



Benefit of deduction is denied as the eligibility of being a ‘small scale industrial undertaking’ is lost in subsequent years even if in the initial year eligibility was satisfied – Supreme Court

Background

Recently, the Supreme Court in the case of Ace Multi Axes Systems Ltd ¹ (the taxpayer) held that the taxpayer is not entitled to the benefit of deduction under Section 80-IB² of the Income-tax Act, 1961 (the Act) since it has lost its eligibility as a ‘small scale industrial undertaking’ in subsequent years even if in the initial year the eligibility criteria was satisfied. The Supreme Court observed that the provision relating to incentive should be construed liberally only when there is a valid principle of interpretation and where there is ambiguity or absurdity or where conditions of eligibility are substantially complied. However, in the present case, the scheme of the statute is clear that the incentive is applicable to a small scale industrial undertaking. The intention of the legislature is in no manner defeated by not allowing the said incentive if the taxpayer ceases to be the class of industrial undertaking for which the incentive is provided even if it was eligible in the initial year.

Facts of the case

- The taxpayer is engaged in manufacture and sale of components/parts of CNC lathes and similar machines. The taxpayer was claiming the benefit of deduction under Section 80-IB of the Act. During the Assessment Year 2005-06, its income was assessed at INR17.98 million.

However, the Commissioner of Income Tax (CIT) interfered with the assessment under Section 263³ of the Act denying the benefit of deduction under Section 80-IB(3) of the Act.

- By virtue of CIT’s revisionary order, the Assessing Officer (AO) disallowed the claim of INR7.58 million towards the benefit of deduction under Section 80-IB(3) of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal (the Tribunal) upheld the order of the AO. However, the High Court reversed the said orders and allowed the claim of the taxpayer.

Issue before the Supreme Court

- Whether the taxpayer is entitled to the benefit of deduction on the ground that during the said 10 consecutive years, it ceases to be a small scale industry?

Supreme Court’s decision

- Section 80-IB(2) of the Act makes the deductions permissible in respect of industrial undertakings fulfilling the conditions specified therein. The scheme applies to small scale industrial undertakings as defined in Clause 14(g) which in terms refers to Section 11B of the Industries (Development and Regulation) Act, 1951.

¹ DCIT v. Ace Multi Axes Systems Ltd (Civil Appeal No. 20854 of 2017) – Taxsutra.com

² Section 80-IB is in Chapter VI-A of the Act which provides for deductions from total income which is to be computed under the relevant provisions. The scheme is to provide incentives for purposes mentioned in different provisions of the said Chapter. It provides for deductions of specified percentage from the profits and gains of the specified industrial undertakings other than infrastructure development undertakings (which are separately dealt with under Section 80 IA).

³ Revisionary powers

- Under the second proviso to Clause 2, disqualification applicable to the industrial undertaking, other than small scale industrial undertakings. Small scale industrial undertakings eligible are only those which begin manufacture or produce, articles or things during the beginning of 1 April 1995 and ending on 31 March 2002. For other categories of industrial undertakings, different periods are prescribed. The scheme of the statute does not in any manner indicate that the incentive provided has to continue for 10 consecutive years irrespective of continuation of eligibility conditions. Applicability of incentive is directly related to the eligibility and not *de hors* the same.
- If an industrial undertaking does not remain small scale undertaking or if it does not earn profits, it cannot claim the incentive. No doubt, certain qualifications are required only in the initial assessment year, e.g., requirements of the initial constitution of the undertaking. Section 80-IB(2) limits eligibility only to those undertakings as are not formed by splitting up of existing business, transfer to a new business of machinery or plant previously used. Certain other qualifications have to continue to exist for claiming the incentive such as employment of particular number of workers in an assessment year. For industrial undertakings other than small scale industrial undertakings, not manufacturing or producing an article or things specified in 8th Schedule is a requirement of continuing nature.
- On examination of the scheme of the provision, there is no manner of doubt that incentive meant for small scale industrial undertakings cannot be availed by industrial undertakings which do not continue as small scale industrial undertakings during the relevant period. Needless to say, each assessment year is a different assessment year, except for block assessment.
- The observations in the High Court's decision is that the object of the legislature is to encourage industrial expansion which implies that the incentive should remain applicable even where on account of industrial expansion small scale industrial undertakings ceases to be small scale industrial undertakings. However, the Supreme Court was unable to appreciate the logic for these observations. The incentive is given to a particular category of the industry for a specified purpose. An incentive meant for small scale industrial undertaking cannot be availed by the taxpayer which is not such an undertaking. It does not, in any manner, mean that the object of permitting industrial expansion is defeated, if the benefit is not allowed to other undertakings. On this logic, the incentive must be given irrespective of any condition as the incentive certainly helps further expansion by reducing the tax burden.
- The concept of vertical equity is well known under which all the taxpayers need not be uniformly taxed. Progressive taxation is a well-known element of tax policy. Higher slabs of tax or higher tax burden on the taxpayer having higher income or higher capacity cannot in any manner, be considered unreasonable.
- Relying on the decision of Bajaj Tempo Ltd.⁴ the taxpayer contended that provision relating to incentive should be construed liberally to advance the objective of the provision. The Supreme Court in that decision has observed that a provision of a taxing statute granting incentive for promoting growth and development should be construed liberally. However, the Supreme Court in the instant case held that the said decision is distinguishable. Construing liberally does not mean ignoring conditions for exemption. The main issue considered in the said decision was that though the undertaking was a genuine 'new industrial undertaking' which was the qualification for the exemption, a nominal part of the undertaking was out of the existing undertaking and building of an existing undertaking was taken on the lease.
- The principle of law considered in Bajaj Tempo is certainly a valid principle of interpretation where there is ambiguity or absurdity or where conditions of eligibility are substantially complied. However, in the present case, the scheme of the statute is clear that the incentive is applicable to a small scale industrial undertaking. The intention of the legislature is in no manner defeated by not allowing the said incentive if the taxpayer ceases to be the class of industrial undertaking for which the incentive is provided even if it was eligible in the initial year. Each assessment year is a separate unit.
- In the case of Citizen Cooperative Society Limited⁵, the Supreme Court considered the incentive under Section 80-P meant for a primary agricultural credit society or a primary cooperative agricultural and rural development bank. The taxpayer was held not to be entitled to the said incentive as business of the taxpayer was held to be

⁴ Bajaj Tempo Ltd. v. CIT [1992] 196 ITR 188 (SC)

⁵ Citizen Cooperative Society Limited v. ACIT [2017] 391 ITR 1 (SC)

financial business to which the incentive was not admissible even though the principle of liberal interpretation in terms of Bajaj Tempo was applied.

- In the case of State of Haryana versus Bharti Teletech Ltd⁶ it was observed that while the exemption notification should be liberally construed, the beneficiary must fall within the ambit of the exemption and fulfill the conditions thereof. In case such conditions are not fulfilled, the issue of application of the notification does not arise. Further, in the case of State of Jharkhand versus Ambay Cements⁷ the High Court having allowed the benefit even though the taxpayer did not qualify for the same, the Supreme Court reversed the view of the High Court and held that the conditions for grant of exemption from tax are mandatory and in absence thereof exemption could not be granted.
- The Supreme Court did not find any difference in the situation where the taxpayer, is not initially eligible, or where the taxpayer though initially eligible loses the qualification of eligibility in subsequent assessment years. In both such situations, the principle of interpretation remains the same. Thus, while there is no conflict with the principle that interpretation has to be given to advance the object of the law, in the present case, the taxpayer having not retained the character of 'small scale industrial undertaking', is not eligible to the incentive meant for that category. Permitting incentive in such case will be against the object of law.
- Accordingly, it has been held that the taxpayer is not entitled to benefit of exemption if it loses its eligibility as a small scale industrial undertaking in a particular assessment year even if in initial year eligibility was satisfied.

Our comments

The issue with respect to the eligibility of incentive provisions vis-à-vis fulfillment of conditions in the initial year of the undertaking has been a matter of debate before the courts.

The Karnataka High Court⁸ in the taxpayer's case had held that the requisite conditions of being small scale industry need to be fulfilled in the initial year and not in the subsequent years. The High Court observed that the intention of the legislature behind granting a deduction under Section 80-IB of the Act was to support industrial growth and wealth creation during the initial period of 10 years, and thus, merely on account of the creation of wealth and its re-investment into business for further growth, the deduction could not be denied.

⁶ State of Haryana v. Bharti Teletech Ltd (2014) 3 SCC 556

⁷ In State of Jharkhand v. Ambay Cements (2005) 1 SCC 368

⁸ Ace Multi Axes Systems Ltd v. DCIT [2014] 367 ITR 266 (Kar)

However, the Supreme Court has held that the taxpayer is not entitled to the benefit of deduction under Section 80-IB of the Act since it loses its eligibility as a small scale industrial undertaking in subsequent years even if in the initial year the eligibility criteria was satisfied. The Supreme Court⁹ has already laid down a principle that the provision relating to incentive should be construed liberally. However, the Supreme Court, in this case, observed that it should be construed liberally only when there is a valid principle of interpretation and where there is ambiguity or absurdity or where conditions of eligibility are substantially complied. In the present case, the scheme of the statute is clear that the incentive is applicable to a small scale industrial undertaking. The intention of the legislature is in no manner defeated by not allowing the said incentive if the taxpayer ceases to be the class of industrial undertaking for which the incentive is provided, even if it was eligible in the initial year.

Taxpayers need to consider the impact of the above decision while claiming deduction under various incentive-related provisions under the Act in a similar situations.



⁹ Bajaj Tempo Ltd. v. CIT [1992] 196 ITR 188 (SC)

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Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur

Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara

iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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