



## While computing a deduction under Chapter VI-A, it is mandatory to consider depreciation – Supreme Court

### Background

Recently, the Supreme Court in the case of *Plastiblends India Limited*<sup>1</sup> (the taxpayer) held that while computing a deduction under Chapter VI-A, it is mandatory to claim depreciation under Section 32 of the Income-tax Act, 1961 (the Act). The taxpayer cannot claim 100 per cent deduction under Section 80-IA of the Act, without taking into consideration depreciation. Further, the taxpayer cannot utilise a depreciation claim in the subsequent years. This would be anathema to the scheme under Section 80-IA of the Act which is linked to profits, and if the contention<sup>2</sup> of the taxpayers is accepted, it will allow them to inflate the profit-linked incentives provided under Section 80-IA of the Act which cannot be permitted.

### Facts of the case

- The taxpayer is engaged in the business of manufacture of master batches and compounds. For this purpose, it had manufacturing undertakings at Daman Units I and II. Units I and II began to manufacture article or things during the Assessment Years (AYs) 1994-95 and 1995-96 respectively. Accordingly, for the year under consideration, i.e., AY 1997-98 profits of the business of both the undertakings were eligible for 100 per cent deduction under Section 80-IA of the Act.
- The taxpayer did not claim depreciation while computing its income under the head profits and gains of business. Consequently, the deduction under Section 80-IA was also claimed on the basis of such profits i.e., without reducing the same by depreciation allowance. This position was accepted by the

Assessing Officer (AO) in an intimation made under Section 143(1)(a) of the Act. Similarly, for the AY 1996-97, the taxpayer did not claim a deduction on account of depreciation. However, this position was not accepted by the AO. Subsequently, the claim of the taxpayer was allowed by the Tribunal.

- The AO initiated reassessment proceedings and passed an assessment order under Section 143(3) read with Section 147 of the Act. Though the taxpayer had disclaimed deduction in respect of depreciation, the AO allowed deduction on this account while computing the profit and gains of business. Subsequently, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the taxpayer's contention that claim for depreciation is optional, based on the Tribunal's order in its own case for AY 1996-97 and hence allowed the appeal. However, the Tribunal reversed the order of the CIT(A) following the decision of the Bombay High Court in the case of *Scoop Industries P. Ltd.*<sup>3</sup>
- The Division Bench of the Bombay High Court observed that there was a conflict of opinion in two earlier decisions, i.e., *Grasim Industries Ltd.*<sup>4</sup> where it was held that the profits and gains eligible for deduction under Chapter VI-A should be the same as profits and gains computed in accordance with the provisions of the Act and included in the gross total income. However, the Bombay High Court in the case of *Scoop Industries P. Ltd.* held that depreciation whether claimed or not has to be

<sup>1</sup> *Plastiblends India Limited v. ACIT* (Civil Appeal No. 12828 of 2017) – Taxsutra.com

<sup>2</sup> The taxpayer has option to not claim depreciation while computing deduction under Chapter VI-A

<sup>3</sup> *Scoop Industries P. Ltd. v. ITO* [2007] 289 ITR 195 (Bom)

<sup>4</sup> *Grasim Industries Ltd. v. ACIT* [2000] 245 ITR 677 (Bom)

reduced for arriving at the profits eligible for deduction under Chapter VI-A. Noticing this conflict of opinion, the matter was referred to the Full Bench, to resolve the conflict.

- The Full Bench of the Bombay High Court has upheld the stand of the tax department. Whilst computing a deduction under Chapter VI-A, it was mandatory to grant deduction by way of depreciation. Section 80-IA of the Act is a complete code in itself. The High Court observed that whereas Chapter IV contains a provision relating to the computation of total income under various heads of income, Chapter VI contains provisions relating to the aggregation of income and set off or carry forward of loss. Chapter VI-A of the Act, on the other hand, provides for special deductions that are allowed at such rates that are specified in the respective provisions on the gross total income of the taxpayer.
- Further, the Full Bench of the Bombay High Court held that the computation of profits and gains for the purposes of Chapter VI-A is different from the computation of profits under the head 'profits and gains of business'. Even assuming that the taxpayer had an option to disclaim current depreciation in computing the business income, depreciation had to be reduced for computing the profits eligible for deduction under Section 80-IA of the Act. The High Court concluded that Section 80-IA provides for a special deduction linked with profits and is a code by itself and in so doing relied on the decisions of this Court in various decisions<sup>5</sup>.

## Supreme Court's decision

- The decision of the Full Bench is based on the decisions of the Supreme Court, and there is no reason to disagree with the same. The Supreme Court decisions are rightly analysed, and ratio thereof is correctly understood and applied. Therefore, the Supreme Court agreed with the Full Bench decision of the Bombay High Court.
- The decision of the Supreme Court in the case of Mahendra Mills Limited<sup>6</sup> cannot be applied while interpreting Section 80-IA of the Act. The decision in Mahendra Mills Limited was rendered while construing the provisions of Section 32 of the Act, as it existed at the relevant time. However, in the present case, the Supreme Court was concerned with the provisions of Chapter VI-A of the Act.

- The Supreme Court made it clear that Section 80-IA of the Act not only contains substantive but procedural provisions for the computation of special deduction. Thus, any device adopted to reduce or inflate the profits of eligible business has to be rejected.
- The taxpayer cannot claim 100 per cent deduction, without taking into consideration depreciation. Further, the taxpayer cannot utilise depreciation claim in the subsequent years. This would be anathema to the scheme under Section 80-IA of the Act which is linked to profits and if the contention of the taxpayers is accepted, it would allow them to inflate the profits linked incentives provided under Section 80-IA of the Act which cannot be permitted.
- The Supreme Court agreed with the High Court that while computing a deduction under Chapter VI-A, it was mandatory to grant a deduction by way of depreciation.

## Our comments

Prior to 2001, there was a controversy of whether a claim of depreciation is the choice of the taxpayers or it has to be mandatorily taken into consideration while computing the business income.

The Supreme Court in the case of Mahendra Mills Limited held that it is a choice of the taxpayer whether to claim or not to claim depreciation. However, the said decision was rendered in the context of determining the total income of an industrial undertaking under Chapter IV of the Act and not in the context of determining the deduction under Chapter VI-A of the Act.

The said decision has been neutralised by the Finance Act, 2001 by way of an introduction of Explanation 5 to Section 32 of the Act. The amendment provides that the depreciation provisions shall apply whether or not the taxpayer has claimed the deduction in respect of depreciation in computing his/her total income.

However, there was no clarity on whether a claim for deduction on account of depreciation is the choice of the taxpayers or it has to be necessarily taken into consideration while computing the deduction under Chapter VI-A of the Act.

The Supreme Court has resolved this controversy and held that while computing deduction under Chapter VI-A, it is mandatory to claim depreciation.

<sup>5</sup> Liberty India v. CIT [2009] 317 ITR 218 (SC), CIT v. Williamson Financial Services & Ors [2008] 297 ITR 17 (SC), CIT v. Doom Dooma India Ltd. [2009] 310 ITR 392 (SC)

<sup>6</sup> CIT v. Mahendra Mills Limited [2000] 243 ITR 56 (SC) – The Supreme Court observed that it is not mandatory to allow depreciation if the taxpayer does not want to claim that. Provision for a claim of depreciation is certainly for the benefit of the taxpayer. If he does not wish to avail that benefit for some reason, benefit cannot be forced upon him. It is for the taxpayer to see if the claim of depreciation is to his advantage. Rather, the tax officer should advise him not to claim depreciation if that course is beneficial to the taxpayer.

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