

Supreme Court holds that 100% deduction under section 80-IC cannot be claimed after initial five years, even if substantial expansion takes place within the ten year block

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In brief

In a recent decision,¹ the Supreme Court (SC) held that 100% deduction under section 80-IC of the Income-tax Act, 1961 (Act) cannot be claimed beyond five years, even if a substantial expansion is undertaken after initial period of five years. The deduction shall be restricted at the rate of 25%/30% (as the case may be) for the next five years.

In detail

Facts

- The decision involves the disposal of the Revenue's appeal in a batch of 30 cases, wherein the fact pattern was the same.
- The taxpayer derives income from manufacturing printed embossed book binding covers. The taxpayer started its business activities in financial year (FY) 2005-06, claiming deduction under section 80-IC of the Act from the initial assessment year (AY) 2006-07. As per section 80-IC (3) of the Act, an eligible taxpayer is allowed deduction of 100% for the first five AYs, and at the rate of 25% for the subsequent five AYs.
- The taxpayer claimed deduction at the rate of 100% of eligible profit for the first five AYs. Meanwhile, the taxpayer carried out substantial expansion of the eligible unit, which was completed in FY 2010-11, and based on this it began claiming deduction at the rate of 100% even after completion of the initial five AYs.
- The tax officer (TO) denied the claim of the enhanced deduction for the AYs beyond the first five AYs on the ground that the taxpayer had already claimed deduction under section 80-IC of the Act at the rate of 100% for the first five AYs, i.e., from the date of setting up of the industrial undertaking.
- The Commissioner of Income-tax (Appeals) [CIT(A)], following an Income-tax Appellate Tribunal's (Tribunal)² ruling upheld the TO's order. Aggrieved, the taxpayer appealed before the Tribunal, which dismissed the appeal of the taxpayer relying on the ruling relied by the CIT(A).
- Dissatisfied with the aforesaid order, the taxpayer appealed before

¹ Civil Appeal No(s). 7208 of 2018

² Hycron Electronics v. ITO [2016] 69 taxmann.com 69 (Chandigarh Tribunal)

the High Court (HC) of Himachal Pradesh along with other taxpayers. The HC decided the issue³ in a composite judgment, in favour of all the taxpayers holding the following:

- Substantial expansion could not be confined to one expansion. As long as requirement of “substantial expansion” provided under section 80-IC of the Act was met, there could be number of multiple substantial expansions.
- There could be more than one “Initial AY.” Within the window period as given under the captioned section, an undertaking or an enterprise could be entitled to deduction at the rate of 100% for a period of more than five AYs, and the deduction is maximum available subject to a cap of ten years as per section 80-IC (6) of the Act.

Issue before the Supreme Court

Whether a taxpayer who sets up a new eligible industry and starts availing exemption of 100% of tax under sub-section section 80-IC (which is admissible for first five AYs) can start claiming the exemption at the same rate of 100% beyond the period of first five AYs on the ground that it has now carried out substantial expansion in its manufacturing unit?

Taxpayer’s contentions

The taxpayer contended that deduction at the rate of 100% should have been allowed for the next five AYs also. The taxpayer carried out “substantial expansion” of the “Unit,” and

thus, by treating the said FY to be the “initial AY,” the deduction at the rate of 100%, instead of 25%, should have been allowed under section 80-IC of the Act.

Revenue’s contentions

- The Revenue contended that only those units existing prior to the incorporation of section 80-IC could undertake substantial expansion and any units established subsequent to the said date being termed as “new industrial units” were ineligible for exemption under section 80-IC, although they might have carried out any expansion, substantial or otherwise.
- For the purpose of section 80-IC of the Act, the taxpayer can have only one AY.

Supreme Court’s decision

- The issue before the SC was answered in favour of the Revenue. It held that taxpayers who had availed deductions at the rate of 100% for the first five AYs on the ground that they had set up a manufacturing unit as prescribed under sub-section (2) of 80-IC of the Act, could not start claiming deductions at the rate of 100% again for next five AYs even if they were undertaking “substantial expansions.”
- The SC held that a cumulative reading of the provisions of section 80-IC reveals the following aspects:
 - Deduction under section 80-IC of the Act is allowable from the “Initial AY,” which is defined as the “AY relevant to the previous year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion.”
- The deduction is allowed at the rate of 100% of such profits and gains for the first five AYs, thereafter, deduction is permissible at 25%. The total period of deduction is 10 years, which means 100% deduction for the first five AYs from the initial AY, and 25% for the next five years.
- Such a situation could not exist where a taxpayer was able to secure deduction at 100% for the entire period of 10 years, and if that was allowed it would amount to doing violence to the provisions of sub-section (3) of section 80-IC of the Act.
- A pragmatic and reasonable interpretation of section 80-IC would be to hold that once the “initial AY” commences, and a taxpayer, by virtue of fulfilling the specified conditions, starts enjoying the deduction, there could not be another “initial AY” for the purposes of section 80-IC within the aforesaid period of 10 years on the basis that it had performed substantial expansion in its unit.
- The SC differentiated its own earlier decision⁴ on the ground that the taxpayer in that case had claimed deduction under section 80-IA by fulfilling the conditions mentioned in sub-section (4) of section 80-IA of the Act which were altogether different.

The takeaways

The controversy on the claim of deduction under section 80-IC at the rate of 100% after the initial five AYs on undertaking substantial expansion is now

³ Stovekraft India v. CIT [2017] 88 taxmann.com 225 (Himachal Pradesh)

⁴ Mahabir Industries v. Pr. CIT [2018] 94 taxmann.com 260 (SC)

settled. After availing deduction for a period of five AYs at 100% of such profits and gains from the eligible “units,” the taxpayer would be entitled to deduction

for the remaining five AYs at 25% only (30% for companies), and not at 100%, irrespective of any substantial expansion.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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