Utilisation of Special Economic Zone Re-investment Reserve (hereinafter referred as reserve) created u/s 10AA of the Income Tax Act, 1961 (Act).

Whether reserve created u/s 10AA of the Act can be used for buying the machinery and using it for (i) same undertaking which created reserve or (ii) other tax incentive undertaking or (iii) company as a whole?

1. In order to decide the above, understanding the meaning of following words stated in section 10AA of the Act are important:

➢ "business"

➢ "undertaking"

➢ "unit"

➢ "undertaking, being the unit"

(a) Business is defined in section 2(13) of the Act to include "*any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture*"

Business is any trade, commerce, manufacturing and adventure done.

(b) Undertaking is defined in Explanation 1 to section 2(19AA) of the Act to include "*any part of undertaking, or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting business activity*"

(c) Unit is not defined under the Act; however, SEZ Act defines unit to mean "*unit set up by an entrepreneur in a Special Economic Zone and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or established after commencement of this Act*"

(d) Undertaking, being the unit not defined under the Act. However, it refers to the unit which is eligible for deduction u/s 10AA of the Act.

2. Section 10AA (1)(ii) states that for claiming deduction from 11th to 15th years, reserve shall be created which shall be utilised for "*the purposes of the __business of the assessee__ in the manner laid down in sub-section (2)*"

3. Sub-section (2) states that amounted credited to the reserve is to be used for acquiring machinery or plant. Till the time plant or machinery is not bought, amount credited to reserve is to be used "*for the purposes of the __business of the undertaking__*" Here, it does not say for which unit it can be used, it only says till the time machinery not bought, amount can be used for "*__business of the undertaking__*".

4. Considering the above wording under the law following views are possible:

(a) One view is that reserve created can be used for the business of the assessee (i.e. units in SEZ as well as outside SEZ) as stated in sub-section (1)(ii) of the Act. Here assessee can plea that on perusal of the wording in the Act, the beneficial view to the assessee should prevail. However, this view may be highly litigative as department may not accept such view.

(a) Second view is that the reserve created by one unit in SEZ can be used by any unit in SEZ forming part of undertaking. This view can be taken on harmonious reading of clause (ii) of sub-section (1) and clause (ii) of sub-section (2) [i.e. for the business of assessee and for the business of undertaking]
This view is also supported on reading on sub-section (5), (6) and (7) where the word used is "*undertaking, being unit*". Thus, wherever, the legislature has intention to make difference between "*undertaking*" and "*undertaking, being unit*", such diference is specifically mentioned. This is a mid way approach as compare to first view stated above. However, department litigating this view cannot be ruled out.

(b) Third and most safest view can be that the reserve is to be used by the unit which created it. It is to be noted that SEZ Act does not use the word "*undertaking*", word used there is "*unit*". So department can take a view that the word "*undertaking*" used in Act is same as used in SEZ Act as "*unit*". Thus, the benefit of reserve should be limited to unit only.

Disclaimer: The content of this documents are solely for informational purpose. It does not constitute professional advice or formal recommendation purpose. While due care has been taken in preparing this document, the existence of mistakes and omissions herein is not ruled out.