

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 11.01.2016

CORAM:

THE HONOURABLE **MR.JUSTICE M.JAICHANDREN**
AND
THE HONOURABLE **MRS.JUSTICE S.VIMALA**

T.C.A.No.389 of 2007

Tube Investments of India Ltd.,
'TIAM House', 28 Rajaji Salai,
Chennai – 600 001

... Appellant

vs.

The Joint Commissioner of Income Tax,
Special Range – I, Chennai – 600 034

... Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, as against the order of the Income Tax Appellate Tribunal, Chennai Bench 'B', dated 21.07.2006, in I.T.A.No.703/Mds/2001.

For Appellant : Mr. V.S.Manoj &
Mr. K.Vaitheeswaran
For Respondent : Mr. T.Ravikumar

J U D G M E N T

(Judgment of the Court was delivered by S.Vimala, J.,)

This Tax Case Appeal has been filed by the Assesee, as against the order of the Income Tax Appellate Tribunal, Chennai 'B'

Bench, dated 21.07.2006, made in I.T.A.No.703/Mds/2001.

Brief facts:-

2. M/s. Tube Investments of India Limited, the appellant herein, is a Public Limited Company, engaged in the manufacture and sale of cycles, cycle accessories, steel tubes and strips etc. The company filed its return of income for the Assessment Year 1997-1998, relevant to the year ended on 31.03.1997, admitting the total income of Rs.3,58,47,750/- under normal method of computation. The return of income was processed under Section 143 (1) (a) of the Income Tax Act (hereinafter referred to as "the Act"). Accepting the return of income, a refund of Rs.1,14,10,224/- was granted to the assessee.

2.1. The case was selected for scrutiny, by issuance of a notice, under Section 143 (2) of the Act, on 28.04.1998. The assessment came to be made under Section 143 (3) of the Act and by the order, dated 27.03.2000, the total income was determined at Rs.8,98,52,050/-.

2.2. Deductions were claimed by the assessee invoking Sections 35D, 36, 37 (4) and 80 HHC of the Act and they were disallowed by the Assessing Officer. As against the order passed, the Assessee filed an appeal before the Commissioner of Income Tax (Appeals) and the Commissioner, by the order, dated 28.02.2001, partly allowed the appeal. Challenging the same, the Assessee filed the Appeal before the Income Tax Appellate Tribunal and the Tribunal, in I.T.A.No.703/Mds/2001, allowed the appeal partly, by the order, dated 27.07.2006.

2.3. As against the order passed by the Income Tax Appellate Tribunal, Chennai 'B' Bench, in I.T.A.No.703/Mds/2001, this appeal has been filed before this Court by the assessee, raising the following substantial questions of law:

(i) Is not the order of the Tribunal vitiated on the soul ground that the evidences relating to factual matter have not been considered before drawing adverse inferences against the appellant?

(ii) Has not the Tribunal erred in confirming the disallowance under Section 37(4) when in fact the expenditure is allowable under Section 37(1) and in respect of assets in transit house, was not the Tribunal wrong in not granting depreciation?

(iii) Has not the Tribunal committed an error both in fact and in law in disregarding the appellant's claim of Rs.50 lakhs?

(iv) Has not the Tribunal failed to consider the alternative plea of the appellant in so far as the bad debt is considered?

(v) Has not the Tribunal erred in not appreciating the facts relating to the claim under Section 35D and confirming the disallowance as made by the Assessing Officer?

(vi) Has not the Tribunal erred in giving direction for the claim under Section 80HHC?

3. The Assessee has raised issues against the disallowance of deductions claimed under Sections 35D, 36, 37(4), and 80HHC of the Act.

Deduction disallowed as claimed under Section 35D of the Act:

4. The appellant had made a claim under Section 35D, for a sum of Rs.26,56,979/-, being 1/10th of the allowable expenditure, for each of the Assessment Years, being the amount spent on new project. It is the grievance of the appellant that the Income Tax Appellate Tribunal did not allow the deduction claimed and that it

ought not to have upheld the decision of the Assessing Officer, disallowing the deduction.

4.1. The appellant, during the assessment year 1995-1996, went for a Global Depository Receipts (GDR) issue for raising capital to fund new projects/extension of their existing facilities and incurred an amount of Rs.5,67,51,709/- as expenses relating to GDR and raised Rs.1,51,64,73,884/- out of the issue. The appellant claimed amortization of GDR expenses as per Section 35D of the Act only to the extent of Rs.36967908/- (restricted to 2.5% of capital expenditure-project cost) against the actual GDR expenses of Rs.5,67,51,709/-.

5. Section 35D of the Act provides for amortization of certain preliminary expenses, which reads as under:

"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 undertaking or in connection with his setting up a new 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 undertaking is completed or the new unit commences production or operation :

[**Provided** that where an assessee incurs after the 31st day of March, 1998, any expenditure specified in sub-section (2), the provisions of this sub-section shall have effect as if for the words "an amount equal to one-tenth of such expenditure for each of the ten successive previous years", the words "an amount equal to one-fifth of such expenditure for each of the five successive previous years" had been substituted.]

(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 the 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 Association 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 charges 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.

(3) Where the aggregate amount of the expenditure referred to in sub-section (2) exceeds an amount calculated at two and one-half per cent—

(a) of the cost of the project, or

(b) where the assessee is an Indian company, at the option of the company, of the capital employed in the business of the company,

the excess shall be ignored for the purpose of computing the deduction allowable under sub-section (1) :

[**Provided** that where the aggregate amount of expenditure referred to in sub-section (2) is incurred after the 31st day of March, 1998, the provisions of this sub-section shall have effect as if for the words “two and one-half per cent”, the words “five per cent” had been substituted.]

Explanation.—In this sub-section—

(a) “cost of the project” means—

(i) in a case referred to in clause (i) of sub-section (1), the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) in a case referred to in clause (ii) of sub-section (1), the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee;

(b) "capital employed in the business of the company" means—

(i) in a case referred to in clause (i) of sub-section (1), the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(ii) in a case referred to in clause (ii) of sub-section (1), the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of

the undertaking or the setting up of the new unit of the company;

(c) “long-term borrowings” means—

(i) any moneys borrowed by the company from Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution [which is eligible for deduction under clause (viii) of sub-section (1) of [section 36](#)] or any banking institution (not being a financial institution referred to above), or

(ii) any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of capital plant and machinery, where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

(4) Where the assessee is a person other than a company or a co-operative society, no deduction shall be admissible under sub-section (1) unless the accounts of the assessee for the year or years in which the expenditure specified in sub-section (2) is incurred have been audited by an accountant as defined in the *Explanation* below sub-section (2) of [section 288](#), and the assessee furnishes, along with his return of income for the first year in which the deduction under this section is claimed, the report of such audit in the prescribed form duly signed and verified by such

accountant and setting forth such particulars as may be prescribed.

(5) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is transferred, before the expiry of the period of ten years specified in sub-section (1), to another Indian company in a scheme of amalgamation,—

(i) no deduction shall be admissible under sub-section (1) in the case of the amalgamating company for the previous year in which the amalgamation takes place; and

(ii) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place.

¹[(5A) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is transferred, before the expiry of the period specified in sub-section (1), to another company in a scheme of demerger,—

(i) no deduction shall be admissible under sub-section (1) in the case of the demerged company for the previous year in which the demerger takes place; and

(ii) the provisions of this section shall, as far as may be, apply to the resulting company, as they would have applied to the demerged company, if the demerger had not taken place.]

(6) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure specified in sub-section (2), the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of this Act for the same or any other assessment year.]

6. Section 35D has been inserted by the Taxation Laws (Amendment) Act, 1970, with effect from April 1, 1971, i.e. for and from assessment year 1971-72. The provisions are new in the sense that there were no corresponding provisions in the 1922 Act. Even under the 1922 Act, the pre-incorporation expenses of a company were held allowable. This section goes to benefit the eligible persons by allowing amortisation, over a ten-year period, of certain preliminary expenses.

6.1. Section 35D enables amortization of specified preliminary expenses, which are otherwise not admissible deductions. Expenditure on issue of shares for public subscription is one such expenditure. Section 35D of the Act applies in two circumstances; (i) pre-business expenses, i.e. expenses incurred before the commencement of business and (ii) expenses incurred in connection with the extension of industrial undertaking or in connection with

setting up a new industrial unit by an establishment which is already in business.

7. The Income Tax Appellate Tribunal, while answering the issue regarding the disallowance of deduction claimed under Section 35D of the Act, has supported the decision of the Assessing Officer. Therefore, it is appropriate to quote the findings of the Assessing Officer, which reads as under:

“It is the contention of the assessee that when the assessee goes on incurring expenses on successive units over a period of years, it will be eligible for a deduction under Section 35D. However, the section does not provide for such a contingency. Moreover, it is but natural for any industrial unit to go for extension. But that does not imply whatever funds obtained by a GDR or Euro Issue has to be assumed to have been used for the capital expansion over a period of so many years. In fact in the assessment year 1996-97, the assessee has claimed by a strange fund flow statement of sources and application of funds that most of the GDR receipts have been utilised for working capital requirements and denied the fact that the funds were utilised for capital purposes.

If the claim of the assessee is accepted, the allowance of deduction under Section 35D will be

available for more than ten successive years which is not permissible. Accordingly the claim of the assessee, under Section 35D will be allowed to the extent of Rs.1039812 only and the balance of Rs.2656979 will be disallowed.”

8. The learned counsel for the assessee submitted that when the claim was allowed for one year, i.e. during 1995-96, there is no reason to refuse the deduction for the consecutive year. This contention would be legally correct, provided, the deduction had been claimed for the consecutive year in respect of the same unit.

9. From the discussions, it is evident that the assessee had claimed deduction in respect of successive units over a period of time; one unit during 1995-96, another unit during 1996-97 and yet another unit during 1997-98. There is also a finding that there is no proof to show that Euro Issue had been used for the capital expansion over a period of so many years. On these findings, the assessing officer has chosen to grant deduction only in respect of one unit, namely, for the unit established in 1995-96 to the extent of Rs.10,39,812/- and disallowed the deduction in respect of other units. Therefore, we find no reason to differ the findings of the

Tribunal.

Deduction disallowed as claimed under Section 36 of the Act:-

10. The assessee had advanced a sum of Rs.100 lakhs to M/s.Sccals Ltd., out of its business surplus on 24.11.1995 on interest, at the rate of 25%, for a period of 120 days. As the cheque issued by the debtor M/s.Sccals Ltd. got dishonoured, the assessee had filed a suit for recovery of money. Interest accrued on the principal of Rs.1 crore was waived from 01.04.1996. 50% of the principal amount was also agreed to be waived on payment of balance of 50% of the advance. Hence, on receipt of Rs.50 lakhs, part of the balance, i.e. Rs.50 lakhs, was written off in the books. This amount of Rs.50 lakhs was claimed as an admissible expenditure, under Section 36(2) of the Act, by way of bad debt. This deduction was disallowed. It is the claim of the assessee that this deduction claimed ought not to have been disallowed.

11. "Bad debts" is a commercial name for trade debts and it cannot include loans made to one's own employee or moneys overdrawn by an employee on commission account, which are entirely private matters independent of the business. The expression 'bad debts' also includes doubtful debts.

12. Clause (vii) [Section 10(2)(xi) of 1992 Act] deals with bad debts, in which, conditions for disallowance has been stipulated:

"This clause grants an allowance in respect of bad debts of a business, profession or vocation and in respect of irrecoverable loans in the case of banking or money-lending business. A bad debt presupposes the existence of a debt [as reported in CIT v. JK Chemicals 207 ITR 985: CIT v. Howrah 236 ITR 156, 164], and in cases in which there never was any debt owing to the assessee, no question can arise of invoking this clause [as reported in National Petroleum v. CIT 13 ITR 336].

13. Four conditions which govern the grant of an allowance under this clause have been enlightened in the decision reported in ***Sarangpur v. CIT [143 ITR 166, 171]***.

(i) The debt or loan should be in respect of a business which is carried on by the assessee in the relevant accounting year.

(ii) The debt should have been taken into account in computing the income of the assessee of the accounting year, or of an earlier accounting year or should represent money lent in the ordinary course of his business of banking or money-lending.

(iii) The amount of the debt or loan, or part thereof, which is claimed as a deduction, should have become bad.

(iv) The amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for a deduction is made for the first time.

14. The contention of the learned counsel for the assessee is that as part of the debt had to be written off, the same should have been allowed as revenue expenditure, and that the Assessing Officer has chosen to treat the same as capital loss, which is not correct in law.

15. A perusal of the order passed by the Income Tax Appellate Tribunal would go to show that rightly, the Tribunal has relied upon the Judgment of this Court in ***CIT vs. Micromax Systems (P) Ltd.***, reported in **(2005) 277 ITR 409** and chosen to confirm the disallowance. In the reported decision, it has been held as under:

“In the present case, it can be seen that the assessee did not write off the debt in question as irrecoverable in his accounts for the previous year. Hence, on the plain language of Section 6(1)(vii) of the Act, the debt cannot be allowed as a “bad debt”. It may be that the assessee committed an inadvertent mistake, but, we cannot go by notions of equity in tax matters. Making a provision is not the same thing as writing off a debt as irrecoverable.”

16. Relying upon the decision reported in ***CIT vs. Abudullabhai Abdul Kadar, [(1961) 41 ITR 545 SC]***, the Assessing Officer held that as the debt due was not an incident to the business, it cannot be termed as a debt and no deduction can be made on account of bad debt and that it should be construed as a capital loss. It would be appropriate to quote the relevant portion of

the said Judgment and the same reads as under:

“Under clause (xi) also a debt is only allowable when it is a debt and arises out of and as an incident to the trade. Except in money-lending trade debts can only be so described, if they are due from customers for goods supplied or loans to constituents or transactions of a similar kind. In every case the test is, was the debt due as an incident to the business; if it is not of that character it will be a capital loss.”

17. The claim for deduction on account of bad debt did not satisfy the eligibility criteria as enunciated in the decision reported in ***Sarangpur v. CIT [143 ITR 166, 171]***. Applying the correct legal position, the Assessing Officer has given a finding that the alleged debt was not part of assessee's stock in trade and that as it has not been incurred while purchasing or selling the goods, in which the company was dealing with, and therefore, the expenditure involved cannot be treated as a debt and therefore, it is not an admissible deduction. Therefore, there is no reason to interfere with the findings of the Tribunal.

Deduction disallowed as claimed under Section 37(4) of the**Act:**

18. The assessee claimed deduction in respect of expenditure on maintenance of guest house, rent paid on guest house and depreciation on assets in the guest house building. The Assessing Officer disallowed the deduction. This finding was confirmed by the Income Tax Appellate Tribunal, relying upon the decision of the Supreme Court reported in ***Britania Industries Ltd. vs. CIT [(2005) 278 ITR 546]***, in which, it was held that depreciation rent repairs under Sections 30 and 32 of the Act and maintenance expenses are not allowable in respect of guest house. The relevant observation reads as under:

“The only question which we are called upon to consider in the instant case is whether the expression 'premises and buildings' referred to in [Sections 30 and 32](#) and used for the purposes of the business or profession would include within its scope and ambit the expression 'residential accommodation including any accommodation in the nature of guest house' used in Sub-sections (3), (4) and (5) of [Section 37](#) of the Act. While the two expressions can be similarly interpreted, a distinction has been sought to be introduced for the purposes of [Section 37](#) by specifying the nature of

building to be a guest house. In our view, the intention of the Legislature appears to be clear and unambiguous and was intended to exclude the expenses towards rents, repairs and also maintenance of premises/accommodation used for the purposes of a guest house of the nature indicated in Sub-section (4) of [Section 37](#). When the language of a statute is clear and unambiguous, the courts are to interpret the same in its literal sense and not to give it a meaning which would cause violence to the provisions of the statute. If the Legislature had intended that deduction would be allowable in respect of all types of buildings/accommodations used for the purposes of business or profession, then it would not have felt the need to amend the provisions of [Section 37](#) so as to make a definite distinction with regard to buildings used as guest houses as defined in Sub-section (5) of [Section 37](#) and the provisions of [Sections 31](#) and [32](#) would have been sufficient for the said purpose. The decisions cited by Dr. Pal contemplate situations where specific provision had been made in [Sections 30 to 36](#) of the Act and it was felt that what had been specifically provided therein could not be excluded under [Section 37](#). The clarification introduced by way of Sub-section (5) to [Section 37](#) was also not considered in the said case.”

As the findings are based on the dictum laid down by the Supreme Court, we find no other grounds to interfere with the findings of the Income Tax Appellate Tribunal.

Deduction disallowed as claimed under Section 80HHC:

19. The last issue to be decided is with reference to deduction claimed under Section 80HHC.

20. The deduction was claimed in respect of the following items:

(a) exim grant; (b) duty draw back; (c) special import licence premium; (d) other income; (e) interest income; (f) insurance claim; (g) consideration for power purchase agreements.

21. While considering the order of the assessing authority, the Tribunal felt that, a) with regard to interest income, insurance claim and other income, there is no discussion about the nature of this income; b) whether these are operational income arising out of manufacturing activity on account of which the assessee is doing business or not; and c) with regard to other head of claim also, there is no discussion.

22. This omission by Assessing Officer as well as Commissioner of Income Tax (Appeals) has been specifically pointed out by the Tribunal and the Tribunal has remitted the issue back to the file of the Assessing Officer, with a direction to find out the nature of the income, and if the income is found to be operational income, then, 90% is to be excluded while computing deduction under Clause (baa) to Explanation to Section 80HHC and this 90% will be excluded out of the gross receipts while computing the export profit for the purpose of deduction under this provision. Therefore, the order of the Tribunal in remanding this issue for consideration on issues pointed out does not suffer from any infirmity and therefore, there is no ground to interfere with the same.

23. The findings rendered by the Income Tax Appellate Tribunal are based on materials and reasons and there are no grounds to disagree with the findings.

24. In the result, the appeal is dismissed.

(M.J.J.) (S.V.J.)
11.01.2016

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M.JAICHANDREN, J.
and
S.VIMALA, J.

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To
1. The Income Tax Appellate Tribunal,
'B' Bench, Chennai.

T.C.A.No.389 of 2007

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