



Deduction under Section 80-IC of the Income-tax Act availed for the first five years at 100 per cent would be available at 25 per cent only even if 'substantial expansion' has been carried out in the subsequent year – Supreme Court

Background

Recently, the Supreme Court of India in the case of *Classic Binding Industries*¹ (the taxpayer) held that once the taxpayer has opted to claim deduction under Section 80-IC of the Income-tax Act, 1961 (the Act) and the initial Assessment Year (AY) has commenced within the tax holiday period of 10 years, there cannot be another initial AY to allow 100 per cent deduction for the next 5 years. Therefore, after availing deduction for first five years at 100 per cent of such profits and gains from the eligible 'units', the taxpayer is entitled to a deduction for remaining five AYs at 25 per cent and not at 100 per cent.

Facts of the case

- The taxpayer derives income from manufacturing of printed embossed book binding cover material of cotton and security fibre of dual coloured combination.
- The taxpayer started its business activity on 11 July 2005 and initial AY for claiming the deduction under Section 80-IC of the Act was AY 2006-07. The taxpayer had already claimed deduction under Section 80-IC of the Act to the extent of the 100 per cent of the eligible profit for five AYs from AY 2006-07 to AY 2010-11. However, the taxpayer had again claimed 100 per cent deduction against eligible profits in the relevant AY 2012-13 which was the seventh year of production for the taxpayer by claiming 'substantial expansion' in Financial Year (FY) 2010-11.
- The Assessing Officer (AO) denied the claim of the enhanced deduction and restricted the deduction to 25 per cent of eligible profits.

- The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal (the Tribunal), following the decision of the Chandigarh Tribunal in the case of *Hycron Electronics*² and other related cases, upheld the order of the AO. However, the High Court held the decision in favour of the taxpayer.
- Aggrieved, the tax department filed an appeal before the Supreme Court.

Supreme Court's decision

- Section 80-IC(6) of the Act provides the maximum period of 10 years for which the deduction can be allowed to any undertaking or enterprise starting from the initial AY. Once the initial AY commences and the taxpayer by virtue of fulfilling the conditions laid down in Section 80-IC(2) of the Act starts claiming deduction, there cannot be another 'Initial Assessment Year' for the purposes of Section 80-IC of the Act within the aforesaid period of 10 years, on the basis that it had carried substantial expansion in its unit.
- In the case of *Mahabir Industries*³, the taxpayer had availed the initial deduction under different provisions⁴. The conditions with respect to those provisions were altogether different. The deduction under different provisions was started at a time when Section 80-IC of the Act was not even on the statute book. Section 80-IC of the Act was inserted by the Finance Act, 2003 with effect from 1 April 2004. The taxpayer in those cases had started claiming and were allowed deductions from the AYs 1998-99 and 1999-2000 under Section 80-IA of the Act and from the AY 2000-01 to AY 2005-06

¹ CIT v. Classic Binding Industries (Civil Appeal Nos 7208 of 2018) – Taxsutra.com

² *Hycron Electronics v. ITO* (ITA No. 798/Chd/2012)

³ *Mahabir Industries v. PCIT* (Civil Appeal Nos. 4765-4766 of 2018, dated 18 May 2018) (Supreme Court)

⁴ i.e. Under Section 80-IA of the Act, i.e. by fulfilling the conditions mentioned in Section 80-IA(4) of the Act

under Section 80-IB of the Act. Thus, the deduction was claimed by the taxpayer in those appeals under the new provision i.e. Section 80-IC of the Act on fulfilling conditions provided in Section 80-IC(2) for the first time for AY 2006-07. Thus, insofar as those cases were concerned, the initial AY under Section 80-IC started only from the AY 2006-07.

- However, in the present case, the position is different. The taxpayer has availed deduction under Section 80-IC of the Act alone. Initially, the taxpayer claimed the deduction on the ground that it had set up its units in the State of Himachal Pradesh. Subsequently, after availing the deduction at 100 per cent, the taxpayer wants a continuation of this rate of 100 per cent for the next five years also under the same provision on the ground that substantial expansion was made.
- The Supreme Court observed that once the taxpayer had started claiming deduction under Section 80-IC of the Act and the initial AY has commenced within the aforesaid period of 10 years, there cannot be another initial AY thereby allowing 100 per cent deduction for the next 5 years also when Section 80-IC(3) of the Act, in no uncertain terms, provides for deduction at 25 per cent only for the next 5 years. It may be asserted again that the taxpayer accepts the legal position that they cannot claim a deduction of more than ten years in all under Section 80-IC of the Act.
- Accordingly, it has been held that after availing deduction for a period of five years at 100 per cent of such profits and gains from the 'units', the taxpayer would be entitled to a deduction for remaining five AYs at 25 per cent and not at 100 per cent.

Our comments

The issue with respect to the eligibility of 100 per cent deduction under Section 80-IC of the Act vis-à-vis substantial expansion in a subsequent year has been a subject matter of debate before the Courts/Tribunal.

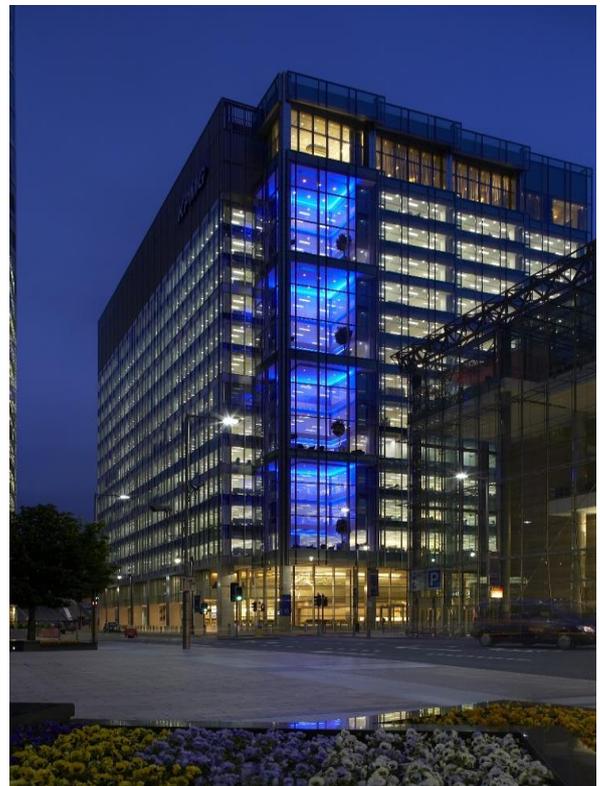
The Himachal Pradesh High Court in the case of *Stovekraft India*⁵ held the taxpayer would be entitled for 100 per cent deduction again for another five years under Section 80-IC(3)(ii) of the Act, subject to a ceiling of 10 years as stipulated under Section 80-IC(6) of the Act. The word 'substantial expansion' cannot be confined to one expansion. As long as the requirement of Section 80-IC(8)(ix) of the Act was met, there can be a number of multiple substantial

expansions. Initial AY means AY relevant to the previous year, in which it completes substantial expansion. Section 80-IC(8)(v) of the Act itself contemplates more than one 'Initial Assessment Year'.

Similarly, the Delhi Tribunal in case of *Tirupati LPG Industries Ltd*⁶ held that where the taxpayer has already claimed 100 per cent deduction for first five years under Section 80-IC of the Act and subsequently carries out substantial expansion after five years, it would be entitled to the enhanced deduction of 100 per cent.

However, the Chandigarh Tribunal in the case of *ZEE Laboratories*⁷ held that the taxpayer was eligible for deduction at 25 per cent on the profit derived from the industrial undertaking under Section 80-IC of the Act despite substantial expansion undertaken by it.

The Supreme Court in the present case distinguished its decision in the case of *Mahabir Industries* and held that once the taxpayer had started claiming deduction under Section 80-IC of the Act and the initial AY has commenced within a period of tax holiday period of 10 years, there cannot be another initial AY. Therefore, the taxpayer would be entitled to a deduction for the remaining five AYs at 25 per cent and not at 100 per cent.



⁵ *Stovekraft India v. CIT* (ITA No.20/2015, 28 November 2017) (HP)

⁶ *Tirupati TPG Industries Ltd v. DCIT* [2014] 45 taxmann.com 326 (Del)

⁷ *ZEE Laboratories v. ITO* (ITA No. 230 & 231/Chd/2016)

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