PROFITS & GAINS DERIVED FROM INDUSTRIAL UNDERTAKING

Any taxing statute administering benevolent provision in respect of particular category of assessees would always generate many interpretative controversies as to the quantum and eligibility of the same. In this context, profits and gains derived from the industrial undertaking with respect to provisions like section 80J, section 80I, section 80IA and sec.80IB have triggered many a controversy and litigation. The article explores the issue in detail.

Special incentive in the form of a tax holiday to new Industrial undertakings has been on the statute book of Income Tax Act ,1961 in one form or the other since its inception. In line with Government's prime agenda of promoting industrialisation and creating employment, assessees who owned and set up industrial undertakings are being encouraged with tax holiday incentives. Basic eligibility to claim such tax holiday is to own an industrial undertaking and derive profits and gains from such undertaking. Profits and gains derived from the industrial undertaking with respect to provisions like section 80J, Section 80I, section 80IA and sec.80IB have triggered many controversies leading to litigations.

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Basic conditions for claim of tax holiday

- Ownership of industrial undertaking
- Such undertaking must be new and should not have been split up or reconstructed from an existing unit.
- Prescribed number of workers to be engaged in such undertaking.
- Conducting manufacturing activity
- Usage of new plant & machinery except to the extent of 20% of the total machinery

In complying with these conditions an assessee used to encounter controversy with respect to establishing the unit as a new unit especially in cases where such assessee had existing manufacturing units. Assessee also faced a controversy in respect of establishing a particular income as profits & gains derived from industrial undertaking.

Wording of provisions of tax holiday

It is pertinent to compare the wording of provisions enshrined in sections 80HH, 80 HHA, 80I, 80J 80IA & 80IB.

Section 80HH: Where the gross

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total income of an assessee includes any profits & gains derived from an industrial undertaking,……

Section 80HHA: Where the gross total income of an assessee includes any profits & gains derived from a small-scale industrial undertaking,…

Section 80-I: Where the gross total income of an assessee includes any profits & gains derived from an industrial undertaking …

Section 80 J: Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking or a ship or the business of a hotel,…

Section 80-IA: Where the gross total income of an assessee includes any profits & gains derived from any business of an industrial undertaking, or the business of a hotel,…

Section 80-IB: Where the gross total income of an assessee includes any profits and gains derived from any business referred to in sub-section (3) to (11) and (11A) (such business being hereinafter referred to as the eligible business)…

Current Provisions– Section 80IA & 80IB

When we look at the current provisions of section 80IA & section 80IB and examine the issue of profits & gains derived from the industrial undertaking, we need to fall back on the case law developed against the provisions of section 80J, 80I, etc. As per the plain reading of the provisions and the prime objective behind this tax holiday, it is enacted to achieve the following:

- Promoting industrialization (more thrust on small scale industries)
- Generating employment
- Developing backward areas of the country.

Basic conditions imposed on an assessee to become eligible for tax holiday prove the mandate of objectives to be achieved as explained above. Basic eligibility to claim tax holiday by the assessee is to earn profits & gains derived from the industrial undertaking. It is obvious that profits & gains should have been derived directly from the industrial undertaking and not in any indirect way. In other words, there must be a direct nexus between profits & gains earned and the industrial undertaking. Only such directly accruing profits & gains from the industrial undertaking would become eligible income for the purpose of tax holiday in the hands of the assessee. Apparently any incidental income not directly accruing from the industrial undertaking runs the risk of judicial scrutiny as to its eligibility for tax holiday purposes. In this context, many dimensions have been unfolded in practical situations, which need to be critically examined whether to treat a particular receipt as profits & gains derived from industrial undertaking.

Profits & gains derived from industrial undertaking

In determining whether a particular receipt constitutes profits derived from the undertaking, it is paramount to bear in mind whether the prime objectives of promoting industrialization and employing prescribed number of workers are being concurrently achieved. In this backdrop different practical situations throw different interpretative problems and one needs to fall back on the plethora of cases decided in the context of the provisions of section 80J, 80I, 80HH & 80HHA etc. As the provisions of

section 80IA & section 80IB are of recent origin, it is imperative that one should look up for judicial guidance in the context of cases decided under the provisions of section 80J, 80I, etc. At the same time, it is also important to appreciate whether there is any significant change in the wording of the provisions between the past and the new.

The word "derive" means to draw or obtain from a source or origin. Supreme Court in its landmark judgment in the case of *Cambay Electric Supply Industrial Co. Ltd. Vs. CIT 113 ITR 84* clearly distinguished between the word "derived" and the word "attributable" in the following manner.

"The legislature has deliberately used the expression "attributable to", having a wider import than the expression "derived from", thereby intending to cover receipts from sources other than the actual conduct of the business of the Specified industry".

It is evident that the word "attributable" is of wider import than the word "derived" and accordingly it is imperative to examine whether a particular receipt is derived from the industrial undertaking or is attributable to the industrial undertaking in a given case. It is also important to note that Supreme Court dealt with the provisions of section 80E in the *Cambay's case (Supra)* where the wording of the provisions covers profits attributable to the undertak-

ing. While explaining the scope of the word "attributable" the Apex court clarified in clear terms that the word "derived" would have a restricted scope. It is in this context, both the revenue and the assessee have to critically examine and determine whether a particular receipt is derived from the industrial undertaking.

Income earned in direct nexus with industrial undertaking: Tax holiday is undoubtedly restricted to income arising from the mainline activity of the industrial undertaking. Any incidental income arising in the course of such activity may not attain the character of income, which is eligible for tax holiday. This process of segregation as to what is directly relatable to the industrial undertaking and what is incidental, is the crux of the issue. In doing so, any income earned to be rated as eligible for tax holiday, it is incumbent on the assessee to establish that the activity carried out for earning such income by the undertaking satisfied the desired objectives of the legislation. It is in this context, careful examination of the facts of each case should reveal whether income earned by the assessee owning the undertaking passes the acid test of eligibility. In other words, any income earned by the assessee owning the industrial undertaking in direct nexus with such undertaking should attain the character of income derived from the industrial undertaking.

Incidental income

It can be understood that income earned by the undertaking without a direct nexus with its main line activity of manufacturing has to be classified as incidental income, which is not eligible for tax holiday. In this context, different judicial rulings give us an insight into what is to be treated as incidental income.

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(a) **Profit on sale of import licenses:** It was held that such profit could not be treated to have been derived from the assessee's manufacturing activity as there was no direct nexus between the two. *CIT Vs. Eastern Seafood Exports (P) Ltd. (1995) 215 ITR 64 (Mad).*

(b) **Interest on bank deposits:** Relief under section. 80I was held to be not available for such income of new industrial undertaking as there was no direct nexus with the manufacturing activity. *CIT Vs. Cochin Refineries Ltd., (1985) 154 ITR 345 (Ker*)

(c) **Interest received from foreign brokers:** Such receipts from foreign brokers was held constituting business income in the hands of an assessee who was a resident shipping company and accordingly such amount was includable in the eligible income for benefits under section 80J. *CIT Vs. South India Shipping Corpn. Ltd. (1995) 216 ITR 651 (Mad)*

It is apparent that what is incidental income would depend on the facts of each case and cannot be generalised by any thumb rule. Anyhow, it is obvious that the income what is not in direct nexus with the manufacturing activity of an industrial undertaking has to be classified as incidental income not eligible for tax holiday.

Benevolent provisions of tax holiday to be construed liberally

Any provision in a taxing statute dealing with tax concession granting incentives for promoting industrial growth and economic development should be construed liberally. An assessee complying with the basic conditions of eligibility should be allowed tax holiday and should not be denied the same on trivial and procedural grounds. Otherwise, the avowed objectives of the legislation would be defeated. Supreme Court observed that since a tax holiday provision for promoting economic growth has to be interpreted liberally, the restriction on it, too has to be construed so as to advance the objective of the provision and not to frustrate it — *Bajaj Tempo Ltd.., Vs. CIT (1992) 196 ITR 188 (SC)*

Lease Rentals received by owner of industrial undertaking on leasing out entire manufacturing facility

In a situation where owner of the industrial undertaking leases out entire manufacturing facility to tide over temporary lull on account of market conditions or financial compulsions is a case study to be examined. In such a scenario, owner of the undertaking being the lessor is being denied tax holiday by the revenue authorities on

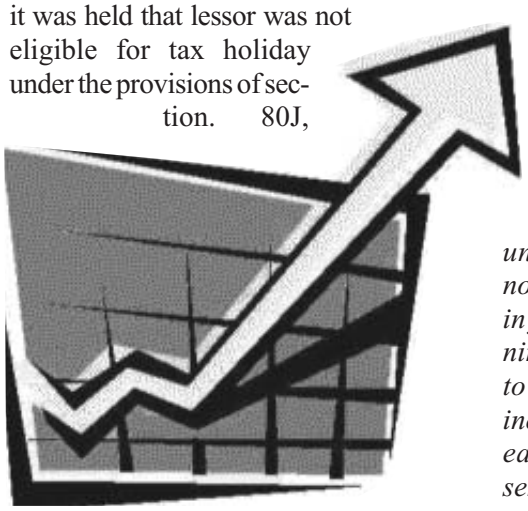
account of the following reasons.

(a) Lessor assessee is not carrying out manufacturing activity on his own.
(b) He has no control on the manufacturing activity.
(c) The condition of employing prescribed number of workers is not being fulfilled by him.
(d) What he receives as lease rentals cannot be treated as derived from the industrial undertaking though, such lease rentals are being accepted by the revenue as business income.
(e) He receives lease rentals whether the lessee carries out production or not.

Lessee not eligible for tax holiday: Lessee has no locus standi to claim tax holiday inspite of carrying out manufacturing activity in the industrial undertaking taken on lease by him simply because he is not the owner of the undertaking and is not the intended party to enjoy tax concession as per the objectives of the legislation. Accepted principle of administering tax concession provisions is to construe such provisions liberally. This theory cannot be extended to make lessee an eligible assessee for claiming tax holiday simply because he is carrying out the manufacturing activity. This would amount to reading something not intended by the legislation. It is obvious that lessee complying with the pivotal conditions like carrying out manufacturing activity by employing prescribed number of workers either with the aid of power or not, cannot make him eligible for claim of tax holiday – *AGS Tiber & Chemical Industries (P) Ltd., Vs. CIT (1998) 233 ITR 207 (Mad).*

CBDT Circular/letter F No. 15/5/63 – IT (AI) dt.13.12.1963 clarified that a successor in a business would be entitled to deduction under section 84 (corresponding to section 80J) for unexpired portion of statutory period. It was held in the above-mentioned case that the circular is not applicable as the assessee was a lessee and not a successor.

Even lessor was held not eligible for tax holiday: In a number of cases it was held that lessor was not eligible for tax holiday under the provisions of section. 80J, though he was the owner of the undertaking. It was denied on account of reasons listed out in para 6 above. Gist of the decisions ruled against the lessor assessee is as under.



(a) *In CIT Vs. Titanium Equipment & Anode Mfg. Co. Ltd., (2003) 259 ITR 487*, Madras High Court observed as under:

"When the assets of the company have been leased out, it cannot be said that those leased assets are being used by the assessee for the manufacture or production of any article. The manufacture or production is by the lessee of the machinery. When the assessee receives rent by leasing out the manufacturing facility, it cannot also be said that the income is derived from the industrial undertaking. He will not be entitled to special deduction under section 80J in respect of such rent."

(b) In *CIT Vs. Cement Distributors Ltd., (1994) 208 ITR 355*, Delhi High Court observed while dealing with the provisions of sec.80HH and 80J as under:

"once settled, lease money becomes payable irrespective of any profit or gain or, for that matter, from the running of the industrial undertaking by the lessee. The lessee may or may not run the unit (industrial undertaking) or may or may not earn any profit or gain and in fact may incur a loss in running it, but he will still be liable to pay the lease money. Thus income by way of lease money earned, though in a wider sense attributable to the undertaking (as it is to leasing out that unit), cannot be said to be profits and gains derived from the industrial undertaking so as to entitle the lessor assessee to a rebate under section 80HH.

On the same analogy no relief is available to the assessee under section 80J in relation to the rent received by him from letting out the entire undertaking of the assessee".

(c) Same ratio was upheld in *CIT Vs. Phoenix Scrap Processors (1995) 211 ITR 341 (Bom)* and also in *CIT Vs. Northern India Iron & Steel Co. Ltd., (1997) 226 ITR 342 (Del)*. It was so held that the lessor assessee had not control over the machinery and could not be said to have manufactured or produced articles.

(d) The same proposition was again confirmed that the lessor was not eligible for 80J benefit in the case of *CIT Vs. Asain Marine Products (P) Ltd., (1999) 239 ITR 349 (Mad).*

Whether lessor really deserves tax holiday

It is pertinent and interesting to note that Hyderabad Bench of ITAT in *Bangaru Manikyam Vs. ITO (1987) 21 ITD 320* held that lessor assessee was eligible for relief under section 80J against the lease income received by leasing out a manufacturing facility. In this case, assessee along with some others had purchased the rice mill with the obvious intention of leasing out the same from time to time. Entire manufacturing facility was leased out and the assessee was also a partner in the lessee firm, which carried out manufacturing activity. In respect of claim under section 80J made by the assessee the Tribunal observed as under:

"For purposes of section 80J or section 80-I, it is the undertaking and not the person owning it who is relevant and the assessee should receive profit from the industrial undertaking. Section 80J or section 80-I has to be read with section 80A. Accordingly, in computing the total income of the firm if any deduction was allowed under section 80J or section 80-I, etc., no deduction under the same section should be made in computing the total income of a partner of the firm, in relation to share of such partner in the income of the firm. In case the lessee firm was not allowed deduction under section 80J, for the reason that it did not own the industrial undertaking, the provisions of section 80A would not be applicable and the assessee would be entitled to claim deduction under section 80J as co-owner-cum partner. That part of the share income derived from the lessee firm which was referable to the new industrial undertaking would certainly partake of the nature of profits and gains derived from the industrial undertaking. Therefore, the assessee was entitled to deduction under section 80J as co-owner-cum-partner after satisfying other conditions envisaged therein".

Apparently any incidental income not directly accruing from the industrial undertaking runs the risk of judicial scrutiny as to its eligibility for tax holiday purposes. In this context, many dimensions have been unfolded in practical situations, which need to be critically examined.

In view of divided judicial thinking, and final verdict from the Apex court being awaited, the lessor assessee deserves tax holiday benefit on the following grounds:

(a) The thrust of tax holiday provisions is on the manufacturing activity with specific number of workers in an industrial undertaking. There seems to be no explicit provision mandating that manufacturing activity should be carried out by owner himself. Basic objective is to promote industrialisation with special emphasis on small-scale industries. Lessee being not eligible for relief, is it justified denying relief in the hands of lessor also? Can a tax holiday provision be denied both in the hands of lessor and lessee, when in real, manufacturing activity was carried out by the undertaking satisfying other conditions. It is critical that the undertaking must carry out manufacturing and not who operates it. Plain wording of the section says so. Would it not amount to defeating the very objective of the legislation?

(b) Any benevolent provisions must be construed liberally and the assessee should not be denied the benefit when he really deserves it. In other words, where lessor assessee maintains control over the assets of the manufacturing facility by employing his technical staff and taking care of repairs and maintenance, he should be allowed the relief as the manufacturing facility being maintained in good working condition is the main source of his income.

(c) Leasing out a manufacturing facility would in no way disturb the status of such facility as an industrial undertaking in the hands of the lessor, when the lessee carries out manufacturing activity. Support can be drawn from the decisions rendered in favour of assessee who worked as job worker producing goods of others. It was held that assessee need not be owner of goods and the manufacturing activity carried out by him was found important. In the same analogy even in the current situation, the lessor assessee should be eligible as

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long as manufacturing activity was carried out by the lessee.

(d) Earning lease rentals by the owner of the undertaking is a process where income is generated in direct nexus with the manufacturing facility. In other words, such lease rental would be received only when the manufacturing facility was maintained in the best working condition-enabling lessee to carry out production. No lessee would pay lease rentals to the lessor keeping the manufacturing facility idle if there is an adverse market condition. Thereby, it is commercially tenable to earn lease rentals only when manufacturing facility was utilised by the lessee producing articles that are in market demand.

(e) It is paramount that the end user of the manufacturing facility should be appreciated to examine whether the objectives of the legislation are being achieved or not. When the objective is to promote manufacturing activity and create employment and if the same is being achieved in a given situation, the lessor should be eligible for claim of tax holiday though, such manufacturing activity is not directly carried out by him. End user of the assets enabled a lessor assessee claim higher rate of depreciation in respect of vehicles leased when lessee used such vehicles on hire – *CIT Vs. Bansal Credits Ltd (2003) 259 ITR 69 (Del).*

(f) Wordings in the provisions of section 80IA & 80IB "any business" in comparison with the earlier provisions like 80J, 80I etc., widens the scope of eligible income for tax holiday. This is on account of wording "any business of an industrial undertaking". Decisions rendered in the context of 80I & 80J may not squarely apply to the situations covered under the provisions of sec.80IA & 80IB. In view of the same, there is a strong case to argue that lease rentals received by the owner of the undertaking would constitute eligible income for tax holiday under section 80IA and 80IB.

In support of this argument Cuttack Bench of ITAT appreciated difference in wording of earlier provisions of section 80J, etc. in comparison with current provisions section 80IA wherein the wording derived from "any business of an industrial undertaking" in place of wording of the old provisions "derived from the industrial undertaking" and observed as under;

"*The word 'business' is a word of wide amplitude so as to cover any trade, industry or any act of adventure in the nature of trade, whereas the word 'industry' is a word of very limited meaning. Whenever the Legislature had intended to give benefit of deductions to the wider extent of income and not only to the income derived from industrial undertaking, it used the expression like 'profit attributed to'. Thus, to give more extended benefit the statute has used the expression 'income derived from business of industrial undertaking'. Thus, the Legislature certainly wanted to give benefit of deduction not only to the income derived from industrial undertaking but to all sort of income which is derived from business of industrial undertaking meaning thereby that all sort of income which is inextricably related to the carrying on of the business of industrial undertaking is to be considered for computing deduction under section 80-IA. Thus, if an act is required to be undertaken essentially for carrying on of the business of industrial undertaking and if any income is generated out of such act, the same is to be considered for computing deduction under section 80-IA". (ACIT Vs. Maxcare Laboratories Ltd. (2005) 92 ITD 11 (Cuttack)*

It is obvious that the intention of the Legislation is to widen the scope of eligible income for tax holiday and any income earned by an undertaking in the course of business shall become eligible for tax holiday.

Conclusion

It is evident that a lessor assessee has a strong case to argue for claim of tax holiday under existing provisions of section 80IA/80IB in view of points made out as above. Undoubtedly, the issue being not free from controversy deserves a relook and reconsideration by the authorities. ■