



100 per cent deduction under Section 80-IC of the Income-tax Act can be claimed on the substantial expansion for fresh five years subject to a total period of deduction not exceeding 10 years

Recently, the Larger Bench of the Supreme Court in the case of Aarham Softronics¹ (the taxpayer) allowed 100 per cent deduction under Section 80-IC of the Income-tax Act, 1961 (the Act) for fresh five years from the year of completion of the substantial expansion subject to a total period of deduction not exceeding 10 years. The Larger Bench of the Supreme Court has recalled the decision of the Division Bench in the case of Classic Binding Industries².

Background

The taxpayer had established new units in specified areas of Himachal Pradesh and Uttaranchal within the qualifying period. For such a new unit, the taxpayer treated the year of manufacture or production of articles of things as the 'initial assessment year'. The taxpayer claimed 100 per cent deduction for the first five years. However, in the sixth year, the taxpayer carried out 'substantial expansion' and claimed that it was entitled to a deduction from profits and gains for another five years at 100 per cent instead of 25 per cent from 6th to 10th year.

The Assessing Officer (AO) disallowed the claim holding that the taxpayer had already claimed a deduction of 100 per cent of profits for the first five years from the initial assessment year and, hence restricted the deduction to 25 per cent of eligible profits. The AO held that the taxpayer was entitled to only 25 per cent deduction from the sixth year to the tenth year and cannot avail a fresh five year tax holiday on account of substantial expansion. The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal held against the taxpayer restricting the deduction to 25 per cent from the sixth year onwards.

The Himachal Pradesh High Court³ held in favour of the taxpayer allowing claim of 100 per cent deduction from the year of substantial expansion subject to a total period of exemption not exceeding 10 years from the date of commencement of manufacture.

Aggrieved, the tax department filed an appeal before the Supreme Court. The Division Bench in the case of Classic Binding Industries⁴ had held in favour of the tax department and restricted the claim of deduction to 25 per cent of profits from the year of substantial expansion.

Supreme Court decision – Larger Bench

The Supreme Court observed that the definition of 'initial assessment year' mentioned in Section 80-IB of the Act could not have been the basis of finding out the definition of 'initial assessment year' under Section 80-IC of the Act.

Section 80-IB(14) of the Act starts with the words 'for the purpose of this section'. Thus, 'initial assessment year' defined therein is relatable only to the deductions that are provided under the provisions of Section 80-IB of the Act.

Section 80-IB of the Act is materially different from Section 80-IC of the Act. Section 80-IC of the Act is a special provision and the deduction under this Section is available only when such undertakings or enterprises are established in particular states i.e. Sikkim, Himachal Pradesh, Uttaranchal or any of the North-Eastern states.

³ Stovekraft India v. CIT [2017] 400 ITR 225 (HP)

⁴ Please refer to KPMG Flash News -

<http://www.in.kpmg.com/taxflashnews/KPMG-Flash-News-Classic-Binding-Industries-2.pdf>

¹ Pr.CIT v. Aarham Softronics (Civil Appeal No. 1784 of 2019, dated 20 February 2019) including various other taxpayers

² CIT v. Classic Binding Industries [2018] 257 Taxman 324 (SC)

Section 80-IC of the Act provides 100 per cent deduction of profits and gains for first five assessment years commencing with the initial assessment year and thereafter 25 per cent (or 30 per cent where the taxpayer is a company) of the profits and gains. The deduction at 25 per cent for the next five years is on the assumption that the new unit remains static insofar as expansion thereof is concerned. However, the moment substantial expansion takes place, another 'initial assessment year' gets triggered. This new event entitles that unit to start getting a deduction at 100 per cent of the profits and gains.

The provision of Section 80-IC of the Act is aimed at encouraging the undertakings or enterprises to establish and set up such units in the aforesaid states to make them industrially advanced states as well. Keeping these objectives in mind for the purpose for which Section 80-IC of the Act was enacted, 100 per cent deduction of the profits and gains is allowed even from the year when there is a substantial expansion in the existing unit. As substantial expansion involves a great deal of investment which has to be, at least 50 per cent in the plant and machinery, of the book value thereof before taking depreciation in any year. With an expansion of such a nature not only there would be an increase in production but the generation of more employment as well, which would benefit the local populace. It is for this reason, carrying out substantial expansion by itself is treated as 'initial assessment year'.

The decision in the case of Dilip Kumar and Co⁵ supports the position that a statute must be interpreted according to the intention of the legislature. If a statutory provision is open to more than one interpretation, the Court has to choose that interpretation which represents the true intention of the legislature.

The Larger Bench of the Supreme Court endorsed the decision in the case of Mahabir Industries⁶ and held that there can be two initial assessment years even as per the definition in Section 80-IC of the Act; one for setting up of a new unit and another for substantial expansion.

Accordingly, the Larger Bench of the Supreme Court held the decision in favour of the taxpayer allowing the claim of deduction of 100 per cent of profits from the year of completion of the substantial expansion, subject to a total period of deduction under Section 80-IC of the Act not exceeding 10 years. The

decision of the Division Bench in the case of Classic Binding omitted to take note of the definition 'initial assessment year' contained in Section 80-IC itself and instead based its conclusion on the definition contained in Section 80-IB of the Act, which does not apply in these cases.

Our comments

The issue with respect to the allowability of 100 per cent deduction under Section 80-IC of the Act from the year of completion of the substantial expansion has been a matter of debate before the Courts.

The Division Bench of the Supreme Court in the case of Classic Binding Industries had held that once the taxpayer had started claiming deduction under Section 80-IC of the Act and the 'initial assessment year' had commenced, there cannot be another 'initial assessment year' merely because the taxpayer undertook 'substantial expansion' within the tax holiday period of 10 years. The taxpayer is entitled to 100 per cent deduction for the first five years and 25 per cent deduction for the next five years, regardless of 'substantial expansion' undertaken anytime during the qualifying period of 10 years.

In the instant case, the Larger Bench of the Supreme Court endorsed the decision in the case of Mahabir Industries and held that there can be two initial assessment years as per the definition in Section 80-IC of the Act; one for setting up of a new unit and another for substantial expansion. The Larger Bench in the present case recalled the decision of Classic Binding Industries and held that the taxpayer is entitled to the claim of deduction of 100 per cent from the year of completion of the substantial expansion, subject to a total period of deduction under Section 80-IC of the Act does not exceed 10 years.

The decision of the Larger Bench of the Supreme Court is a welcome step and puts to rest the controversy with respect to the availability of such deduction for units undertaking substantial expansion.

⁵ Commissioner of Customs (Import) v. Dilip Kumar and Company and Others (2018) 9 SCC 1

⁶ Mahabir Industries v. Principal Commissioner of Income Tax (Civil Appeal Nos. 4765-4766 of 2018, dated 18 May 2018)

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