KARNATAKA SMALL SCALE INDUSTRIES DEVELOPMENT CORPORATION LTD. A

v.

COMMISSIONER OF INCOME TAX, BANGALORE

DECEMBER 3, 2002

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[RUMA PAL AND B.N. SRIKRISHNA, JJ.]

Income Tax Act, 1961:

Section 115-J—Special provisions for assessment of Tax on book profit for certain period/previous years in respect of certain companies—Deductions under other provisions of the Act—Held, such deductions are necessary ingredient of the formula under the said provision of law which is taken into account while assessing notional income for computing tax on book profit. C

Words and Phrases: D

'written down value'—Meaning of.

The question which arose in these appeals was whether the deductions permissible under the provisions of the Income Tax Act can be considered to have been actually allowed when the assessee has been made liable to pay 30 per cent of the book profits in term of Section 115-J of the Act. E

It was contended for the assessees that since benefit of deduction was not allowed while assessing income of the assessee for calculating tax on book profit they should be permitted to carry forward the same for the relevant previous year under the provisions of the Act including Section 115-J; and that assessable income under Section 115-J could not be extended to include the fictional deductions. F

On behalf of Revenue, it was submitted that under Section 115-J(2) assessee could not be permitted to carry forward those deductions which had already been allowed while assessing zero tax figure for the previous years. G

Dismissing the appeals, the Court

HELD: 1. The very object of the provision of Section 115-J is to tax such companies which are making huge profits and also declaring substantial H

A dividends, but are managing their affairs in such a way as to avoid payment of income tax, as a result of various tax concessions and incentives and for that purpose the taxable income is determined under sub-section (1) of Section 115J, if any loss equal to the income thus determined is allowed to be adjusted, then that would frustrate and nullify the very object of enacting the provision. [461-E, F]

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Suryalatha Spg. Mills Ltd. v. *Union of India,* (223 ITR 713), approved.

Lallcherra Tea Co. (O) Ltd. v. *Commissioner of Income tax,* 239 ITR 611 and *Madeva Upendra Sinai* v. *Union of India and Ors.* 98 ITR 209, distinguished.

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2.1. Section 115-J(1) provides for two stages. The first stage envisages computation of income after taking into consideration all deductions allowable under the Income Tax Act. It is only after the deductions are given effect to, and if the resultant income is less than 30 per cent of the book profit, that the assessee's total income would be deemed to have a notional income fixed D at 30 per cent of its book profit. It may be that the assessees are not required to pay tax on the figure of the assessable income arrived at after deducting the amounts permissible under the Act. However, it cannot be said that the deductions are not taken into account. If the deductions had not in fact been allowed then the assessee would not have had an assessable income less than E 30 per cent of the book profit, the deductions claimed are not ignored but are a necessary ingredient of the formula for applying the fictional total income. [459-C, E-H]

2.2. All that Section 115-J(2) does is to preserve the right to carry forward the balance of the unabsorbed deductions in the relevant previous year F to the next assessment year. Section 115-J does not create any right nor does it serve to allow all the deductions taken into consideration for determining whether the total income should be quantified under Section 115-J(1), to be carried forward under sub-section (2) of Section 115-J. It allows only the unabsorbed losses, depreciation, investment allowance etc. which otherwise G could have been carried forward, to be carried forward. This construction of sub-sections (1) and (2) Section 115-J is in keeping with the avowed purpose for which Chapter XII-B was introduced in the Act by the Finance Act, 1987. In addition, a contemporaneous exposition of the purport of Section 115-J is contained in Circular No. 495 dated 22nd September 1987 issued by the Central Board of Direct Taxes. Had Section 115-J not been introduced, the H assessee would have been entitled under the provisions of Sections 32(2),

32A(3), 72(i)(ii), 73, 74, 74A(3) and 80(J)(3) to carry forward only the unabsorbed depreciation allowance under Section 32, investment allowance under Section 32-A, losses under Sections 72, 72A, 73, 74 of the Act and permissible deductions under Section 80J to the following assessment year to be set off against the profits and gains of that assessment year.

[460-B-E, G; 461-H]

Commissioner of Income Tax, Kanpur **v.** *Mother India Refrigeration Industrties,* **[1985] 4 SCC 1;** *Mancheri Puthusseri Ahmed* **v.** *Kuthiravattam Estate Receiver,* **[1996] 6 SCC 185;** *Commissioner of Income Tax, Bombay City I* **v.** *Dharampur Leather Co. Ltd. 60,* **ITR 165 and** *Madeva Upendra Sinai* **v.** *Union of India and Ors.* **98 ITR 209, distinguished.**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 823 of 2000.

From the Judgment and Order dated 29.9.1999 of the Karnataka High Court in TTRC No. 144 of 1995.

WITH

Civil Appeal Nos. 824/2000, 825-826/2000, 2715-2716/2000, 3546-3547/2001.

S. Ganesh, K.T. Anantharaman, Vasudevan Raghavan, and Dhruv Mehra for M/s. K.L. Mehta & Co., for the Appellant.

R.P. Bhat, Ms. Neera Gupta, Ranbir Chandra and Ms. Sushma Suri, for the Respondent.

The Judgment of the Court was delivered by

RUMA PAL, J. All these appeals are disposed of by this common judgment.

The assessees who are in appeal before us are companies who have been subjected to imposition of tax on 30% of their book profits in accordance with section 115J(1) of the Income Tax Act, 1961 (referred to as the 'Act').

Section 115J is in Chapter XII-B of the Act which is entitled 'Special Provisions Relating to Certain Companies'. It was inserted by the Finance Act, 1987 with effect from the Assessment Year 1988-89 and remained in operation till the Assessment Year 1990-91. The relevant extract of section

A 115-J reads as follows:

> "115J. (1) Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee being a company other than a company engaged in the business of generation or distribution of electricity, the total income, as computed under this Act in respect
> B of any previous year relevant to the assessment year commencing on or after the 1st day of April, 1988 but before the 1st day of April 1991 (hereinafter in this section referred to as the relevant previous year), is less than thirty per cent of its book profit, the total income of such assessee chargeable to tax for the relevant previous year shall be
> C deemed to be an amount equal to thirty per cent of such book profit.
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> (1A) Every assessee, being a company, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956.
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> D .....
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> (2) Nothing contained in sub-section (1) shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of sub-section (2) of Section 32 or sub-section (3) of Section 32-A or clause
> E (ii) of sub-section (1) of Section 72 or section 73 or section 74 or sub-section (3) of section 74A or sub-section (3) of section 80J."

The question to be determined in all these appeals is whether the deductions which are permissible under the provisions of the Act can be
F considered to have been actually allowed when the assessee has been made liable to pay 30 per cent of its book profits in terms of section 115-J of the Act.

The Income Tax Appellate Tribunal, Bangalore Bench held that in determining the total income of the assessee under other provisions of the
G Act, depreciation actually considered for calculating the taxable income shall be the depreciation which is deemed to have been actually allowed. According to the Tribunal, this depreciation has to be considered while determining the written down value of the assets for the subsequent assessment year even though the taxable income of the assessee was determined with reference to book profit pursuant to section 115-J(1) of the Act. It also held that the
H scheme for levying tax by considering 30% of the book profit under section

115J(1) to be the deemed total income, as "an artificial process super-imposed on the regular process of determination of the total income of the assessee in the usual manner". A

The Tribunal at the instance of the assessee formulated the following questions under section 256(1) of the Act and referred the same to the High Court for its opinion: B

> "1. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the amounts of business loss, unabsorbed depreciation, unabsorbed investment allowance etc., as at the beginning of the accounting year are required to be adjusted and set off to the extent of such brought forward business loss, unabsorbed depreciation etc., would have been adjusted and set off had the assessee been assessed to tax in the regular way in accordance with the provisions of Sec.28 to 43 of the Income Tax Act, 1961 and not by way of application of the provisions of Sec.115J(1) and that the resultant amounts of losses, unabsorbed depreciation, unabsorbed investment allowance etc. only will be required to be carried forward to the next year? C D
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> 2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the written down values of the assets will have to be adjusted by deducting therefrom the amounts of depreciation which would have been allowed on such assets in the regular method of assessment in accordance with the provisions of Section 28 to 43 of the Income Tax Act, 1961 without applying the provisions of Section 115J(1), and the resultant amounts of written down values will only have to be carried forward to the next year." E F

Similar orders were passed by the Tribunal in the case of other appellants. The High Court by a common order and judgment upheld the reasoning of the Tribunal and answered the references in favour of the Revenue and against the assessees.

According to Mr. S. Ganesh, learned senior counsel appearing on behalf of one of the appellants, an assessee-company which was otherwise entitled to various deductions under the provisions of the Act from its total income, in computing its total income, was liable under section 115-J to pay tax of 30 per cent of the company's book profit irrespective of the actual deductions claimed by it for the period when section 115-J was in operation. It is submitted G H

A that in such circumstances it cannot be said that the benefits of deduction which the assessee had claimed had been actually allowed and, therefore, the assessee/appellant should have been permitted to carry forward the unabsorbed investment allowance or depreciation claimed by it for the relevant previous year, under the provisions of sub-section (2) of section 115-J read with sections 32-A and 32-A (3)(iii). Reliance was placed on section 43(6) which B defines 'written down value' as meaning the actual cost of the asset less depreciation actually allowed. It is submitted that therefore in computing the income for the next assessment year the assessee who had paid 30 per cent of the book profit in the preceding assessment year could claim to adjust the depreciation and investment allowance since the depreciation and the C investment allowance claimed in the preceding year had not been actually allowed. Reliance has been placed on the decisions reported in *Commissioner of Income Tax, Bombay City I* v. *Dharampur Leather Co. Ltd.,* 60 ITR 165 and *Madeva Upendra Sinai* v. *Union of India and Ors.,* 98 ITR 209 in support of this submission. According to the Mr. Ganesh, the entire investment allowance and unabsorbed depreciation as on April 1998 remained intact and was not D written off or obliterated by computation of income of 30 per cent of the book profit under section 115-J.

Mr. Dhruv Mehta, learned counsel for another appellant/assessee has adopted these arguments and has further submitted that the fiction of the E assessable income under section 115-J could not be extended to include the fictional deductions. It was stated that where deductions were sought to be adjusted, this has been expressly provided for, as for example under section 44 AD, sub-section (2) & (3) and section 44 AF, sub-sections (2) & (3). Reference has been made to the decisions of this Court in *Commissioner of Income Tax, Kanpur* v. *Mother India Refrigeration Industries* [1985] 4 SCC F 1 (para 10) and *Mancheri Puthusseri Ahmed* v. *Kuthiravattam Estate Receiver* [1996] 6 SCC 185 to contend that a statutory fiction must be limited strictly to the purpose for which it is introduced. In any event, it is submitted by learned counsel that if there were any doubt in the interpretation of the provisions, the doubt must be resolved in favour of the assessee on the basis G of the principles enunciated in *Commissioner of Income Tax, Bangalore* v. *A.H. Gotla,* 56 ITR 323.

Mr. R.P. Bhat, learned senior counsel appearing on behalf of the Revenue has submitted that section 115-J was aimed at those companies which were in fact profit making but submitted 'nil' assessments of their total income by H virtue of the deductions permitted under the Act. In the case of such "zero-

tax companies", the intention of section 115-J was to levy tax on such companies by fixing a notional asssessable income which was 30 per cent of the book profit. Learned counsel has relied upon the reasoning of the decision of the Division Bench of the Andhra Pradesh High Court in *Suryalatha Spg. Mills Ltd.* v. *Union of India,* (223 ITR 713) and has submitted that the assessee cannot under section 115-J (2), be permitted to carry forward those deductions which had already been claimed and allowed by the Department in arriving at the zero assessment figure. According to Mr. Bhat, had the deductions not been actually allowed as claimed by the appellant, then the assessee would not have been liable to pay only the tax on the book profit but tax on the actual income.

The constitutional validity of section 115-J of the Act is not in dispute before us. The only issue is its interpretation.

Section 115-J(1) commences with a non obstante clause. Plainly read, it provides for two stages:

(a) computation of income of the assessee under the Act in respect of any previous year relevant to the assessment year commencing on or after 1st April 1988 and before 1st July 1991;

(b) If the income as computed under the Act in respect of the relevant previous year is less than 30 per cent of its book profit, then the deemed total income of the assessee chargeable to tax for the relevant previous year would be equal to 30 per cent of the book profit.

The first stage referred to above envisages computation of income under the Act, that is, after taking into consideration all deductions allowable under the Act. It is only after the deductions are given effect to, and if the resultant income is less than 30 per cent of the book profit, that the assessee's total income would be deemed to have a notional income fixed at 30 per cent of its book profit. It may be that the assessees are not required to pay tax on the figure of the assessable income arrived at after deducting the amounts permissible under the Act. However, it cannot be said that therefore the deductions are not taken into account. If the deductions had not in fact been allowed then the assessee would not have had an assessable income lesser than 30 per cent of its book profit, entitling it to pay tax only on 30 per cent of its book profit. In deeming the total income to be 30 per cent of the book profit, the deductions claimed are not ignored as contended by the appellants but are a necessary ingredient of the formula for applying the fictional total

A income. The decisions cited in the context of the operation of statutory fictions are not apposite as there is no notional or fictional but actual deduction. Once the deductions are taken into consideration and the assessee is put into the category of those companies covered by section 115J(1) only then is the assessee required to pay on a notional income of 30 per cent of its book profits.

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Had sections 115J not been introduced, the assessee would have been entitled under the provisions of sections 32(2), 32(A)(3), 72(I) (ii), 73, 74, 74A(3) and 80(J)(3) to carry forward only the unabsorbed depreciation allowance under section 32, investment allowance under section 32-A, losses under sections 72, 72A, 73, 74 and permissible deductions under section 80J to the following assessment year to be set off against the profits and gains of that assessment year. All that section 115-J(2) does is to preserve this right viz. to carry forward the balance of the unabsorbed deductions in the relevant previous year to the next assessment year. Section 115-J does not create any right nor does it serve to allow all the deductions taken into consideration for determining whether the total income should be quantified under section 115-J (1), to be carried forward under sub-section 2 of section 115-J. It allows only the unabsorbed losses, depreciation, investment allowance etc. which otherwise could have been carried forward, to be carried forward.

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This construction of sub sections (1) and (2) section 115J is in keeping with the avowed purpose for which Chapter XII-B was introduced in the Act by the Finance Act, 1987. This was stated by the Finance Minister in his budget speech in the following manner:

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> "It is only fair and proper that the prosperous should pay at least some tax. The phenomenon of so called 'zero-tax' highly profitable companies deserves attention. In 1983, a new section 80VVA was inserted in the Act so that all profitable companies pay some tax. This does not seem to have helped and is being withdrawn. I now propose to introduce a provision whereby every company will have to pay a 'minimum corporate tax' on the profits declared by it in its own accounts. Under this new provision, a company will pay tax on at least 30 per cent, of its book profit This measure will yield a revenue gain of approximately Rs.75 crores."

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In addition, a contemporaneous exposition of the purport of section

1. Reported in (1987) 165 ITR (St.) 14

H 2. Reported in 168 ITR (St.) p. 87 at page 111

115J is contained in Circular No. 495 dated 22nd September 1987 issued by the Central Board of Direct Taxes. The Circular gives explanatory notes on the provisions relating to direct tax in the Finance Act. With reference to section 115J, it was said:

> "Section 115J, therefore, involves two processes. Firstly, an assessing authority has to determine the income of the company under the provisions of the Income-tax Act. Secondly, the book profit is to be worked out in accordance with the Explanation to section 115J(1) and it is to be seen whether the income determined under the first process is less than 30 per cent of the book profit. Section 115J would be invoked if the income determined under the first process is less than 30 percent of the book profit. The Explanation to sub-section (1) of section 115J gives the definition of the "book profit" by incorporating the requirement of section 205 of the Companies Act in the computation of the book profit. Brought forward losses or unabsorbed depreciation whichever is less would be reduced in arriving at the book profits. Sub-section (2), however, provides that the application of this provision would not affect the carry forward of unabsorbed depreciation, unabsorbed investment allowance, business losses to the extent not set off, and deduction under section 80J, to the extent not set off as computed under the Income-tax Act".

The Division Bench of the Andhra Pradesh High Court in *Suryalatha Spg. Mills Ltd.* (supra) had construed section 115J in favour of the Revenue *inter alia* because: "the very object of the provision of section 115J is to tax such companies which are making huge profits and also declaring substantial dividends, but are managing their affairs in such a way as to avoid payment of income tax, as a result of various tax concessions and incentives and for that purpose the taxable income is determined under sub-section (1) of section 115J, if any loss equal to the income thus determined is allowed to be adjusted, then that would frustrate and nullify the very object of enacting the provision". The reasoning appears to us to be unexceptionable.

In *Lallcherra Tea Co. (O) Ltd.* v. *Commissioner of Income Tax*, 239 ITR 611 relied upon by the appellant, the Guwahati High Court was considering a case of an assessee-company which had filed a return in which the total income computed was less than 30 per cent of its book profit. After computing its book profit, in terms of section 115-J (1), a sum of Rs. 74,477 was deemed to be the total income chargeable to tax for the assessment year, namely, 1987-88. In the assessment year 1988-89, the company sought to deduct the

A sum of Rs. 74,477 rounded off to Rs. 74,450 from its total income. The Revenue opposed this. The submission of the assessee was that the tax would not have been demanded against the amount which was adjusted. Upsetting the finding of the Tribunal, the Court held in favour of the assessee on the basis of a hypothetical example which, in our view, proceeds on a complete mis-appreciation of section 115-J.

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The decision of this Court in *Madeva Upendra Sinai* v. *Union of India,* (supra) related to the constitutional validity of the Taxation Laws (Extension to Union Territories) (Removal of Difficulties) Order No. 2 of 1970 by which the provisions of the Act were extended with certain amendments to the C Union Territories of Goa, Daman and Diu w.e.f. 1st April 1963. The decision turned on the wording of section 43(6) of the 1961 Act which defines 'written down value' in so far as it is relevant:

(a) in the case of assets acquired in the previous year, the actual cost to the assessee;

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(b) in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed to him under this Act, or under the Indian Income Tax Act, 1922 (11 of 1922), or any Act repealed by that Act, or under any executive orders issued when the Indian Income-tax Act, 1886 (2 of 1886) was in force.

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Under the laws in force in the former Portuguese territory, no allowance in the nature of depreciation was permitted in computing the gross income. According to the assessees since there was no depreciation allowed under the Portuguese law in the said relevant previous year, it could not be said to F have been actually allowed and that, therefore, they were entitled to adjust the entire depreciation in the accounting year. This was more than what was available to assessee who had all along been covered by the 1961 Act. Parity amongst the assessees was sought to be brought about by the impugned Order by providing notional depreciation in prior years for the 'new assessee'. This was held to be unconstitutional. In this context, the Court held that:

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"the word 'depreciation actually allowed' in section 43(6)(b) connote depreciation that has actually been taken into account and given effect to by the income tax authorities in the computation of the profits and gains of the business in assessing income tax for earlier years."

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Since there was no law between the date the territories were merged in India and the date when the Income Tax Act was extended to those territories under which the income of those prior years could be computed, there was no question of any depreciation being claimed, allowed or carried forward by the assessee for any year prior to 1963. A similar decision was taken by this Court in *Commissioner of Income Tax, Bombay City I* v. *Dharampur Leather Co. Ltd.* (supra). Both decisions are distinguishable since, for the reasons stated we have held that there is no notional but actual deduction in this case.

For the reasons aforesaid, we have no hesitation in confirming the decision of the High Court and dismissing these appeals with costs.

S.K.S. Appeals dismissed.