Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 1094 OF 2009
(Arising out of S.L.P.(C) No.13070 of 2007)

Commr. of Income Tax, Dibrugarh ... Appellant (s)

versus

Doom Dooma India Ltd. ... Respondent (s)

With

Civil Appeal No. 1093 of 2009 – Arising out of S.L.P. (C) No.13069 of 2007
Civil Appeal No. 1095 of 2009 – Arising out of S.L.P. (C) No.13072 of 2007
Civil Appeal No. 1096 of 2009 – Arising out of S.L.P. (C) No.13074 of 2007
Civil Appeal No. 1097 of 2009 – Arising out of S.L.P. (C) No.16860 of 2008

J U D G M E N T

S. H. KAPADIA, J.

1. Delay condoned.

2. Leave granted.

3. This batch of civil appeals is directed against judgments dated 22.11.06 and 8.1.07 of the High Court of Guwahati, Assam,

in appeals under Section 260A of the Income-tax Act, 1961 in respect of assessment years 1988-89, 1989-90, 1990-91 and 1991-92.

4. What is the meaning of the expression "depreciation actually allowed" in Section 43(6)(b) of the 1961 Act (as it stood at the relevant time)? How is the depreciation to be computed in cases falling under Rule 8 of the Income-tax Rules, 1962, which deals with taxability of composite income? These are the two questions which arise for determination in this batch of civil appeals.

Background facts in Civil Appeal No. of 2009 (Arising out of S.L.P.(C) No.13070 of 2007)

5. The facts in all these civil appeals are similar. Respondent-assessee, at the relevant time, was in the business of growing and manufacturing of tea. In this case we are concerned with the assessment year 1988-89. Applicability of Rule 8 is not in dispute. Assessee raised additional grounds before CIT(A) at the time of hearing of the appeal *inter alia* stating that the AO had erred in determining the opening "written down value" of the block of assets without following the provisions of Section 43(6)(b) of the 1961 Act. According to the assessee for arriving at the opening "written down value" of the block of assets, the AO erred in deducting 100 per cent of the depreciation for the preceding year calculated at the

prescribed rate from the opening “written down value”. However, the assessee claimed that only 40 per cent of the depreciation allowed at the prescribed rate ought to have been deducted and not 100 per cent as done by the AO. In this connection reliance was placed by the assessee on Section 43(6)(b) of the 1961 Act. Accordingly, by additional grounds which were allowed to be raised, the assessee sought a direction from CIT(A) to the AO to determine the "written down value" in accordance with the provisions of Section 43(6)(b) by deducting only 40 per cent of the depreciation computed at the prescribed rate, being depreciation actually allowed. This argument of the assessee came to be rejected by CIT (A).

6. Aggrieved by the decision, the assessee carried the matter in appeal to the Tribunal. By its decision the Tribunal, following the decision of the Calcutta High Court in the case of **Commissioner of Income-tax v. Suman Tea and Plywood Indusries (P) Ltd. – (1993) 204 ITR 719,** held that since 40 per cent of the assessee’s composite income is chargeable under Section 28 of the 1961 Act, for the purposes of computing the "written down value" of depreciable assets used in the tea business, only 40 per cent instead of 100 per cent of depreciation allowable at the prescribed

rate shall be deducted in the case of the assessee. This view of the Tribunal has been affirmed by the impugned judgment of the High Court. Hence this civil appeal(s) by way of special leave petition(s) is filed by the Department.

Answer to Question No.(1) – meaning of the expression "depreciation actually allowed" in Section 43(6)(b) of the 1961 Act

7. Deductions by way of depreciation allowance have been specifically recognized and dealt with in Sections 32, 34 and 43(6) of the 1961 Act (which deals with the definition of the words "written down value"). Section 32 adopts two methods in allowing depreciation. In the case of ocean-going ships, depreciation is allowed, year after year, at the fixed percentage on the original cost of the asset [**See**: Section 32(1)(i)]. This is called the straight-line method. In the case of non-ocean-going ships and buildings, machinery, plant or furniture, the prescribed percentage of depreciation is to be computed on the basis of "written down value" of the asset [**See**: Section 32(1)(ii)]. This is known as "written-down value" method. Both these methods seek to ensure that the total depreciation allowance(s) granted, year after year, does not exceed 100 per cent, of the original cost of the asset. In the straight-line method, the entire depreciation is written off sooner than in the

"written down value" method, if the figures of the actual cost and the prescribed percentage are the same in either case. Section 32 (2) allows the carry forward and unabsorbed depreciation allowances to any subsequent year, without any time limit, where such non-absorption is "owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains being less than the allowance". Depreciation loss under Section 32 (2) stands on the same footing as any other business losses. An assessee claiming depreciation of assets has to show that such assets are owned by him and are used by him in the accounting year for the purpose of his business, the profits of which are being charged [**See**: Section 32(1)(i)]. Further, the total of all deductions in respect of depreciation under Section 32(1)(i), made year after year, should not, in any event, exceed the actual cost of the assets to the assessee [**See:** Section 34(2)(i)]. The definition of "actual cost" is to be found in Section 43(1) and the definition of "written down value" is to be found in Section 43(6) of the 1961 Act. The latter defines "written down value" under Section 43(6) to mean –

(a) in the case of assets acquired in the previous year, the actual cost to the assessee;

(b) in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation(s) actually allowed under the 1961 Act.

8. The key word in Section 43(6)(b) of the 1961 Act is “actually”. We quote hereinbelow an important observation, made by this Court on the meaning of the words “actually allowed” in Section 43 (6)(b) in the case of **Madeva Upendra Sinai v. Union of India and Others – (1975) 98 ITR 209** at pages 223 & 224, which reads as under:

> “The pivot of the definition of "written-down value" is the "actual cost"' of the assets. Where the asset was acquired and also used for the business in the previous year, such value would be its full actual cost and depreciation for that year would be allowed at the prescribed rate on such cost. In subsequent year, depreciation would be calculated on the basis of actual cost less depreciation actually allowed. The key word in clause (b) is "actually". It is the antithesis of that which is merely speculative, theoretical or imaginary. "Actually" contra-indicates a deeming construction of the word "allowed" which it qualifies. The connotation of the phrase "actually allowed" is thus limited to depreciation *actually taken into account or granted and given effect to*, i.e. debited by the Income-tax Officer against the incomings of the business in computing the taxable income of the assessee; it cannot be stretched to mean "notionally allowed" or merely allowable on a notional basis.”
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> ….
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> “From the above conspectus, it is clear that the essence of the scheme of the Indian Income-tax Act is that depreciation is allowed, year after year, on the actual cost of the assets as reduced by the depreciation *actually allowed* in earlier years. It follows, therefore, that even in the case of assets acquired before the previous year, where in the past no depreciation was

> computed, actually allowed or carried forward, for no fault of the assessee, the "written-down value" may, under clause (b) of Section 43(6), also, be the actual cost of the assets to the assessee."

9. Therefore, this Court has clearly laid down the meaning of the words "actually allowed" in Section 43(6)(b) to mean - "limited to depreciation actually taken into account or granted and given effect to, i.e. debited by the Income-tax Officer against the incomings of the business in computing the taxable income of the assessee".

Answer to Question No.(2) – computation of depreciation in cases covered by Rule 8 which deals with taxability of composite income

10. In the case of **Commr. of Income-tax, Madhya Pradesh, Nagpur and Bhandara v. Nandlal Bhandari Mills Ltd. – (1966) 60 ITR 173,** which judgment was in the context of composite income, the question *inter alia* arose whether depreciation "actually allowed" would mean depreciation deducted in arriving at the taxable income or the depreciation deducted in arriving at the world income (composite income). In that case the assessee was a company incorporated in Indore. It owned and ran a textile mill. Until 1.4.1950, when Income-tax Act, 1922 was extended to Part B States including Madhya Bharat of which Indore became a part, the assessee was assessed at Bombay under the Income-tax Act,

1922 as a non-resident and for some years as resident. The assessee was also assessed in Indore under the Indore Industrial Tax Rules, 1927. For those years in which it was assessed as a non-resident under Income-tax Act, 1922, only that part of its profits attributable to the sale proceeds of goods received in British India were brought to tax. For the assessment years in question, in ascertaining the "written down value" of the building, machinery and plant, under paragraph 2 of the Taxation Laws Order, 1950, only the greater of the two depreciations “actually allowed” in British India and in Indore could be taken into account. The ITO took into account the depreciation allowances for the years up to 1944 as computed under Income-tax Act, 1922 for the purposes of ascertaining the world income of the assessee, and for the years 1945 to 1948, he took into account the income as computed under Indore Industrial Tax Rules 1927; and on that basis the ITO arrived at the "written down value" as on January 1, 1949. The assessee contended, *inter alia,* that in regard to the years up to 1944 only the proportionate depreciation attributable to the taxable income came within the meaning of the words “actually allowed” in the old section corresponding to Section 43(6)(b) of the 1961 Act. This contention of the assessee was accepted by the majority judgment which held that in fixing the depreciation allowances for the years

in which the assessee was assessed as a non-resident under the Income-tax Act, 1922, the ITO had "actually allowed" only a portion of the amount towards depreciation allowable in assessing its world income. It was further held that the mere fact that in the matter of calculation, the total amount of depreciation was first deducted from the world income (composite income) and thereafter a proportion was struck did not amount to an actual allowance of the entire depreciation in ascertaining the taxable income that accrued in British India. Therefore, it was held, that, the depreciation deducted in arriving at the taxable income alone could be taken into account and not the depreciation taken into account for arriving at the world income (composite income).

11. In our view the above judgment of the Supreme Court squarely applies to the present case. Assessee is engaged in the business of growing and manufacturing of tea. As per the provisions of Section 10(1) of the 1961 Act read with Rule 8, 40 per cent of the business income derived from the sale of tea grown and manufactured in India by the assessee was liable to tax. In the above judgment of the Supreme Court, the Court was concerned with the world income, in this case we are concerned with the composite income. Therefore, in our view the judgment of the

Supreme Court, above referred to, is squarely applicable to the present case. Therefore, we do not see any infirmity in the impugned judgment of the High Court.

12. Be that as it may, we can give the following illustration(s) which will give an example of how the "written down value" needs to be computed:

Illustration 'A'

	Rs.
Income from sale of tea	1000
Less: Expenses -	
Depreciation	(100)
Others	(300)
Business Profit	600
Income subject to charge under the Income Tax Act by application of Rule 8 (40% of 600)	240

Illustration 'B'

	Rs.
Income from sale of tea (40% of 1000)	400
Less: Expenses -	
Depreciation	(40)
Others (40% of 300)	(120)
Business Profit subject to charge of income tax (40% of 600)	240

13. Analysing the above two charts, we find that at the end of computation the income chargeable to tax by applying Rule 8 comes to Rs.240. Under Illustration 'A', the normal depreciation is Rs.100 which is deductible from Rs.1000 being the income from sale of tea. On the other hand, under Illustration 'B', we have taken 40 per cent of each of the items, namely, income from sale of tea, depreciation and other expenses. Accordingly, on comparison it may be noted that whereas income from sale of tea is Rs.1000 under Illustration 'A', proportionately it comes to Rs.400 under Illustration 'B'. Similarly, depreciation under Illustration 'A' which is normal depreciation is Rs.100 whereas in Illustration 'B' at 40 per cent the pro rata depreciation is 40. What is important to be noted is that at the end of computation under both the Illustrations, the income taxable by applying Rule 8 comes to Rs.240 in both the cases. The only difference is that in Illustration 'B' we have gone by pro rata basis.

14. The important thing to be noted is that according to the Department, in the succeeding year, the opening "written down value" of the assets would be Rs.900 (Rs.1000 for the cost of the assets less Rs.100) as indicated in Illustration 'A' whereas, if one goes by Illustration 'B' the "written down value" comes to Rs.960

(Rs.1000 for the cost of the asset(s) minus 40), being the depreciation in Illustration 'B'.

15. According to the assessee, in view of the law laid down by the judgment of this Court in the case of **Madeva Upendra Sinai (supra)**, the "written down value" should be computed at Rs.960 and not at Rs.900 as claimed by the Department.

16. In our view, in cases where Rule 8 applies, the income which is brought to tax as "business income" is only 40 per cent of the composite income and consequently proportionate depreciation is required to be taken into account because that is the depreciation "actually allowed". Hence we find no merit in the civil appeals filed by the Department.

17. Before concluding, we may state that the judgment of this Court in **Commissioner of Income Tax** v. **Willamson Financial Services and Others – (2008) 297 ITR 17**, has no application to the present cases. **Willamson Financial Services** case (supra) was rendered in the context of deduction under Section 80-HHC of the 1961 Act. Section 80-HHC comes under Chapter VIA. Chapter VIA refers to special deductions. It is a separate Code by itself. There

is a distinction between "deductions/allowances in Section 30 to Section 43D" and "deductions admissible under Chapter VIA". Deductions/allowances provided in Sections 30 to 43D are allowed in determining Gross Total Income and are not chargeable to tax because the same constitute charge on profit, whereas, deductions under Chapter VIA are allowed from Gross Total Income chargeable to tax. Therefore, the judgments rendered in the context of Section 80-HHC of the 1961 Act, both by this Court and by the Kerala High Court, stand on different footing.

18. For the aforestated reasons, we find no merit in the Department's civil appeals which are accordingly dismissed with no order as to costs.

.....J.
(S.H. Kapadia)

.....J.
(H. L. Dattu)

New Delhi;
February 18, 2009.