IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA.

ITA No. 4002 of 2013.
Reserved on: October 18, 2014.
Decided on: October 28, 2014.

Commissioner of Income Tax, Shimla ……Appellant.

Versus

M/S Yash International Inc. ……Respondent.

Coram
The Hon'ble Mr. Justice Rajiv Sharma, Judge.
The Hon'ble Mr. Justice Sureshwar Thakur, Judge.
Whether approved for reporting? [1] ***Yes.***

For the appellant: Mr. Gaurav Sharma, Advocate, vice Ms. Vandana Kuthiala, Advocate.

For the respondent: Mr. Vishal Mohan, Advocate.

Justice Rajiv Sharma, J.

This appeal is directed against the order of Income Tax Appellate Tribunal, Chandigarh Bench (Chandigarh), passed in ITA No. 1012/CHD/2011 dated 23.11.2012. It was admitted on the following substantial question of law:

> "Whether a new partnership firm which has been formed by the same partners by splitting up the business of an existing partnership by and which utilizes the infrastructure and employees of the existing firm, would be entitled to 1st year of deduction under Section 80 1C of the Income Tax Act?"

2. Key facts, necessary for the adjudication of this appeal are that the Assessing Officer, passed the order dated 30.12.2009. He worked out the excess gross profit at Rs. 49,28,454/-. The same was brought to tax and no deduction under Section 80 1C was allowed on it. The assessee filed an appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals), allowed the same on 1.8.2011. The

[1] Whether reporters of the local papers may be allowed to see the judgment?

Revenue filed an appeal before the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal dismissed the Revenue's appeal on 23.11.2012. Hence, this appeal.

3. According to Mr. Gaurav Sharma, Advocate, the Firm i.e. M/S Yash Electrical has formed a unit under the name and style of M/S Yash International having same partners as in the case of M/S Yash Electricals, Baddi. Only the wife was introduced as new partner of erstwhile firm who did not contribute any capital except sharing of profit at the end of the year. The workers of M/S Yash Electricals were also shifted to the new unit and the control and management of the existing and new unit remained the same. He supported the orders passed by the Assessing Officer dated 30.12.2009. He also contended that the new unit was formed by splitting up the existing business. On the other hand, Mr. Vishal Mohan, Advocate, has supported the appellate orders.

4. We have heard the learned Advocates on both the sides and gone through the orders and record carefully.

5. The Assessing Officer, vide order dated 30.12.2009, has himself observed that the assessee has set up a new unit in a new building and installed a new machinery. The assessee-firm has invested an amount of Rs. 1,64,82,152/- as on 31.3.2007 in its plant and machinery and out of this total investment of Rs. 1,64,82,152/- the plant and machinery to the tune of Rs. 2,15,631/- was purchased from the erstwhile M/S Yash Electricals, which constitutes merely 1.31% of the total value of the plant and machinery. This investment was in conformity with Section 80 1C(4) of the Income Tax Act and Explanation appended thereto. The investment under plant and machinery of the

erstwhile Yash Electricals, as on 31.3.2007, stood at Rs. 14,23,832/- vis-à-vis investment in plant and machinery of the new unit at Rs. 1,64,82,152/-. The new undertaking made an investment of Rs. 10,20,000/- for the purchase of land and Rs. 1,41,73,219/- for construction of the new building. The installed capacity of the new undertaking was 13 lac fans. However, the installed capacity of the erstwhile firm was 6 lacs. The assessee firm had different PAN number, separate registration under the H.P. State Industrial Development Corporation and Department of Industries, Solan, as Small Scale Industry, at different location on a different plot No. 3.

6. The new undertaking has different customers. The Assessing Officer has erred in law by coming to the conclusion that the new undertaking was formed by splitting up of business, already in existence. For all intents and purposes, the assessee-firm is a new Unit. The Assessing Officer has ignored the quantum of fresh capital, investment in plant and machinery, new building, new registration number and PAN number. The new unit cannot be even presumed as reconstruction of the old existing business, much less the formation of the undertaking by splitting up the existing undertaking. The shifting of the employees would not affect the constitution of the new firm to avail the benefit under Section 80 1C of the I.T. Act. The learned Assessing Officer has not correctly appreciated the ratio of the judgment rendered by the Hon'ble Supreme Court in the case of ***Textile Machinery Corp. Ltd. Vrs. CIT (1977) 107 ITR 195 (SC).*** In the instant case also, the new unit has emerged. It is physically separate industrial unit.

7. Their lordships of the Hon'ble Supreme Court in ***Textile Machinery Corp. Ltd. Vrs. CIT (1977) 107 ITR 195 (SC),*** have held as under:

> " The principal object of Sec. 15-C is to encourage setting up of new industrial undertakings by offering tax incentive within a period of 13 years from April 1, 1948. Section 15-C provides for a fractional exemption from tax of profits of a newly established undertaking for five assessment years as specified therein. This section was inserted in the Act in the 1949 by Section 13 of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949 (Act 67 of 1949) extending the benefit to the actual manufacture or production of articles commencing from a prior date, namely, April 1, 1948. After the country had gained independence in 1947 it was most essential to give fillip to trade and industry from all quarters. That seems to be the background for insertion of Section 15-C.
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> It is also significant that the limit of the number of years for the purpose of claiming exemption has been progressively raised from the initial 3 years in 1949 to 6 years in 1953, 7 years in 1954, 13 years in 1956 and 18 years in 1960. The incentive introduced in 1949 has been thus stepped up ever since and the only object is that which we have already mentioned.
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> Under sub-section (1) of S. 15-C the tax shall not be payable by an assessee on profits not exceeding six per cent per annum on the capital employed in the new industrial undertaking from the profits of which alone exemption is claimed. Sub-section (2) of Section 15-C has a negative as well as a positive aspect. Negatively, the new industrial undertaking of the assessee should not be formed-
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> (1) by the splitting up of the business already in existence,
> (2) by the reconstruction of business already in existence, or
> (3) by the transfer to a new business of building, machinery or plant used in a business which was being carried on before April 1, 1948.
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> We agree that it is not possible to exclude any new industrial undertaking other than the three categories mentioned above.
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> We are concerned in these appeals with the type No. 2 mentioned above. Positively, the new industrial undertaking must produce result, that is to say, it has to manufacture or produce articles at any time within a period of 13 years from April 1, 1948. The further requirement under sub-section (2) is with regard to the personnel in the undertaking, namely, that ten or more workers have to work in the manufacturing process carried on with the aid of power or twenty or

more workers have to carry on work without the aid of power. The above element with regard to the number of workers engaged in the undertaking would go to show that even small industrial undertakings, newly started, are within the exemption clause, where, for example, twenty workers may complete the industrial process without the aid of power. There is no controversy about the positive aspects in these appeals.

Again, the new undertaking must not be substantially the same old existing business. The third excluded category mentioned above is significant. Even if a new business is carried on but by piercing the veil of the new business it is found that there is employment of the assets of the old business, the benefit will be not available. From this it clearly follows that substantial investment of new capital is imperative. The words "the capital employed" in the principal clause of Section 15-C are significant, for fresh capital must be employed in the new undertaking claiming exemption. There must be a new undertaking where substantial investment of fresh capital must be made in order to enable earning of profits attributable to that new capital.

The assessee continues to be the same for the purpose of assessment. It has its existing business already liable to tax. It produced in the two concerned undertakings commodities different from those which he has been manufacturing or producing in its existing business. Manufacture or production of articles yielding additional profit attributable to the new outlay of capital in a separate and distinct unit is the heart of the matter, to earn benefit from the exemption of tax liability under Sec. 15-C. Sub-section (6) of the section also points to the same effect, namely, production of articles. The answer, in every particular case depends upon the peculiar facts and conditions of the new industrial undertaking on account of which the assessee claims exemption under Section 15-C. No hard and fast rule can be laid down. Trade and industry do not run in earmarked channels and particularly so in view of manifold scientific and technological developments. There is great scope for expansion of trade and industry. The fact that an assessee by establishment of a new industrial undertaking expands his existing business, which he certainly does, would not, on that score, deprive him of the benefit under Section 15-C. Every new creation in business is some kind of expansion and advancement. The true is not whether the new industrial undertaking connotes expansion of the existing business of the assessee but whether it is all the same a new and identifiable undertaking separate and distinct from the existing business. No particular decision in one case can lay down an inexorable test to

determine whether a given case comes under Section 15-C or not. In order that the new undertaking can be said to be not formed out of the already existing business, there must be a new emergence of a physically separate industrial unit which may exist on its own as a viable unit. An undertaking is formed out of the existing business if the physical identity with the old unit is preserved. This has not happened here in the case of the two undertakings which are separate and distinct.

It is clear that the principal business of the assessee is heavy engineering in the course of which it manufactures boilers, wagons, etc. If an industrial undertaking produces certain machines or parts which are by themselves, identifiable units being marketable commodities and the undertaking can exist even after the cessation of the principal business of the assessee, it cannot be anything but a new and separate industrial undertaking to qualify for appropriate exemption under Section 15-C. The principal business of the assessee can be carried on even if the said two additional undertakings cease to function. Again, the converse is also true. The fact that the articles produced by the two undertakings are used by the Boiler Division of the assessee will not weigh against holding that these are new and separate undertakings. On the other hand the fact that a portion of the articles produced in these two new industrial undertakings had been sold in the open market to others is a circumstance in favour of the assessee that the new industrial units can function on their own. Use of the articles by the assessee is not decisive to deny the benefit of Section 15-C.

Section 15-C partially exempts from tax a new industrial unit which is separate physically from the old one, the capital of which and the profits thereon are ascertainable. There is no difficulty to hod that Sec. 15-C is applicable to an absolutely new undertaking for the first time started by an assessee. The cases which give rise to controversy are those where the old business is being carried on by the assessee and a new activity is launched by him by establishing new plants and machinery by investing substantial funds. The new activity may produce the same commodities of the old business or it may produce some other distinct marketable products, even commodities which may feed the old business. These products may be consumed by the assessee in his old business or may be sold in the open market. One thing is certain that the new undertaking must be a integrated unit by itself wherein articles are produced and at least a minimum of ten persons with the aid of power and a minimum of twenty persons without the aid of power have been employed. Such a new industrially recognisable unit of an assessee cannot be said to be reconstruction of his old business since there is no transfer of any assets of the old business to the new undertaking which

takes place when there is reconstruction of the old business. For the purpose of Section 15-C the industrial units set up must be new in the sense that new plants and machinery are erected for producing either the same commodities or some distinct commodities. In other to deny the benefit of Section 15-C the new undertaking must be formed by reconstruction of the old business. Now in the instant case there is no formation of any industrial undertaking out of the existing business since that can take place only when the assets of the old business are transferred substantially to the new undertaking. There is no such transfer of assets in the two cases with which we are concerned.

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Reconstruction of business involves the idea of substantially the same persons carrying on substantially the same business. It is stated on behalf of the Revenue that the same company in the instant case continues to do the same business of heavy engineering no matter certain spare parts necessary as components to completion of the end-product are now manufactured in the business itself. The fact that the assessee is carrying on the general business of heavy engineering will not prevent him from setting up new industrial undertakings and from claiming benefit under Section 15-C if that section is otherwise applicable. However, in order to be entitled to the benefit under Section 15-C, the following facts have to be established by the assessee, subject always to the time-schedule in the section :-

> (1) investment of substantial fresh capital in the industrial undertaking set up.
> (2) employment of requisite labour therein,
> (3) manufacture or production of articles in the said undertaking,
> (4) earning of profits clearly attributable to the said new undertaking, and
> (5) above all, a separate and distinct indentity of the industrial unit set up.

We may add that there is no bar to an assessee carrying on a particular business to set up a new industrial undertaking on account of which exemption of tax under Section 15-C may be claimed.

The legislature has advisedly refrained from inserting a definition of the word 'reconstruction' in the Act. Indeed, in the infinite variety of instances of restructuring of industry in the course of strides in technology and of other developments, the question has to be left for decision on the peculiar facts of each case.

If any undertaking is not formed by reconstruction of the old business that undertaking will not be denied the benefit of Section 15-C simply because it goes to expand the general business of the assessee on

some directions. As in the instant case, once the new industrial undertakings are separate and independent production units in the sense that the commodities produced or the results achieved are commercially tangible products and the undertakings can be carried on separately without complete absorption and losing their identity in the old business, they are not to be treated as being formed by reconstruction of the old business."

8. In the case of ***Commissioner of Income Tax Delhi-I, vrs. Gedore Tools India Pvt. Ltd. (1980) 126 ITR 673 (Delhi),*** the Division Bench of the Delhi High Court, after relying upon the decision of Textile Machinery Corp. Ltd. (supra) has held as under:

" Applying these principles to the present case, it is clear that the new unit has not been formed by the splitting up or reconstruction of the existing business. The second unit has not derived anything from the old unit either by way of equipment or by way of factory buildings. No assets of the old unit have been transferred to the new unit nor has the identity of the first unit been impaired in any way. The mere fact that the second unit manufactures some of the items which were manufactured by the first unit, does not make it an integral part of the first unit. It would survive independently of the first unit. In the words of the Tribunal, the new factory is a viable unit, can run by itself, and has "a separate and distinct personality".

But in order avail of the exemption it is apparent that a substantial employment of new capital is imperative. Section 80J of the Act is intended to encourage, inter alia, the setting up of new industrial undertakings. This is obviously with a view to expand industry, employment opportunities and production of goods. The section provides for a deduction from the profits and gains derived from the new industrial undertaking to the extent it does not exceed "six per cent per annum on the capital employed" in the industrial undertaking calculated in the prescribed manner. It is, therefore, clear that the employment of capital is a condition precedent to attract the exemption under section 80J of the Act. However, the question posed is, must fresh capital be issued or

raised by the assessed-company for the new unit or can it employ the surplus reserves which are available with it ?

It would appear to us that it is not necessary for the employment of the capital to be formal in the sense of actually raising the captial and putting it into the new industrial undertaking. Employment of capital in a new industrial undertaking is different from the capital belonging to the assessed-company. If surplus reserve capital is available with the assessed-company it can utilize a specific amount of this capital for the purchase of the plant and machinery, buildings and other assets of the new undertaking. As soon as the capital is so utilized for acquiring assets for the new undertaking, it will be an employment of capital. The actual amount of capital so utilized employed in the new undertaking would then qualify for the purpose of calculating the deduction. The utilization of a definite amount of capital appears to be contemplated in order to attract the provisions of the section. Further, as the reserves of the assessed-company are distinct from the assets employed in the old unit it would not be a case of transfer of assets of the old unit or business to the new undertaking."

9. In the case of ***Commissioner of Income Tax Bihar, vrs. Ridhkeren Someni (1980) 121 ITR 668 (Pat.),*** the Division Bench of the Patna High Court, after taking into consideration the decision of Textile Machinery Corp. Ltd. (supra) has held as under:

" Section 84 of the Act, which is the same as Section 80J, grants exemption to newly established undertakings as mentioned in Sub-clause (1). Sub-clause (4), so far as it is relevant, states that the section applies to any industrial undertaking which is not formed by the splitting up, or the reconstruction, of a business already in existence. It is thus clear that if the new industrial undertaking could be said to have been formed either by the splitting up or reconstruction of business which was already in existence, the exemption could not be claimed.

The meaning of the expression " reconstruction " has now been finally settled by the decision of the Supreme Court in Texile Machinery Corporation Ltd. v. CIT [1977] 107 ITR 195, wherein the observation of Buckley J. in In re South African Supply and Cold Storage Co. [1904] 2 Ch 268 (Ch D), dealing with the meaning of the word " reconstruction " in a company matter, has been approved. The Supreme Court has also approved the decision of the Bombay High Court in CIT v. Gaekwar Foam and Rubber Co. Ltd. [1959] 35 ITR 662 as also the decision of the Delhi High Court in CIT v. Ganga Sugar Corporation Ltd. [1973] 92 ITR 173, 179, where the following observations were made :

> " We have given the matter our earnest consideration and are of the view that in the reconstruction of a business, as in the reconstruction of a company, there is an element of transfer of assets and of some change, however partial or restricted it may be, of ownership of the assets."

After endorsing the above view, the Supreme Court observed (p. 206) :

> " Reconstruction of business involves the idea of substantially the same persons carrying on substantially the same business."

It is thus clear that, in view of the facts stated, it cannot be said that the same persons were carrying on substantially the same business in this case. It is also clear that the business of the assessee could not be said to be reconstruction of a business already in existence.

In view of these decisions, learned standing counsel for the department did not seriously press the alternative argument which was canvassed before the Tribunal.

What was, however, pressed more seriously was the argument that the business of the assessee was formed on the splitting up of a business already in existence. Learned counsel referred to the decision of the Kerala High Court in Chembra Peak Estates Ltd. v. CIT [1972) 85 ITR 401 but it must be stated at once that this decision is of not much assistance as, in this case, on the facts, the Tribunal found that a new factory was formed by the splitting up of a business already in existence. Thus, the factual

finding being as noticed above, the Kerala High Court held that the assessee was not entitled to exemption under Section 84(1) read with Section 84(2) of the Act.

In our view, it is not necessary to define as to what the expression " splitting up of a business " means. It will be sufficient to indicate that, in the facts and circumstances of the case, it cannot be said that the new industrial undertaking of the assessee was formed by the splitting up of any existing business."

10. In the case of ***Commissioner of Income Tax, vrs. Kamani Engineering Corporation Ltd. (1986) 161 ITR 473 (Bom.),*** the Division Bench of the Bombay High Court, has held as under:

" In appeal before the Income-tax Appellate Tribunal, the Revenue contended that the business started at Jaipur was merely an extension of the existing business of the assessee and that it had only shifted a part of its capacity there and so the provisions of section 80J of the Income-tax Act, 1961, were not attracted. The Tribunal held that the new unit at Jaipur was intended to utilise a part of the capacity for which the assessee had a licence and that there was no shifting of machinery or plant already in existence or splitting up or reconstruction of the business already in existence. Following the decision of the Calcutta High Court in CIT v. Indian Aluminium Co. Ltd. , in preference to the earlier decision of the Calcutta High Court in CIT v. Textile Machinery Corporation , the Tribunal granted to the assessee the benefit of the provisions of section 80J.

Mr. Jetly, learned counsel for the Revenue, submitted that inasmuch as there was unity of control in regard to the Jaipur plant and inasmuch as there was a shifting of a part of the capacity to Rajasthan, the provisions of section 80J of the Income-tax Act, 1961, were not attracted.

There is not a word to show that there was, in fact, unity of control. The shifting of a part of the capacity would seem to us to

make no difference where, as here, new plant and machinery was set up in a new building constructed for the purpose. We see no merit whatever in the Revenue's contention."

11. Their lordships of the Hon'ble Apex Court in the case of ***Bajaj Tempo ltd. vrs. Commissioner of Income Tax, (1992) 186 ITR 188 (SC),*** have held as under:

"The initial exercise, therefore, should be to find out if the undertaking was new. Once this test is satisfied then clause (1) should be applied reasonably and liberally in keeping with spirit of Section 15C(I) of the Act. While doing so various situation may arise for instance the formation may be without anything to do with any earlier business. That is the undertaking may be formed without splitting up or reconstructing any existing business or without transfer of any building material or plant of any previous business. Such an undertaking undoubtedly would be eligible to benefit without any difficulty. On the other extreme may be an undertaking new in its form but not in substance. It may be new in name only. Such an undertaking would obviously not be entitled to the benefit. In between the two there may be various other situations. The difficulty arises in such cases. For instance a new company may be formed, as was in this case a fact which could not be disputed, even by the Income-tax Officer, but tools and implements worth Rs. 3,500/- were transferred to it of previous firm. Technically speaking it was transfer of material used in previous business. One could say as was vehemently urged by the learned counsel for the department that where the language of statute was clear there was no scope for interpretation. If the submission of the learned counsel is accepted then once it is found that the material used in the undertaking was of a previous business there was an end of inquiry and the assessee was precluded from claiming any benefit. Words of a statute are undoubtedly the best guide. But if their meaning gets clouded then the courts are required to clear the haze. Sub-section (2) advances the objective of sub-section (1) by including in it every undertaking except if it is covered by clause (i) for which it is necessary that it should not be formed by transfer of building or machinery. The restriction or denial of benefit arises not by transfer of building or material to the new company but that it should not be formed by such transfer. This is the key to the interpretation. The formation should not be by such transfer. The emphasis is on formation not on use. Therefore it is not every transfer of building or material but the one which can be held to have resulted in formation of the undertaking."

12. Accordingly, the assessee was entitled to the benefit of Section 80 1C of the Income Tax Act. The substantial question of law is answered in favour of the assessee.

13. Consequently, the appeal is dismissed.

(Rajiv Sharma),
Judge.

October 28, 2014,
(karan)

(Sureshwar Thakur),
Judge.