IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO.388 OF 1997

M/s. International Computers
Indian Manufacture Limited,
Fazalbhoy Building, M.G.Road,
Bombay-400023. ...Applicant.

V/s.

The Commissioner of Income Tax,
Bombay City-II, Bombay. ...Respondent.

Mr.Harinder Toor with Ms.Madhura Kulkarni i/b. Crawford Bayley & Co., for the Applicant.

Ms.Suresh Kumar, for the Respondent.

CORAM: M.S.SANKLECHA, &
G.S. KULKARNI, JJ.

Reserved On : 20th February, 2015.

Pronounced on: 12th March, 2015

ORDER:- (Per G.S.Kulkarni, J.)

1. By this Income Tax Reference under Section 256(1) of the Income Tax Act,1961 (for short "the Act"), the Income Tax Appellate Tribunal (Tribunal) has referred the following questions of law for decision of this Court:-

"(I) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in not granting depreciation on a part of issue of shares capitalised to Plant & Machinery and factory equipment Rs.29,668/- ?

(II) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in not granting depreciation of Rs.1,97,636/- on the cost of issue of shares capitalised to plant and machinery and factory equipment Rs.29,668/- and Rs.9,79,438/- towards capital work-in-progress ?"

2. Facts in brief are :- The Assessment Years in question are 1980-81 and 1981-82 respectively. In the Assessment Year 1980-81, the assessee had issued 6,25,000 equity shares of Rs.10/- each. Accordingly, a sum of Rs.62.50 lakhs was adjusted by issue of shares and the balance application money was refunded to the subscribers. The increase in the share capital was for setting up an unit for the manufacture of computer and OEM peripheral manufacturing project. For the issue of shares, the assessee had incurred expenses of Rs.14,21,276/- under different heads like financial consultancy, managerial fees, legal fees, underwriting commission, advertisement, issue house expenses, printing charges etc. Out of total expenditure of Rs.14,21,276/-, the assessee capitalised a sum of Rs.29,668/- on plant & machinery and factory equipment and Rs.9,79,438/- on the work-in-progress. The balance sum of Rs.4,12,170/- was treated as preliminary expenses and on these expenses had claimed relief under Section 35D of the Act in the following Assessment Year i.e. 1981-82. On

the capitalised amount of Rs.29,668/-, the assessee claimed depreciation of Rs.4,203/- in the said Assessment Year. The applicant justified the claim for depreciation on the ground that these amounts which were capitalised, represented expenditure incurred in raising finance for the acquisition of and/or for brining into existence capital assets and thus formed part of the cost of fixed assets. In support of its claim for depreciation under Section 32 of the Act, the applicant principally relied upon the decision of the Supreme Court in the case of "*Chellapalli Sugars Ltd. Vs. CIT, (98 ITR 167)*". The Assessing Officer in the assessment order dated 1 March 1984 held that the expenditure of Rs.14,21,276/- was in the nature of expenses listed under Section 35D of the Act and thus were required to be treated in accordance with Section 35D of the Act and not in the manner as done by the assessee in claiming depreciation under Section 32 of the Act and disallowed the Assessee's claim for depreciation on the capitalised sum of Rs.29,668/- for an amount of Rs.4,203/-. Similarly, for the Assessment year 1981-82 by an Assessment order dated 25 March 1984, applying the same yardstick the Assessing Officer rejected the claim of the assessee for depreciation on the sum of Rs.9,79,438/-, amounting to Rs.1,97,636/-. Thus for the Assessment Year 1980-81 and Assessment Year 1981-82 the Assessing Officer disallowed the Assessee's claim for depreciation on the capitalised amount of Rs.4,176/- and Rs.1,97,636/- respectively.

3. The assessee approached the Commissioner of Income Tax

(Appeals) (for short 'CIT (A)') against the order dated 1 March 1984 and 25 March 1984 passed by the Assessing Officer disallowing its claim for depreciation for Assessment Years 1980-81 and 1981-82 respectively. CIT(A) by a common order dated 31 January 1985 rejected the ground as raised in this behalf by the assessee while holding that this claim of the assessee seeking depreciation on the basis of judgment of the Supreme Court in the case of "*Chellapalli Sugars Ltd"*(supra) was misconceived as the said decision of the Supreme Court cannot be applied in the facts of the case.

4. The assessee being aggrieved by the decision of the CIT (A) rejecting its claim for depreciation for both the Assessment Years approached the Tribunal. The Tribunal by common order dated 4 April 1991 passed on the two appeals of the assessee for the Assessment Year 1980-81 and Assessment Year 1981-82 upheld the order passed by CIT(A). The Tribunal observed thus:-

> *"7. The third ground of appeal is that the CIT(A) erred in not allowing depreciation on the expenditure incurred on the issue of shares which was capitalised. The assessee had incurred total expenditure of Rs.14,21,276/- on issue of shares out of which Rs.29,668/- were capitalised to plant and machinery and factory equipment, an amount of Rs.4,12,170/- related to preliminary expenses and the balance amount was for work-in-progress. The assessee claimed that this amount was incurred on raising finance by issue of shares for purchase of fixed assets and for working capital requirements. In support of the same, the assessee filed details of expenditure and copy of the advertisement. The assessee in this connection relied upon the decision of the Supreme Court in the case of Challapalli Sugars Ltd. Vs. CIT and decision of Madras High Court in the case of CIT Vs. Lucas V.S.lmt. (No.1) (110 ITR 338). The CIT(A) hold that the decision in the case of Challapalli Sugars Ltd. (supra) must be stretched in the manner so as to claim depreciation incurred on issue share capital. The departmental representative relied upon the orders of the CIT(A).*

8. We have heard the rival submissions. There is no doubt that the Supreme Court held in the case of Challapalli Sugar Ltd. Vs. CIT (88 ITR 167) that the initial expenditure incurred including interest could be capitalised to the extent it was incurred prior to the commencement of the production. The Supreme Court held that since the actual cost was not defined, it should be construed in a sense which no commercial man would misunderstand and it would be necessary to ascertain the connection of the expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The CIT(A) had made reference to the Bombay High Court decision in the case of CIT Vs. Greater Eastern Shipping Co.Ltd. (118 ITR 774) wherein, it has held that all expenditure incurred directly or indirectly or intimately on the capital assets acquired by the assessee may be allowed to be included in the actual cost. Similarly in the case of CIT Vs. Polychem Ltd. (98 ITR 575) Bombay High Court held that printing and stationery expenses had no connection with the acquisition and installation of machinery and could not be allowed. In this connection reference may also be made to provisions of Section 35D which provides for amortisation of certain preliminary expenses which includes expenditure in connection with the issue, for public subscription, of shares in debentures. Thus there is independent provision for amortisation expenses in connection with share issue expenses. Under the circumstances, we agree with the CIT (A) that assessing officer was right in disallowing the depreciatic on the amount capitalised. Hence, this ground of appeal is dismissed."

5. The assessee, thereafter, approached the Tribunal for a reference to be made to this Court under Section 256(1) of the Act which the Tribunal has referred the above questions for our decision.

6. We have heard the learned Counsel for the assessee and the learned Counsel for the Revenue. We have perused the orders passed by the Assessing Officer, CIT (A) and the Tribunal.

7. The short issue which arises for our consideration is, as to whether

the depreciation on a part of the expenditure on the issue of shares which was capitalised by the assessee can be said to be rightly disallowed by the Assessing Officer as upheld by the Tribunal. In the facts of the case the question would be required to be decided taking into consideration the provisions of Section 32 and 35D of the Act as applied by the Revenue. Section 32 provides for depreciation in respect of plant and machinery or furniture owned by the assessee and used for the purpose of business or profession. In the present case, the assessee is claiming depreciation on the capitalised expenditure on issue of shares which ex facie cannot fall within the purview of Section 32. Section 35D of the Act provides for amortisation of certain preliminary expenses incurred by the assessee being an Indian company incurred after 31st day of March,1970 in respect of expenditure specified in sub-section (2) before the commencement of the business or after the commencement of the business, in connection with the extension of an industrial undertaking or in connection with his setting up a new industrial unit. It would be useful to extract Section 35D of the Act which reads thus :-

> "**Amortisation of certain preliminary expenses**
>
> **35D.** (1) Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31st day of March,1970, any expenditure specified in sub-section (2), -
>
> (i) before the commencement of his business; or
>
> (ii) after the commencement of his business, in connection with the extension of his industrial undertaking or in connection with his setting up a new industrial unit,
>
> the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten

successive previous years beginning with the previous year in which the business commences or, as the case may be the previous year in which the extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

(2) The expenditure referred to in sub-section (1) shall be the expenditure specified in any one or more of the following clauses, namely-

(a) expenditure in connection with -

(i) preparation of feasibility report;

(ii) preparation of project report;

(iii) conducting market survey or any other survey necessary for the business of the assessee;

(iv) engineering services relating to the business of the assessee;\

Provided that the work in connection with preparation of the feasibility report or the project report or the conducting of market survey or of any other survey or the engineering services referred to in this clause is carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board;

(b) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;

(c) where the assessee is a company, also expenditure-

(i) by way of legal charges for drafting the Memorandum and Articles of the company;

(ii) on printing of the Memorandum and Articles of Association;

(iii) by way of fees for registering the company under the provisions of the Companies Act,1956 (1 of 1956);

(iv) in connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charge for drafting, typing, printing and advertisement of the prospectus;

(d) such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of this Act) as may be prescribed."

(emphasis supplied)

9. A plain reading of the above provision indicates that the Legislature has thought it appropriate to give a special benefit to the assessee

after 31 March 1970 in respect of preliminary expenditure incurred by the assessee which may be a company or a person (other than a company), in respect of expenditure specified in sub-section (2) incurred before commencement of business or after the commencement of business, in connection with the extension of industrial undertaking or in connection with setting up a new industrial unit. Sub-section (2) of Section 35D of the Act sets out the categories of expenditures relevant for the purpose of Section 35D. The relevant clause for the present reference is sub-clause (c) of sub-section (2) which concerns the expenditure by a company in connection with the issue, for public subscription, of shares or debentures, underwriting commission, brokerage and charge for drafting, typing, printing and advertisement of the prospectus. This provision, therefore, allows amortisation of the specific category of expenditures incurred by the assessee, by way of deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years as provided therein. The legislature, therefore, having specifically provided for amortisation of the preliminary expenditure which includes expenditure incurred for issuance of shares by the assessee in connection with the issue of shares, the Assessing Officer had rejected the claim of the assessee for depreciation on the capitalised expenditure on issue of shares for the Assessment Years in question. It was held by the Tribunal that the claim of the assessee for depreciation on such expenditure being capitalised could not be allowed taking into consideration the provisions of Section 32 of the Act and taking into consideration the specific

provision for amortisation as provided by the Legislature under Section 35D.

10. As regards the contention of the Assessee as to the application of the decision of the Supreme Court in the case of "*Chellapalli Sugars Ltd. Vs. CIT*" (supra), the Assessing Officer, the CIT(A) and the Tribunal have correctly held that the same was not applicable in the facts of the present case. In this decision the Supreme Court was not dealing with an issue in regard to expenditure incurred by the Assessee in issuing shares. As also provisions of Section 35D of the Act was not on the Statute book. In the case before the Supreme Court, interest was paid before the commencement of production on amounts borrowed by the assessee for acquisition and installation of plant and machinery. As the expression "actual cost" was not defined in the Statute, the Supreme Court held that it should be construed in the sense the term would be understood in common commercial parlance in accordance with the normal rules of accountancy prevailing in commerce and industry. It was observed that accepted rule of accountancy for determining cost on fixed assets was to include all expenditure necessary to bring such assets into existence and put them in working condition. It was held that in case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets created as a result of such expenditure. In the case before the Supreme Court, the issue was

payment of interest, before commencement of production, on the amount borrowed by the assessee for acquisition and installation of plant and machinery. In the present case, the assessee having issued shares and incurred expenses on issuance of shares which were sought to be capitalised by the assessee cannot be said to be expenditure incurred for installation of plant and machinery so as to apply the ratio of the decision in "*Chellapalli Sugars Ltd.*" (supra) to the facts of the present case. Moreover, as regards the category of expenditure capitalised by the assessee, the provisions of Section 35D(2)(c)(iii) of the Act were held to be attracted. We do not find that the reasoning as adopted by the Tribunal in not applying the ratio in "*Chellapalli Sugars Ltd.*" case, is in any manner inappropriate.

11. To bolster the submission that the Revenue had appropriately applied Section 35D(2)(c)(iii) of the Act in the facts of the case, learned Counsel for the Revenue has drawn our attention to the decision of the Division Bench of this Court in the case of "*Commissioner of Income Tax Vs. Mahindra Ugine and Steel Co.Ltd., (250 ITR 84)*". In this case the Division Bench was concerned about the stamp duty paid on debentures issued whether was allowable as the item of deduction under Section 35D of the Act. In deciding the issue that such expenditure fell under Section 35D(2)(c) of the Act, the Division Bench has observed thus:-

> " ***Two points arise for consideration in this appeal.***
> Firstly, whether the Tribunal was right in holding that the stamp duty paid on debenture issue was an allowable item of

> deduction under section 35D of the Income-tax Act, 1961. Section 35D deals with amortisation of certain preliminary expenses. Under section 35D(1) where an assessee, being an Indian company, incurs, after March 31, 1970, expenditure specified in Sub-section (2) of Section 35D before the commencement of his business, or after the commencement of his business, in connection with the extension of his industrial undertaking, the assessee shall be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the industrial undertaking is completed. Section 35D(2) enlists the expenditure in respect of which deduction can be claimed by the assessee. Section 35D(2)(c) stipulates that where the assessee is a company and it incurs expenditure in connection with the issue, for public subscription of debentures of the company, such expenditure shall be an item of deduction contemplated by Section 35D(1). It is contended on behalf of the Department that payment of stamp duty on the debenture issue is not an item of allowable deduction. The Tribunal has rejected the contention. We agree with the decision of the Tribunal. The expression in connection with the issue of public subscription of the debentures of the company essentially for the expansion of the business is a very wide expression and it would certainly include the stamp duty payable by the assessee on the debenture issue. Section 35D would apply only in respect of expenditure which is otherwise not allowable under the law, for example, capital expenditure. Therefore, in this case, the judgment of the Supreme Court in the case of India Cements Ltd. v. CIT , applies in respect of expenditure on account of stamp duty even after introduction of Section 35D. Under the circumstances, the Tribunal was right in allowing the said deduction."

We are in complete agreement with the view taken by the Division Bench in the above case. Applying the same parameters as held by the Division Bench, the expenditure as incurred by the assessee in the present case can very well be said to fall within the provisions of Section 35D of the Act.

12. In the decision of Rajasthan High Court in the case of "*Autolite India Ltd. Vs. Commissioner of Income Tax, (264 ITR 117)*" following the

decision of the Division Bench of this Court in "*Commissioner of Income Tax Vs. Mahindra Ugine and Steel Co.Ltd.*" (supra), the Rajasthan High Court held that the claim of the assessee in respect of expenditure incurred on the public issue to raise capital for expansion of his business would fall under sub-clause (iv) of Section 35D(2)(c) of the Act and the assessee would be entitled for the benefit of the provisions of Section 35D of the Act.

13. A similar view was taken by the Madras High Court in the case "*Commissioner of Income Tax vs. Ashok Leyland Ltd., (349 ITR 663)*" and by the Madhya Pradesh High Court in the case "*Shree Synthetics Ltd. Vs. Commissioner of Income Tax and Anr., (303 ITR 451)*".

14. We now deal with the last limb of the applicant's submissions namely that in deciding this reference we may decide broader issues than those referred to us by the Tribunal. While making this submission, learned Counsel for the applicant does not dispute that the question as framed has to be decided in favour of the revenue. Learned Counsel for the applicant relies on the decision of the Division Bench of this Court in the case "*Indoswe Engineers (P.) Ltd. Vs. State of Maharashtra, (101 STC 177(Bombay))*" to contend that in exercising the reference jurisdiction under Section 256(1) of the Income Tax Act, this Court should not limit itself to the questions which are referred by the Tribunal or the aspect which came to be decided by the Tribunal, but may consider diverse

aspects which would otherwise fall under the provision in question. In dealing with this proposition, a Division Bench of this Court held that the legal position in this regard was no more res integra inasmuch as once a broad question has been referred, the High Court is not required to limit itself only to a particular aspect on which decision was rendered by the Tribunal. It was held that there is no limitation that reference should be limited to those aspects of questions which were argued before the Tribunal or decided by the Tribunal and that all aspect may be argued and considered where question involves more than one aspect. A reference was made by the Division Bench to the decision of the Supreme Court in the case of "*Commissioner of Income Tax Vs. Scindia Steam Navigation Co.Ltd. (42 ITR 589)*" and another decision of the Supreme Court in the case of "Salem Co-operative Central Bank Ltd. *Vs. Commissioner of Income Tax, (201 ITR 697)*" in which the Supreme Court held that it cannot be said that High Court is bound by the terms of the question referred and cannot correct the erroneous assumption of law underlying the question. In this case it is not contended that there is an error of law in framing the question. We, however, find that the issue as arising in the present reference is not of that broad nature which would call for consideration diverse aspects falling under the provisions. The question referred by the Tribunal in the present reference is limited and specifies to the aspect of the decision of the Tribunal in not allowing depreciation on the part of the expenditure incurred on the issue of shares which was capitalised arising out of the controversy before the Tribunal. In view of this limited

controversy, we do not feel that there is any need for us to consider any broader issues which do not specifically fall for our consideration. The questions which are referred to us are specific in nature and cannot be artificially broadened so as to apply the case law relied upon by the applicant. We, therefore, reject this submission as made on behalf of the applicant.

15. In the light of our above discussion, we answer the question nos.1 and 2 in the affirmative and in favour of the Revenue and against the assessee. The reference stands disposed of accordingly.

(G.S.KULKARNI,J.) **(M.S.SANKLECHA,J.)**