IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 295 of 1985

For Approval and Signature:

Hon'ble MR.JUSTICE J.M.PANCHAL
and
Hon'ble MR.JUSTICE M.S.SHAH

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME TAX

Versus

NIPA TWISTING WORKS

Appearance:

MR BB NAYAK with M/s. MANISH R BHATT & Co.
for Petitioner
SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE J.M.PANCHAL
and
MR.JUSTICE M.S.SHAH

Date of decision: 25/01/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE J.M.PANCHAL)

At the instance of the Revenue, the Income Tax Appellate Tribunal, Ahmedabad Bench 'B' has referred following question of law for our opinion under section 256(1) of the Income-tax Act, 1961 ("the Act" for short), for Assessment Year 1979-80 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was entitled to the benefits of investment allowance ?"

2. FACTS

The respondent-assessee was a firm and was carrying on business of twisting majuri in the name and style of 'M/s. Nipa Twisting Works'. During the previous year, relevant to the Assessment Year 1981-82, the firm was dissolved on June 30, 1980 and its assets had been distributed amongst the partners in specie. The reserve credited under section 32-A(4) of the Act had also been so distributed. While framing the assessment under section 143(3) of the Act, Income-tax Officer withdrew the investment allowance of Rs. 20,899/allowed to the assessee on the ground that on the dissolution of the firm, the machineries were transferred to the partners before 8 years within the meaning of section 32A(5) of the Act and reserve was also transferred to the partners within the meaning of section 32A(5)(c) of the Act.

3. On appeal before the CIT (Appeals), the assessee relied on the decision of the Supreme Court in MALABAR FISHERIES CO. v. COMMISSIONER OF INCOME-TAX, KERALA, (1979) 120 ITR 49 and contended that since on the dissolution of the firm no transfer of assets had taken place, the provisions of section 32A(5) of the Act were not attracted. The Commissioner (Appeals) however, upheld the action of I.T.O. taking the view that closing of reserve account by transfer of 1/4th of the amount to each partner's account was not a purpose of the undertaking. Feeling aggrieved by the order of CIT (Appeals), the assessee went in appeal before the Tribunal. Relying on the aforesaid decision of the Supreme Court as well as the decision of the Gujarat High Court in ABDUL REHMAN HAJI MIYA v. V.P.MINOCHA, INCOME-TAX OFFICER, AHMEDABAD AND OTHERS, (1977) 106 ITR 821, it was argued by the assessee before the Tribunal that when machinery is divided amongst partners on dissolution of firm, no transfer or utilisation of

machinery takes place and therefore, development rebate was not liable to be withdrawn. At the time of hearing of the matter, two learned Members of the Tribunal having differed on the question of allowability of investment allowance, the point of difference, "Whether on the facts and circumstances of the case, the assessee is entitled to benefit of investment allowance ?" was referred to Third Member. The Third Member found that the two branches into which the partners had separated have continued the business and the assets of the business which they had jointly owned had been only distributed among them in specie. The Third Member further found that the reserve was also so distributed and in the continued business the reserve continued as such. In view of the above referred to findings, the learned Third Member of the Tribunal deduced that the assessee had not allowed the reserve to disappear in such a way that it was not available for the purchase of machinery, nor transferred the assets of the firm on its dissolution and as there was no breach of provisions of section 32A(5) of the Act, investment allowance granted could not have been withdrawn. In view of the opinion of the learned Third Member of the Tribunal, the appeal filed by the assessee was allowed by the Tribunal. Thereupon the Commissioner of Income Tax, Surat claimed reference, which claim was accepted by the Tribunal and that is how the above referred to question arises for our consideration in this Reference.

4. Mr. B.B.Nayak, learned counsel for the Revenue submitted that on dissolution of the firm, the assessee had disabled itself from continued exclusive user of the machinery for the purpose of its business for the specified period and, therefore, the consequences specified in Section 32A(5) of the Act will follow. According to the learned counsel for the Revenue where the machinery or plant is not wholly used by the assessee for the purpose of business carried on by him for the specified period and such user is given over to another, it can be said that the machinery or plant is 'otherwise transferred' by the assessee to another person. What was emphasised by the learned counsel was that the reserve must be used for 10 years by the assessee who had obtained investment allowance and when the firm is dissolved within 10 years of grant of investment allowance, the investment allowance is liable to be withdrawn. In support of his submissions, the learned counsel placed reliance on the decisions of the Supreme Court in (1) COMMISSIONER OF INCOME TAX v. NARANG DAIRY PRODUCTS, (1996) 219 ITR 478, and (2) SOUTH INDIA STEEL ROLLING MILLS v. COMMISSIONER OF INCOME-TAX, (1997) 224

ITR 654.

5. Though served, none appears on behalf of the respondent.

We have heard the learned counsel for the Revenue and taken into consideration the relevant decisions on the point.

OPINION

6. Under section 32A of the Act, investment allowance is allowed in respect of new machinery and plant to the extent of 25% of the actual cost of machinery or plant, which is owned by the assessee and is wholly used for the purposes of business carried out by him. It is not only the ownership of the plant or machinery, but also its exclusive user by the assessee for the purposes of his business, that is essential to enable the assessee to get investment allowance under section 32A. Moreover, under section 32(A)(4) an amount equal to 75% of the investment allowance to be actually allowed has to be debited to the profit and loss account and credited to a reserve account. In cases where an assessee disables himself from such continued exclusive user of the plant or machinery for the purpose of his business for the period specified in section 32A(5) of the Act, the consequences specified in the said section will follow, provided the machinery or plant is "otherwise transferred". The definition of "transfer" in section 2(47) is an inclusive one and does not exclude the contractual or the ordinary meaning of the word "transfer". The words "otherwise transferred" occurring in section 32A(5)(a) should bear an appropriate meaning in the context of the main provision i.e. section 32A of the Act. Section 32A(5)(a) is closely linked to section 32A(1) of the Act. Keeping in view the purpose for which the relief by way of investment allowance is afforded under section 32A(1) of the Act, in cases where the machinery or plant is not wholly used by the assessee for the purpose of business carried on by him, for the specified period and such user is given over to another, it can be stated that the machinery or plant is "otherwise transferred" by the assessee to another person.

7. In Bharat Petroleums v. Commissioner of Income-tax, Gujarat-V, (1979) 116 ITR 75, the assessee firm consisting of six partners, was carrying on business with its head office at Rajkot and branches at Bhavnagar, Ahmedabad,Anand, Mehsana and Bhuj. By a deed dated June 27, 1968, the business of the partnership at Bhuj branch

was transferred to a new independent firm which came into existence on June 21, 1968 and consisted of the original six partners and six other partners. All the assets and liabilities of the Bhuj branch of the original firm as on June 26, 1968, were taken over by the new firm at Bhuj and it was stipulated that the business of the new firm would have no connection whatsoever with the business carried on by the original parent firm at Rajkot, Bhavnagar, Ahmedabad, Anand and Mehsana. By another agreement dated May 31, 1969, which was to come into effect on June 1, 1969, the partners of the original assessee-firm agreed that its business was to be so reconstituted that there would be a separate firm for carrying on the business at each of the centres. The assessee claimed development rebate on plant and machinery installed at Mehsana and Bhuj in the previous year relevant to the assessment year 1968-69; whereas in the previous year relevant to the assessment year 1969-70, the assessee claimed development rebate on plant and machinery installed at Rajkot and Ahmedabad. The I.T.O. declined to grant development rebate claimed by the assessee on its plant and machinery on the ground that the machinery on which development rebate was claimed had been sold to the newly constituted partnership firm within the period of eight years and therefore, conditions laid down in Section 34 of the Act were not fulfilled for claiming development rebate. On appeals, the A.A.C. affirmed the decision of the I.T.O. The Appellate Tribunal dismissed the appeals of the assessee. On reference, High Court held that when the assets are distributed amongst the partners, no transfer of machinery takes place and, therefore, the development rebate should not have been withdrawn.

In Malabar Fisheries Co. v. Commissioner of Income-tax, Kerala (supra), a firm consisting of four partners carried on six different businesses. During the accounting periods relevant to the assessment years 1960-61 to 1963-64 it installed various items of machinery in respect of which development rebate was allowed to it under section 33. The firm was dissolved on March 31, 1963 and under the deed of dissolution one of the firm's businesses was taken over by one of the partners and the remaining five by two of the other partners, and the fourth partner had received a sum of Rs.3,81,082/- in lieu of his share in the assets of the firm. The question was whether the rebate allowed to the firm could be withdrawn on the ground that there was a sale or transfer of the machinery within the meaning of section 34(3)(b) read with section 2(47) of the Act. The Supreme Court while holding that section 34(3)(b) was not

applicable to the case and the development rebate allowed to the firm could not have been withdrawn, has observed as under :-

"A partnership firm under the Indian Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm's property or the firm's assets all that is meant is property or assets in which all partners have a joint or common interest. It cannot, therefore, be said that, upon dissolution, the firm's rights in the partnership assets are extinguished. It is the partners who own jointly or in common the assets of the partnership and, therefore, the consequence of the distribution division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of s. 2(47) of the I.T.Act, 1961. There is no transfer of assets involved even in the sense of any extinguishment of the firm's rights in the partnership assets when distribution takes place upon dissolution.

In order to attract s. 34(3)(b) it is necessary that the sale or transfer of assets must be by the assessee to a person. Dissolution of a firm must, in point of time, be anterior to the actual distribution, division or allotment of the assets that takes place after making accounts and discharging the debts and liabilities due by the firm. Upon dissolution the firm ceases to exist: then follows the making up of accounts, then the discharge of debts and liabilities and thereupon distribution, division or allotment of assets takes place inter se between the erstwhile partners by way of mutual adjustment of rights between them. The distribution, division or allotment of assets to the erstwhile partners, is not done by the dissolved firm. In this sense there is no transfer of assets by the assessee (dissolved firm) to any person. It is not correct to say that the distribution of assets takes place eo instanti with the dissolution of the firm or that it is effected by the dissolved

firm."

8. In view of the above referred to decisions, prima-facie it would appear that the view taken by the Tribunal is correct one. However, later decisions of the Supreme Court indicate that a different principle has been enunciated by the Supreme Court after reviewing the law on the point. In Commissioner of Income-tax v. Narang Dairy Products (supra), the assessee-firm carried on the business of manufacture of milk powder. For the Assessment Year 1965-66, the Income-tax Officer allowed development rebate in respect of the entire machinery and plant owned by the assessee and used for the said business in the sum of Rs. 1,00,093/-. A part of the machinery was subsequently sold. The value of the machinery that was left entitling the assessee to the development rebate for the said year was determined at Rs. 85,222/-. This machinery was left out by the assessee on August 27, 1969 for a period of three years with a provision for further renewal of the agreement or for outright purchase. In the circumstances, the Income-tax Officer by an amendment order had withdrawn the development rebate of Rs. 1,00,093/-. The Tribunal was of the view that no transfer was involved by the lease agreement and so section 34(3)(b) of the Act was not attracted. The Tribunal refused to make a reference and the High Court dismissed an application to direct a reference. On appeal to the Supreme Court by special leave, the Supreme Court has held that the withdrawal of the development rebate by the Income-tax Officer in the amendment order relying on section 34(3)(b) of the Act was justified. After considering the scheme of sections 2(47), 33 & 34 of the Act, the Supreme Court has held as under :

"In this case, the machinery or plant was not sold. Admittedly, the machinery was let out by the assessee to Hindustan Lever Limited on August 27, 1969, within a period of eight years from the end of the previous year in which it was acquired. The only question is whether it can be said that the machinery or plant was "otherwise transferred" by the assessee to any person. Under section 33(1)(a) the development rebate is allowed in respect of the new machinery and plant which is owned by the assessee and is wholly used for the purpose of business carried on by him.When the machinery was let out by the assessee to Hindustan Lever Limited, it cannot admit of any doubt that the said machinery or plant could not and was not used by the assessee

for the purpose of business carried on by him. It is not only the ownership of the plant or machinery, but also its exclusive user by the assessee for the purpose of his business, that is essential to enable the assessee to get development rebate under section 33(1)(a). In cases where an assessee disables himself from such continued exclusive user of the plant or machinery for the purpose of his business for the specified period, the consequences specified in section 34(3)(b) will follow, provided the machinery or plant is "otherwise transferred". It is true that there is no sale; nor is there any complete extinguishment of the right of the assessee in the machinery or plant by the grant of lease; but the exclusive possession and enjoyment of the machinery or plant by the assessee no longer exists or survives. Such right to exclusive possession and enjoyment vests in the lessee and it is a case where the machinery or plant is "otherwise transferred" to the lessee. It is a case where the machinery or plant is "otherwise transferred" by the assessee to any person before the expiry of eight years from the end of the previous year in which it was acquired. Even assuming that the transaction may not be a "transfer" as defined under section 2(47) of the Act, in our view, the definition section is an inclusive one and does not exclude the contextual or the ordinary meaning of the word, "transfer". There are different shades of meaning to the word "transfer", viz. "to make over possession of to another", "a delivery of title or property from one person to another", "to displace from one surface to another", "removal", "hand over", "make over possession of property to another", "change", "displace", etc. The words "otherwise transferred" occurring in section 34(3)(b) should bear an appropriate meaning, in the context of the main provision, section 33(1)(a) of the Act. Section 34(3)(b) is closely linked to section 33(1)(a) of the Act. Keeping in view the purpose for which the relief by way of development rebate is afforded under section 33(1)(a) of the Act, in cases where the machinery or plant is not wholly used by the assessee for the purpose of business carried on by him, for the specified period, and such user is given over to another, it can be safely stated that the machinery or plant is "otherwise transferred" by the assessee to another person.

In the above view of the matter, we are of the view that the withdrawal of the development rebate by the Income-tax Officer in the amendment order dated March 30, 1970, by relying on section 34(3)(b) of the Act is justified. We are broadly in agreement with the decision of the Kerala High Court reported in Blue Bay Fisheries (P.) Ltd. v. CIT (1987) 166 ITR 1, in the interpretation of the crucial words occurring in section 34(3)(b) of the Act, "otherwise transferred". We set aside the decision of the Allahabad High Court and also of the Appellate Tribunal and answer the question formulated by the Revenue under section 256(1) of the Act in the negative, in favour of the Revenue and against the assessee."

9. Again, in South India Steel Rolling Mills (supra) the appellant-firm was constituted with four partners. Two of them retired and the partnership was reconstituted with the remaining two partners continuing the same business. On March 3, 1968, one of the two partners died. As a result, the partnership stood dissolved and on March 5, 1968, a new partnership was constituted comprising the surviving partner and the legal heirs of the deceased partner. The firm had been granted the benefit of development rebate under section 33(1)(a) of the Income-tax Act, 1961, but since the partnership stood dissolved on March 3, 1968 before the expiry of eight years from the grant, the Commissioner of Income-tax, in revision under section 263 of the Act, withdrew the development rebate that had been granted for the assessment years in question. The Tribunal held against the appellant and on a reference, the High Court held that the firm became extinct before the expiry of the eight year period and what came afterwards was a different entity even if it comprised only the surviving partner and the deceased partner's legal representatives, and that, therefore, there was non-compliance of the conditions necessary for grant of the rebate. The Supreme Court while dismissing the appeal has held as under :-

"Having regard to the words "which is owned by the assessee and is wholly used for the purposes of the business carried on by him", in section 33(1)(a), it must be held that the benefit of development rebate is available only to the assessee, which is owning the machinery or plant and is using it wholly for the purpose of the

> business carried on by him. Similarly, in section 34(3)(a), the words used are "to be utilised by the assessee during a period of eight years next following for the purpose of the business of the undertaking". The grant of development rebate under section 33(1)(a) is subject to the conditions laid down in section 34(3)(a), which means that the assessee who has obtained the development rebate under section 33(1)(a) must also be the assessee, who should utilise the amount credited to the reserve account during the period of eight years next following for the purpose of the business of the undertaking for which the development rebate was given. The condition for grant of rebate under section 33 read with section 34(3)(a) would not be satisfied, if the assessee who has availed of the rebate ceases to exist before the expiry of the period of eight years. Since the firm which had been granted the rebate had been dissolved and ceased to exist before the expiry of eight years, the rebate was liable to be withdrawn."

10. We may state that in South India Steel Rolling Mills (supra), the Supreme Court has considered its earlier decision rendered in Malabar Fisheries Co. (supra) and distinguished the same. In view of two later judgments of the Supreme Court, we are of the opinion that the law laid down by this Court in Bharat Petroleums (supra) is no longer a good law and the assessee would not be entitled to the relief of investment allowance on the basis of the said decision. We may also state that the scheme contemplated by section 33(1)(a) and 34(3)(a) relating to development rebate is in paramateria with the scheme of investment allowance contemplated by section 32A of the Act. Thus, the principles enunciated by the Supreme Court in Commissioner of Income-tax v. Narang Dairy Products (supra) and South India Steel Rolling Mills (supra) while construing the provisions relating to development rebate would apply with all force while considering the question of grant of withdrawal of investment allowance under section 32A of the Act.

11. It is not in dispute that on dissolution of the firm, the assets which were jointly owned, had been distributed amongst the partners, nor it is in dispute that the reserve had also been so distributed. Therefore, as the machinery was otherwise transferred by the assessee to another person before expiry of eight years from the end of previous year in which it was

acquired, the Income-tax Officer was justified in withdrawing the investment allowance on the ground that the said allowance was wrongly made for the purpose of the Act. Similarly, before the expiry of ten years period, the assessee had utilized the amount credited to the reserve account under sub-section (4) of section 32A of the Act by distribution to the partners on dissolution of the firm and as there was breach of provisions of section 32A(5)(c) of the Act, the Income-tax Officer was justified in withdrawing the investment allowance granted to the assessee.

12. In view of the above discussion, we are of the opinion that on the facts and in the circumstances of the case, the Tribunal was not right in law in holding that the assessee was entitled to the benefit of investment allowance. The Reference is, therefore, answered in the negative i.e. in favour of the Revenue and against the assessee.

The Reference stands disposed of accordingly with no order as to costs.

(J.M.Panchal, J.)

(M.S.Shah, J.)

(patel)