union of India*, (1998) 234 ITR 690, 691 (All)].

Right to adopt lower than the presumptive rate.—Although, as a result of the **omission** (**w. e. f. 1-4-1997**) of **section 44AD(5)** of the 1961 Act by **the Finance Act, 1997** (26 of 1997), the right of the assessee to adopt lower than the presumptive rate as envisaged in section 44AD(1) of the 1961 Act has already been taken away, the provisions of the sections 44AA(2)(*iii*) and 44AB(*c*) of the 1961 Act, with effect from 1-4-1998, make it obligatory [on the supposed assumption that such right still exists] on the part of such an assessee to maintain accounts under section 44AA of the 1961 Act, get these accounts audited under section 44AB of the 1961 Act and submit the report of audit within the prescribed time limit.

From the above, it is clear that the omission (w. e. f. 1-4-1997) of section 44AD(5) of the 1961 Act makes it mandatory to tax the profits and gains of a business covered by section 44AD of the 1961 Act by adopting a rate not lower than the presumptive rate prescribed in that behalf in all cases where the gross receipts paid or payable in respect of such business is equal to, or less than, an amount of ₹ 40 lakhs.

Subsequently, **section 44AD(5)** of the 1961 Act has again been **inserted** (**w. r. e. f. 1-4-1997**) by **the Income-tax (Second Amendment) Act, 1998**, which provides that nothing contained in sections 44AD(1) to (4) of the 1961 Act shall apply where the assessee claims and produces evidence to prove that the profits and gains from the aforesaid business during the previous year relevant to the assessment year 1997-98 or any earlier assessment year, are lower than the profits and gains specified in section 44AD(1) of the 1961 Act, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee and determine the sum payable by the assessee on the basis of assessment made under section 143(3) of the 1961 Act.

From the above, it is apparent that the right to adopt lower than the presumptive rate has been revived, under the newly inserted section 44AD(5) of the 1961 Act, only in relation to assessment year 1997-98 or any earlier assessment year, but not any subsequent assessment year (*i.e.*, assessment year 1998-99 onwards). Here, it is pertinent to note that section 44AD(5) of the 1961 Act, as it stood between 1-4-1994 and 31-3-1997, gave such right to adopt lower than the presumptive rate in relation to assessment years 1994-95 to 1996-97.

Further, as a result of the **insertion** (**w. r. e. f. 1-4-1998**) of **section 44AD(6)** of the 1961 Act by **the Finance Act, 1999** (27 of 1999), the right to adopt lower than the presumptive rate has also been revived, for and from assessment year 1998-99. The so-inserted section 44AD(6) of the 1961 Act opens with a *non obstante* clause "Notwithstanding anything contained in the foregoing provisions of this section", thus, overriding the provisions of sub-sections (1) to (5) of section 44AD of the 1961 Act, and enacts that an assessee may claim lower profits and gains than the profits and gains specified in section 44AD(1) of the 1961 Act, if he—

—keeps and maintains such books of account and other documents as required under section 44AA(2) of the 1961 Act; and

—gets his accounts audited and furnishes a report of such audit as required under section 44AB of the 1961 Act.

The following *Circular No. 3, dated 9-2-2001* is on the point of filing of audit report for assessment year 1998-99:—

"*Filing of audit report under sections 44AD*(*6*)*, 44AE*(*7*) *and 44AF*(*5*) *of the Income-tax Act, 1961, for assessment year 1998-99.*—Sections 44AD, 44AE and 44AF of the Income-tax Act, 1961, provide for estimating the income under the head "Profits and gains of business or profession" in the cases of assessees

engaged in the business of (*i*) civil construction, (*ii*) plying, hiring or leasing goods carriages and (*iii*) retail businesses; provided the turnover or the number of vehicles, as the case may be, is below a specified figure.

2. Up to the assessment year 1997-98, under the provisions of the Income-tax Act, the above assessees could return income lower than the estimated income subject to compulsory scrutiny under section 143(3) of the Income-tax Act, 1961.

3. For assessment year 1998-99 and subsequent years, sub-section (6) of section 44AD, sub-section (7) of section 44AE and sub-section (5) of section 44AF provide that in case of a returned income lower than the income estimated under the provisions of the corresponding section, the assessees must keep and maintain such books of account or other documents as required under sub-section (2) of section 44AA and get their accounts audited and furnish a report of such audit as required under section 44AB. The requirement of section 44AB is that the audit report must be audited by an accountant before the specified date and the same must also be furnished by that date in a prescribed form.

4. Sub-section (6) of section 44AD, sub-section (7) of section 44AE and sub-section (5) of section 44AF were inserted with retrospective effect from April 1, 1998, by the Finance Act, 1999. Accordingly, the assessees were not in a position to file the audit report for the assessment year 1998-99 before the specified date; as on that date these sub-sections did not exist in the statute. Hence the default of assessees in complying with the requirement of filing the audit report before the specified date for the assessment year 1998-99 was due to circumstances beyond the control of such assessees. **To remove the genuine hardship** in all such cases, the Board hereby directs that for the assessment year 1998-99, the audit report, where called for under the provisions of sections 44AD(6), 44AE(7) and 44AF(5), if not filed by the specified date as stipulated under section 44AB, could be filed any time before the completion of assessment and in all such cases the provisions of sections 44AD(6), 44AE(7) and 44AF(5) will be deemed to have been complied with.

5. The contents of this circular may be brought to the notice of all concerned."

Matter remanded.—In *CIT v. Sobti Construction* (*India*), (2008) 307 ITR 374, 377 (Del), matter remitted to AO to calculate the estimated profit on the unaccounted receipts of ₹ 39,44,536.

In *Kesar Singh v. CIT*, (2011) 336 ITR 205 (Punj), it has been held that the Department failed to rebut that there was no discussion or finding in the order of the Tribunal that the order of the Commissioner (Appeals) was erroneous and reasons for such a finding, as such, the case remanded to the Tribunal for fresh decision on the merits.

The writ application succeeds and the earlier order passed by the AO hereby quashed and set aside. The AO now needs to reconsider the issue with regard to claim of the writ applicant for lower rate of profit and not @ 8% as earlier [*Engineering Professional Co. Pvt. Ltd. v. Deputy CIT*, (2020) 424 ITR 253, 267 (Guj) = (2020) 313 CTR (Guj) 272].

Reference may also be made to *CIT v. California Design & Construction INC India Ltd.*, (2011) 202 Taxman 392 (Punj).

LexisNexis

Omitted/Phased-out provisions of section 44AF of the 1961 Act

[1][**S. 44AF. Special provisions for computing profits and gains of retail business.—**(1) Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of an assessee engaged in retail trade in any goods or merchandise, a sum equal to five per cent of the total turnover in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum as declared by the assessee in his return of income shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession":

Provided that nothing contained in this sub-section shall apply in respect of an assessee whose total turnover exceeds an amount of forty lakh rupees in the previous year.

(2) Any deduction allowable under the provisions of sections 30 to 38 shall, for the purposes of sub-section (1), be deemed to have been already given full effect to and no further deduction under those sections shall be allowed:

Provided that where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed under sub-section (1) subject to the conditions and limits specified in clause (*b*) of section 40.

(3) The written down value of any asset used for the purpose of the business referred to in sub-section (1) shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

(4) The provisions of sections 44AA and 44AB shall not apply in so far as they relate to the business referred to in sub-section (1) and in computing the monetary limits under those sections, the total turnover or, as the case may be, the income from the said business shall be excluded.]

[2][(5) Notwithstanding anything contained in the foregoing provisions of this section, an assessee may claim lower profits and gains than the profits and gains specified in sub-section (1), if he keeps and maintains such books of account and other documents as required under sub-section (2) of section 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB.]

[3][(6) Nothing contained in this section shall apply to any assessment year beginning on or after the 1st day of April, 2011.]

LexisNexis

Introduction under 1961 Act.—*The Finance Act, 1997.*—By **the Finance Act, 1997** (26 of 1997), **section 44AF** has been **inserted** (**w. e. f. 1-4-1998)**.

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 763, dated 18-2-1998*, as follows:—

'**25.** *Introduction of special provision for computing profits and gains of retail trades.*—**25.1** In order to simplify the procedure of computation of income of retail trades, a new scheme for computing profits and gains of such businesses presumptively at five per cent. of the gross receipts has been introduced. This scheme is similar to the presumptive schemes of computation of income under section 44AD or section 44AE. A new section 44AF has been inserted in the Income-tax Act. Consequently, Chapter XII-C which provided for a flat tax of ₹ 1,400 for small businesses has been deleted.

25.2 This amendment will take effect from the 1-4-1998, and will, accordingly, apply in relation to the assessment year 1998-99 and subsequent years. [*Section 14*]'.

Legislative amendments under 1961 Act.—I. *The Finance Act, 1999.*—By **the Finance Act, 1999** (27 of 1999), **section 44AF(5)** has been **inserted** (**w. r. e. f. 1-4-1998**).

For the scope and effect of the above insertion, reference may be made to paras. 26 to 26.3 of the *Departmental Circular No. 779, dated 14-9-1999*.

II. *The Finance (No. 2) Act, 2009.*—By **the Finance (No. 2) Act, 2009** (33 of 2009), **section 44AF(6)** has been **inserted** (**w. r. e. f. 1-4-2009**).

For the scope and effect of the above insertion, reference may be made to paras. 21 to 21.3 of the *Departmental Circular No. 5/2010, dated 3-6-2010*.

---

1. Section 44AF has been inserted by the Finance Act, 1997 (26 of 1997), s. 14 (w. e. f. 1-4-1998).
2. Sub-section (5) has been inserted by the Finance Act, 1999 (27 of 1999), s. 31 (w. r. e. f. 1-4-1998).
3. Sub-section (6) has been inserted by the Finance (No. 2) Act, 2009 (33 of 2009), s. 22 (w. r. e. f. 1-4-2009).

Section 44AF of 1961 Act replaces the scheme of payment of a flat tax of ₹ 1,400 by small businessmen.—It is pertinent to note that the presumptive scheme as envisaged in section 44AF of the 1961 Act is, in effect, replacing the scheme of payment of a flat tax of ₹ 1,400 for small businessmen which was operative for assessment years 1993-94 to 1997-98, which scheme was contained in sections 115K to 115N of the 1961 Act forming part of Chapter XIIC of the 1961 Act.

Provisions of section 44AF(1) of 1961 Act are of overriding nature.—Section 44AF(1) of the 1961 Act overrides the provisions of sections 28 to 43C of the 1961 Act as that sub-section begins with a *non obstante* clause, namely, 'Notwithstanding anything to the contrary contained in sections 28 to 43C'.

Applicability of section 44AF(1) of 1961 Act.—The provisions of **section 44AF(1)** of the 1961 Act are applicable, **for and from assessment year 1998-99**, to an assessee engaged in retail trade in any goods or merchandise. Such assessee, hereinafter, referred to as an 'eligible assessee'.

As provided for in the **proviso to section 44AF(1)** of the 1961 Act, nothing contained in section 44AF(1) of the 1961 Act shall apply in case the aforesaid total turnover exceeds an amount of ₹ 40 lakhs.

*Wholesaler as also wholesaler-cum-retailer not covered.—*As section 44AF(1) of the 1961 Act specifically employs the expression 'an assessee engaged in retail trade' (retailer) and there being a well-defined distinction between a 'retailer' and a 'wholesaler', a wholesaler cannot be brought within the purview of section 44AF(1) of the 1961 Act. Further, a wholesaler-*cum*-retailer cannot also be brought under the precincts of section 44AF(1) of the 1961 Act except in relation to turn over pertaining to the retail trade if the same can be ascertained.

According to *Black's Law Dictionary*, Sixth Edition (p. 1315), the expression 'retailer' means "A person engaged in making sales to ultimate consumers. One who sells personal or household goods for use or consumption.". The expression 'wholesaler' has been assigned the meaning "One who buys in comparatively large quantities, and then resells, usually in smaller quantities, but never to the ultimate consumer. He sells either to a 'jobber' a sort of middleman, or to a 'retailer' who in turn sells to the consumer." [*Black's Law Dictionary*, Sixth Edition (p. 1597)].

LexisNexis

Section 44AF of the 1961 Act applies only to a retail trader who is not involved in wholesale trade. The Tribunal held that the presumption has not been rebutted by the revenue and that it has failed to prove that the assessee was rightly assessed under section 44AF of the 1961 Act [*CIT v. Ranjeet Kumar Sethia,* (2005) 198 CTR (Raj) 550, 551].

Deemed profits and gains.—By virtue of the provisions of section 44AF(1) of the 1961 Act, in the case of an eligible assessee, higher of the following sum shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession":—

(*a*) a sum equal to 5% of the gross receipts paid or payable to the assessee in the previous year on account of such business; or

(*b*) a sum higher than the aforesaid sum as declared by the assessee in his return of income.

No deduction under sections 30 to 38 of 1961 Act to be allowed.—As per the provisions of **section 44AF(2)** of the 1961 Act, any deduction allowable under the provisions of sections 30 to 38 of the 1961 Act shall, for the purposes of section 44AF(1) of the 1961 Act, be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.

However, the **proviso to section 44AF(2)** of the 1961 Act specifically provides that the salary and interest paid to the partners of the assessee-firm shall be deducted while computing the income of such firm subject to the conditions and limits specified in section 40(*b*) of the 1961 Act.

Written down value deemed to be calculated on the basis of deemed allowance of depreciation.—Under **section 44AF(3)** of the 1961 Act, the written down value of any asset used for the purpose of the business referred to in section 44AF(1) of the 1961 Act shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

Sections 44AA and 44AB of 1961 Act not to apply.—Section 44AF(4) of the 1961 Act enacts that the provisions of sections 44AA and 44AB of the 1961 Act shall not apply in so far as they relate to the business referred to in section 44AF(1) of the 1961 Act and in computing the monetary limits under those sections, the total turnover or, as the case may be, the income from the said business shall be excluded.

However, it is pertinent to note that with effect from 1-4-1998, the provisions of section 44AA(2)(*iii*) and section 44AB(*c*) of the 1961 Act make it obligatory to maintain books of account and to get such accounts audited even in case of a business referred to in section 44AF(1) of the 1961 Act if the assessee has claimed his income to be lower than the presumptive rate.

It seems difficult to reconcile the provisions of section 44AA(2)(*iii*), section 44AB(*c*), the proviso to section 44AF(1) and section 44AF(4) of the 1961 Act.

Whether right given to adopt lower than the presumptive rate?—Although the provisions of section 44AF of the 1961 Act as finally enacted does not give any right to an assessee engaged in retail business as envisaged in section 44AF of the 1961 Act, the provisions of the sections 44AA(2)(*iii*) and 44AB(*c*) of the 1961 Act, with effect from 1-4-1998, make it obligatory [on the supposed assumption that such right has been given] on the part of such an assessee to maintain accounts under section 44AA of the 1961 Act, get these accounts audited under section 44AB of the 1961 Act and submit the report of audit within the prescribed time limit.

From the above, it is clear that as no right has been given to adopt lower than the presumptive rate, it is mandatory to tax the profits and gains of a business covered by section 44AF of the 1961 Act by adopting a rate not lower than the presumptive rate in all cases where the total turnover in respect of such business is equal to, or less than, an amount of ₹ 40 lakhs in the previous year.

As a result of the **insertion** (**w. r. e. f. 1-4-1998**) of **section 44AF(5)** of the 1961 Act by **the Finance Act, 1999** (27 of 1999), the assessee has been given a right to adopt lower than the presumptive rate.

Section 44AF of 1961 Act not applicable for and from assessment year 2011-12.—Section 44AF(6) of the 1961 Act, which has been **inserted** (**w. r. e. f. 1-4-2009**), by **the Finance (No. 2) Act, 2009** (33 of 2009) enacts that nothing contained in section 44AF of the 1961 Act shall apply to any assessment year beginning on or after 1-4-2011.

LexisNexis

Omitted/Phased-out provisions of section 44D of the 1961 Act

[1][**S. 44D. Special provisions for computing income by way of royalties, etc., in the case of foreign companies.—**Notwithstanding anything to the contrary contained in sections 28 to 44C, in the case of an assessee, being a foreign company,—

(*a*) the deductions admissible under the said sections in computing the income by way of royalty or fees for technical services received [2][from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern] before the 1st day of April, 1976, shall not exceed in the aggregate twenty per cent of the gross amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property;

(*b*) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty or fees for technical services received [3][from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern] after the 31st day of March, 1976, [4][but before the 1st day of April, 2003].

[5][(*c*) * * * *]

[6][(*d*) * * * *]

Explanation.—For the purposes of this section,—

(*a*) "fees for technical services" shall have the same meaning as in [7][*Explanation* 2 to clause (*vii*) of sub-section (1) of section 9];

(*b*) "foreign company" shall have the same meaning as in section 80B[8];

(*c*) "royalty" shall have the same meaning as in [9][*Explanation 2* to clause (*vi*) of sub-section (1) of section 9];

(*d*) royalty received [10][from Government or an Indian concern in pursuance of an agreement made by a foreign company with Government or with the Indian concern] after the 31st day of March, 1976, shall be deemed to have been received in pursuance of an agreement made before the 1st day of April, 1976, if such agreement is deemed, for the purposes of the proviso to clause (*vi*) of sub-section (1) of section 9, to have been made before the 1st day of April, 1976.]

Introduction under 1961 Act.—*The Finance Act, 1976.*—By **the Finance Act, 1976** (66 of 1976), **section 44D** has been **inserted** (**w. e. f. 1-6-1976**).

---

1. Section 44D has been inserted by the Finance Act, 1976 (66 of 1976), s. 10 (w. e. f. 1-6-1976).

2. Subs., for "from an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern", by the Finance Act, 1983 (11 of 1983), s. 19(*a*) (w. e. f. 1-6-1983).

3. Subs., for "from an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern", by the Finance Act, 1983 (11 of 1983), s. 19(*a*) (w. e. f. 1-6-1983).

4. Ins. by the Finance Act, 2003 (32 of 2003), s. 27 (w. e. f. 1-4-2004).

5. Clause (*c*) has been omitted by the Finance Act, 1994 (32 of 1994), s. 17 (w. e. f. 1-4-1995). Prior to its omission, clause (*c*) stood as follows:—

'(*c*) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing income by way of interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency.'.

Above clause (*c*) was inserted by the Finance Act, 1983 (11 of 1983), s. 19(*b*) (w. e. f. 1-6-1983).

6. Clause (*d*) has been omitted by Act 32 of 1994, s. 17 (w. e. f. 1-4-1995). Prior to its omission, clause (*d*) stood as follows:—

'(*d*) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income referred to clause (*ab*) of sub-section (1) of section 115A.'.

Above clause (*d*) was inserted by the Finance (No. 2) Act, 1991 (49 of 1991), s. 16 (w. r. e. f. 1-4-1989).

7. Subs., for "*Explanation* to clause (*vii*) of sub-section (1) of section 9", by the Finance (No. 2) Act, 1977 (29 of 1977), s. 29(1)(*a*)(*i*) (w. e. f. 1-4-1977).

8. It is pertinent to note that clause (4) of section 80B, defining "foreign company" has been omitted by the Direct Tax Laws (Amendment) Act, 1987 (4 of 1988) (w. e. f. 1-4-1989). With effect from 1-4-1989, section 2(23A), newly inserted by that Act, defines that expression.

9. Subs., for "the *Explanation* to clause (*vi*) of sub-section (1) of section 9", by Act 29 of 1977, s. 29(1)(*a*)(*ii*) (w. e. f. 1-4-1977).

10. Subs., for "from an Indian concern in pursuance of an agreement made by a foreign company with the Indian concern", by Act 11 of 1983, s. 19(*c*) (w. e. f. 1-6-1983).

LexisNexis

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 202, dated 5-7-1976*, as follows:—

'**26.** *Special provisions for computing income by way of royalties and technical service fees in the case of foreign companies—New section 44D.*—**26.1** Hitherto, income by way of royalties received under agreements made after the 31-3-1961, and approved by the Central Government was taxed in the hands of foreign companies at the rate of 52.5 per cent. (income-tax 50 per cent. *plus* surcharge 2.5 per cent.). Income by way of technical service fees received under agreements made after the 29-2-1964, and approved by the Central Government was also taxed at the same rate. In either case, the taxable income was determined on net basis, *i.e.*, after allowing deduction in respect of costs and expenses incurred for earning the income.

26.2 The Finance Act, 1976 (66 of 1976), has inserted a new section 44D in the Income-tax Act, 1961, which lays down special provisions for computing income by way of royalties and fees for technical services received by foreign companies from Indian concerns. Where such income is received under agreements made before the 1-4-1976, the deduction in respect of expenses incurred for earning such income will be subject to a ceiling limit of 20 per cent. of the gross amount of such income, as reduced by the amount, if any, of so much of the royalty income as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property. The aforesaid ceiling limit will be applicable in relation to all royalties and technical service fees received by foreign companies from Indian concerns, irrespective of whether such royalties or technical service fees are received under agreements which have been approved by the Central Government or not. For this purpose, an agreement made by a foreign company with an Indian concern on or after the 1-4-1976, will be regarded as agreement made before that date if such agreement is made on the basis of proposals approved by the Central Government before that date and the foreign company has exercised an option in this behalf under section 9(1)(*vi*).

26.3 As regards royalties and technical service fees received under agreements made on or after the 1-4-1976 (other than agreements which though made on or after that date are regarded as having been made before that date as explained in paragraph 26.2), no deduction will be allowed in computing the income from the aforesaid sources, regardless of whether the agreement has been approved by the Central Government or not. Such royalties and technical service fees will, if payable under agreements which have been approved by the Central Government, be charged to tax at the flat rates specified in new section 115A of the Income-tax Act.

26.4 These amendments have come into force with effect from the 1-6-1976[11], and will apply in relation to the assessment year 1977-78 and subsequent years.'.

LexisNexis

Legislative amendments under 1961 Act.—I. *The Finance (No. 2) Act, 1977.*—By **the Finance (No. 2) Act, 1977** (29 of 1977), the following **amendments** (**w. e. f. 1-4-1977**) have been made—

—***Explanation (a)* to section 44D** has been **amended**; and

—***Explanation (c)* to section 44D** has been **amended**.

II. *The Finance Act, 1983.*—By **the Finance Act, 1983** (11 of 1983), the following **amendments** (**w. e. f. 1-6-1983**) have been made—

—**sections 44D(*a*) and (*b*)** have been **amended**;

—**section 44D(*c*)** has been **inserted** before the *Explanation*; and

—***Explanation* (*d*) to section 44D** has been **amended**.

The scope and effect of the above amendments have been elaborated in the following portion of the *Departmental Circular No. 372, dated 8-12-1983*, as follows:—

'*(xxvii) Taxation of certain incomes of foreign companies—Sections 44D and 115A.*—**36.1** Section 44D(*a*) of the Income-tax Act provides that in the case of a foreign company, the deductions admissible under sections 28 to 44C of the Act in computing the income by way of royalty or fees for technical services received from an Indian concern in pursuance of an agreement made with the Indian concern before 1-4-1976, shall not exceed 20 per cent. of the gross amount of such income. Where such agreement is made after 31-3-1976, section 44D(*b*) provides that no deduction will be allowed in respect of any expenditure or allowance under any of the said sections in computing such income. In other words, the gross amount of income by way of royalties or fees for

11. It has been brought to the notice of the CBDT by the audit that in case of one assessee, the Assessing Officer applied incorrectly the amended provisions of section 44D on a *pro rata* basis with effect from 1-6-1976, for the assessment year 1977-78, instead of applying these for the entire previous year. Thus, it is clarified *vide Circular No. 282, dated 22-9-1980* that the restrictions placed by section 44D apply for the entire previous year relevant to the assessment year 1977-78 and onwards; the relevance of the date 1-6-1976, is for purposes of section 195 only. In other words, it is merely intended to regularise any deduction made under that section up to 31-5-1976, in accordance with the earlier provision in this regard.

technical services received by foreign companies from an Indian concern under agreements made after 31-3-1976, is chargeable to tax. Under section 115A(1)(*b*) of the Income-tax Act, the gross amount of such income is chargeable to tax at the flat rate of forty per cent. if the relevant agreement is approved by the Central Government. A lower rate of twenty per cent. is, however, applicable in respect of lump sum royalties received for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing, etc.

36.2 The Finance Act, 1983 (11 of 1983), has amended the aforesaid provisions of sections 44D and 115A so as to extend their application also in cases where such income by way of royalty or fees for technical services is received by a foreign company from Government.

36.3 The Finance Act, 1983 (11 of 1983), has also amended section 44D to provide for the taxation of the gross amount of income by way of interest received by foreign companies from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency. Under an amendment made to section 115A of the Act, the gross amount of income by way of interest will be charged to tax at the rate of 25 per cent.

36.4 The aforesaid amendments take effect from 1-6-1983, and will, accordingly, apply in relation to the assessment year 1984-85, and subsequent years. [*Sections 19 and 35 of the Finance Act, 1983*]'.

III. *The Finance (No. 2) Act, 1991.*—By **the Finance (No. 2) Act, 1991** (49 of 1991), **section 44D(*d*)** has been **inserted** (**w. r. e. f. 1-4-1989**).

The scope and effect of the above insertion have been elaborated in the following portion of the *Departmental Circular No. 621, dated 19-12-1991*, as follows:—

'**43.12** Section 115A of the Income-tax Act provides for special rates of tax in respect of income from dividends, royalty, technical fees, etc., in the case of foreign companies. Section 44D of the Income-tax Act provides that such income in the hands of foreign companies shall be taxed on gross basis without allowing for any deduction in respect of expenditure. By the Direct Tax Laws (Amendment) Act, 1989, an insertion was made in section 115A to provide for a special rate of tax in respect of income of a foreign company from units of a mutual fund. However, no corresponding amendment was made in section 44D.

43.13 With a view to bring parity in respect of incomes which are taxed at special rates in respect of foreign companies, section 44D has been amended to clarify that the income from units of a mutual fund in the hands of a foreign company would also be taxed on gross basis.

43.14 This amendment takes effect retrospectively from 1st April, 1989.'.

IV. *The Finance Act, 1994.*—By **the Finance Act, 1994** (32 of 1994), **sections 44D(*c*) and (*d*)** have been **omitted** (**w. e. f. 1-4-1995**).

For the scope and effect of the above omission, reference may be made to paras. 47.6 and 47.7 of the *Departmental Circular No. 684, dated 10-6-1994*.

V. *The Finance Act, 2003.*—By **the Finance Act, 2003** (32 of 2003), **sections 44D(*b*)** has been **amended** (**w. e. f. 1-4-2004**).

For the scope and effect of the above amendment, reference may be made to paras. 37 to 37.7 of the *Departmental Circular No. 7 of 2003, dated 5-9-2003*.

Illustrations.—A foreign company could not claim any deduction for expenditure higher than 20% of the gross amount of royalty or fees received by it in pursuance of an agreement which was executed between the parties on 27-6-1960 for a period of 20 years and which was subsequently amended by an agreement dated 2-5-1975. This was so in view of the specific provisions of clause (*a*) of section 44D of the 1961 Act [*Dunlop Rim & Wheel Co. Ltd. v. CIT,* (1994) 73 Taxman 134, 142-43 (Cal)].

In *CIT v. O.N.G.C.*, (2008) 299 ITR 438, 444 (Uttaranchal), it has been held that the company has received fee for rendering technical services and, thus, is liable to pay tax under section 44D read with section 115A of the 1961 Act. Also see, *CIT v. ONGC Ltd.,* (2009) 309 ITR 244, 246 (Uttarakhand); *CIT v. ONGC Ltd.,* (2009) 309 ITR 447, 450 (Uttarakhand); *B.J. Services Co. Middle East Ltd. v. Deputy DIT*, (2011) 339 ITR 169 (Uttarakhand).

In *DIT v. Rio Tinto Technical Services*, (2012) 340 ITR 507 (Del), it has been held that since the income earned by the assessee was taxable as fee for technical services, section 44D of the 1961 Act is applicable to the instant case.

The payment for services in question is fees for technical services and not as services in connection with extraction of mineral oil and, thus, held taxable under the provisions of section 44D of the 1961 Act [*CIT v. ONGC*, (2012) 343 ITR 267 (Uttarakhand)].

LexisNexis

From the provisions of section 44D(*b*) of the 1961 Act, it is clear that no deduction can be available under that section in case the consideration received pursuant to the agreement is by way of fees for technical services as defined under *Explanation 2* to section 9(1)(*vii*) of the 1961 Act [*International Operating Services Ltd. v. CIT,* (1997) 228 ITR 599, 603 (Karn)]. In the facts of that case, the assessee-company (foreign company) was held not entitled to any deduction out of the gross consideration it received under the agreement with the Indian company.

LexisNexis