

## ***Deduction under section 80-IB in subsequent years allowed to an SSI post ‘formative conditions’***

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### ***In brief***

In a recent decision in the case of **Ace Multi Axes Systems Limited**, the Karnataka High Court (HC) has held that the requisite condition of being a small-scale industry (an SSI) need be fulfilled only in the initial year, and not in the subsequent years.

In coming to the above conclusion, the HC observed that the intention of legislature behind granting a deduction under section 80-IB of the Income-tax Act, 1961 (the Act) was to support industrial growth and wealth creation during the initial period of ten years, and thus, merely on account of the creation of wealth and its re-investment into business for further growth (thereby no longer remaining an SSI), the deduction could not be denied.

### ***In detail***

#### ***Facts***

- The taxpayer<sup>1</sup> was engaged in the manufacture and sale of components/ parts of CNC lathes and similar machines. It was an SSI and regularly claimed a deduction under section 80-IB(3) of the Act.
- In Assessment Year (AY) 2005-06, the ninth year of claiming benefit under section 80-IB(3) of the Act, it ceased to be an SSI. The Tax Officer (TO) completed the assessment by allowing the benefit after certain adjustments.
- Subsequently, the Commissioner of Income-tax (CIT), exercising his review powers conferred

under section 263<sup>2</sup> of the Act, directed the TO to disallow the deduction under section 80-IB(3) of the Act since it was no longer an SSI in AY 2005-06.

- The taxpayer preferred an appeal to the Commissioner of Income-tax (Appeals) (CIT(A)), but the appeal was dismissed. Aggrieved by this order of the CIT(A), the taxpayer preferred an appeal to the Income-tax Appellate Tribunal (Tribunal). The Tribunal had upheld the principle

that each assessment year was independent and that the conditions specified under section 80 IB of the Act, including the need for the taxpayer to be an SSI, had to be fulfilled for each year in order to be eligible for benefit under section 80-IB(3) of the Act.

- Aggrieved by this order, the taxpayer preferred an appeal before the HC.

#### ***Issue***

When once the eligible business of an taxpayer is given the benefit of deduction under section 80-IB of the Act on the taxpayer having satisfied the conditions mentioned in sub-section (2) of section 80-IB, could the taxpayer be denied the benefit of the deduction on the ground that, during the said ten consecutive years, it ceased to be an SSI?

<sup>1</sup> Ace Multi Axes Systems Ltd v. DCIT [TS-484-HC-2014(Karnataka)]

<sup>2</sup> Subject to fulfillment of certain conditions, if the CIT considers that any order passed by the Tax Officer is erroneous insofar as it is prejudicial to the interests of the revenue, he may, after giving the taxpayer an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment

### **Taxpayer's contentions**

- As per section 80-IB(2) of the Act, the following conditions needed to be satisfied in order to be eligible to claim deduction:
  - It was not formed by splitting up or reconstruction of a business already in existence.
  - It was not formed by transfer of machinery or plant being previously used.
  - It manufactured or produced any article or thing, other than certain specified articles or things. However, in case of an SSI, it could manufacture or produce even those articles or things.
  - It must have more than 10 employees if the unit was running with the aid of power, and more than 20 employees, in case the unit was running without the aid of power.
- If these conditions were satisfied, then under section 80-IB(3) of the Act, an SSI [(as per section 11B of the Industries (Development & Regulations) Act, 1951 (65 of 1951) – hereinafter referred to as the IDR Act] which had commenced operations between April 1, 1995 and March 31, 2002 was eligible for a deduction of 30% (25% in case of a non-company) of the profits of the unit.
- As the taxpayer's operations had started within the aforesaid period and it had also fulfilled the requirements of section 80-IB(2) of the Act, it was eligible for deduction in the initial year. In a subsequent year, even though it no longer was an SSI as per section 11B of the IDR Act on

account of increase in limit of investment in plant and machinery, such a relief could not be denied as the provisions of section 80-IB did not require the fulfilment of eligibility conditions in the subsequent years.

### **Revenue's contentions**

- Each assessment year was separate and independent; and the revenue authorities had every power to examine and analyse the facts and figures as well as relevant law points of each year to find out whether all the conditions were fulfilled or not.
- In case of an SSI, in addition to the four conditions mentioned in section 80-IB(2) of the Act, there was an additional condition that the unit should be categorized as a SSI as per section 11B of the IDR Act.
- The requirements of manufacturing article or things, minimum number of employees, and categorization an SSI under section 11B of the IDR Act were volatile and unstable on a year-on-year basis. The eligible undertaking had to show in each subsequent year of claim that these three conditions had not been violated.
- In case of the taxpayer, it was an SSI unit in the initial assessment years, but in the AY 2005 06, it was not an SSI and accordingly, deduction sought under section 80-IB(3) of the Act had to be denied.

### **High Court's ruling**

- The HC observed that section 80-IB(3) of the Act mandated that the SSI would be eligible for the said deduction for a period of ten consecutive years, beginning with the initial assessment year.

- Section 80-IB of the Act did not expressly require the manufacturing unit to be in the small scale sector for the entire period of ten years during which the deduction was claimed.
- The probable object behind the legislature for providing a period of 10 years was to allow these industries to stabilize. Therefore, if an SSI, in the course of ten years, stabilizes early, makes further investments in the business, and that results in it's going outside the purview of the definition of an SSI, that should not come in the way of its claiming benefit under section 80 IB of the Act for ten consecutive years, from the initial assessment year.
- Keeping in mind the objective of industrial growth, if two interpretations were possible, the courts had to lean in favour of the taxpayer and extend the benefit of deduction to the taxpayer. Thus, the taxpayer was entitled to deduction under section 80-IB(3) of the Act.

### **The takeaway**

The above ruling emphasises that in interpreting incentive provisions, the objectives behind introduction of these incentive provisions have to be kept in mind.

Until this judgement is reversed, SSI units who have lost SSI status after the first year should find this judgement to be an extremely welcome support.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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