

M/S. SHASUN CHEMICALS AND DRUGS LTD.

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v.

COMMISSIONER OF INCOME TAX-II, CHENNAI

(Civil Appeal No. 9611 of 2016)

SEPTEMBER 16, 2016

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[A.K. SIKRI AND N.V. RAMANA, JJ.]

Tax :

Income Tax Act, 1961 – ss.35D, 36, 40A(9), 43B – Amortization of expenditure – Deduction of payment of bonus from business income – Assessee issued public shares in order to raise funds to meet the capital expenditure for expansion of its existing units of production and for research and development – Assessee claimed amortization of expenditure incurred towards share issue expense u/s.35D of the Act – Furthermore, assessee claimed deduction u/s. 36 of the Act, regarding bonus paid to its employees – Claim disallowed by High Court – On appeal, held: Amortization of expenditure u/s.35D, is allowed for period of 10 years @ 1/10th of each – On facts, benefit was allowed for first two assessment years by assessing officer and therefore, it could not have been denied in subsequent block period – Payment of bonus is allowable deduction u/s.36(1)(ii) and s.40A(9) has no application to it – s.43B(b) is also not applicable as this provision does not mention about bonus – Therefore, assessee entitled to benefit u/s.35D and s.36.

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Allowing the appeals, the Court

HELD:

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Whether expenditure incurred on issue of shares is eligible to be amortized under section 35D of the Act ? :

1. The Assessing Officer had allowed the claim of the assessee in this behalf for the Assessment Years 1994-95 and 1996-97. Such expenses which are incurred and amortization whereof is sought u/s. 35D of the Act, it is allowed for a period of 10 years @ 1/10th each. The claim of the assessee for the year 1995-96 was found to be justified and allowable under the provisions of the Act and on that basis 1/10th share issue expenses

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A was allowed u/s. 35D of the Act. When it was again claimed for the Assessment Year 1996-97, though it was disallowed and on directions of the Appellate Authority, the Assessing Officer made physical verification of the factory premises. On satisfaction, expenses were allowed for the Assessment Year 1996-97 as well. Once, this position is accepted and the clock had started running in favour of the assessee, it had to complete the entire period of 10 years and benefit granted in first two years could not have been denied in the subsequent years as the block period was 10 years starting from the Assessment Year 1995-96 to Assessment Year 2004-05. The High Court, however, disallowed the same following the judgment of this Court in the case of *Brook Bond India Ltd.* However, in spite of the argument raised to the effect that the aforesaid judgment was rendered when s. 35D was not on the statute book and this provision had altered the legal position, the High Court still chose to follow the said judgment. It is here where the High Court went wrong as the instant case is to be decided keeping in view the provisions of s.35D of the Act. Thus, the assessee was entitled to the benefit of s.35D for the Assessments Years in question. [Paras 12, 13][78-G-H; 79-A-B, E-F; 80-A-D]

E Whether deduction on account of payment of bonus to the employees of the assessee is not eligible under section 36 of the Act, as it is hit by section 40A(9) of the Act? :

F 2.1 Since, payment was made by assessee to its employees from the Trust, the Assessing Officer took the view that as the payment is not made by the assessee to the employees directly in cash, it is not allowable in view of the provisions of s.40A(9) of the Act. Though this view was not accepted by the CIT(A) as well as ITAT, the High Court has found justification in the stand taken by the Assessing Officer. The High Court has gone wrong in relying upon the provisions of s.40A(9) of the Act. [Para 14][80-G-H; 81-A]

H 2.2 Section 40A(9) deals with deductions in respect of the amount paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company etc. The condition is that such sum has to be paid for the purpose and to the extent provided by or under clause (iv) or clause (iva)

or clause (v) of Sub-s.(1) of s. 36. However, in the instant case, concern is with the payment of bonus which is allowable as deduction under clause (ii) of sub-s.(1) of s.36. Therefore, s.40A(9) has no application. Insofar as the provisions of s.43B are concerned, they are also not applicable inasmuch as clause (b) of s. 43B refers to the sum payable by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees. Thus, this provision also does not mention about bonus. The provisions of s.36 enumerate various kinds of expenses which are allowable as deduction while computing the business income u/s. 28 of the Act. The amount paid by way of bonus is one such expenditure which is allowable under clause (ii) of sub-s. (1) of s.36. There is no dispute that this amount was paid by the assessee to its employees within the stipulated time. Embargo specified u/ss. 43B or 40A(9) of the Act does not come in the way of the assessee. Therefore, the High Court was wrong in disallowing this expenditure as deduction while computing the business income of the assessee and the decision of the ITAT was correct. [Para 17][82-C-H; 83-A-B]

Brook Bond India Ltd. v. Commissioner of Income Tax W.B(III) (1997) 10 SCC 362 : 1997 (2) SCR 524 – referred to.

Case Law Reference

1997 (2) SCR 524 referred to Para 6

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 9611 of 2016.

From the Judgment and Order dated 25.04.2011 of the High Court of Judicature at Madras in Tax Case (Appeals) No. 48 of 2008

WITH

C. A. No. 9612 of 2016.

J. Balachander, V. Ramasubramanian, A. Lakshminarayanan, Advs. for the Appellant.

K. Radhakrishna, Sr. Adv., Rupesh Kumar, Inder Vir Singh, Mrs. Anil Katiyar, Advs. for the Respondents.

The Judgment of the Court was delivered by

A **A. K. SIKRI, J.** 1. Leave granted.

2. Matter heard finally.

B 3. Two issues are raised in these appeals by the appellant/assessee, which is a public limited company engaged in the business of manufacture and sale of bulk drugs and intermediates. The first issue is regarding the amortization of expenditure under Section 35D of the Income Tax Act, 1961 (hereinafter referred to as the 'Act'). The second issue pertains to the deduction for payment of bonus by the assessee to its employees. The Assessment Years in question are 1999-2000 and 2001-02. The brief facts which are relevant for deciding the aforesaid issues are as under:

C 4. The assessee went in for public issue of shares in order to raise funds to meet the capital expenditure and other expenditure relating to expansion of its existing units of production both at Pondicherry and Cuddalore and for expansion of its Research and Development Activity.

D The assessee issued to public 15,10,000 equity shares of Rs.10/- each for cash at a premium of Rs.30/- per share aggregating to Rs. 6,04,00,000/-.

E 5. The aforesaid issue was opened for public subscription during the financial year ending 31.03.1995 relevant to the Assessment Year 1995-96. The assessee has, in the prospectus issued, clearly stated under the column projects that the production capacity of its existing products, more particularly Ibuprofen and Ranitidine, is as follows:

“The Company is undertaking the following expansion projects:

F (1) Ibuprofen: The installed capacity of the ibuprofen plant at Pondicherry is proposed to be increased from the present level 840 tpa to 1200 tpa. The increase in capacity would be primarily due to improvements in the process developed inhouse, resulting in a significant reduction in the batch processing time. The additional plant and machinery required to support the increase in capacity would include additional raw material storage facilities, chilling plant and laboratory facilities aggregating to Rs.95 lakhs.

G (2) Ranitidine Expansion: The installed capacity of the Ranitidine plant at Cuddalore is proposed to be increased

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from 60 tpa to 180 tpa in two phases. In the first phase, the capacity is proposed to be increased to 120 tpa by installation of additional plant and machinery. The cost of this phase, including construction of a modern administration block at Cuddalore, is estimated at Rs.286 lakhs.” A

6. The assessee incurred a sum of Rs.45,51,890/- towards the aforesaid share issue expenses and claimed 1/10th of the aforesaid share issue expenses each year under Section 35D of the Act from the Assessment Years 1995-96 to 2004-05. The Assessing Officer on the same set of facts allowed the claim of the assessee (1/10th of the share issue expenses under Section 35D of the Act) for the initial Assessment Year being the Assessment Year 1995-96 after examining the materials produced. However, the Assessing Officer disallowed the expenses for the Assessment Year 1996-97 on the ground that the share issue expenses are not eligible for deduction in view of the decision of this Court in the case of Brook Bond India Ltd. vs. Commissioner of Income Tax W.B(III) (1997) 10 SCC 362 = 225 ITR 798 SC, stating that the expenditure incurred is capital in nature and hence not allowable for computing the business profits. B C D

7. Aggrieved against the aforesaid disallowance made by the Assessing Officer for the Assessment Year 1996-97, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), [hereinafter referred to as CIT(A)] who vide his order directed the Assessing Officer to verify physically the factory premises of the assessee and find out, whether there were any additions to the plant and machinery at the factory and whether there were any additions to the buildings at the factory whereby any expansion has been made to the existing industrial undertaking to justify the claim made by the assessee. E F

8. In furtherance to the aforesaid direction, the Assessing Officer after making due physical verification of the factory premises and on being satisfied with the expansion of the facilities to the industrial undertaking duly allowed the claim of share issue expenses. While doing so, the Assessing Officer, for the Assessment Year 1996-97, passed a detailed and elaborate order after scrutinizing all the materials made available to him and recorded a positive finding of fact that there was an expansion to the existing units of the industrial undertaking and after being satisfied of the same duly allowed the claim of share issue expenses under Section 35D of the Act. G H

A It is relevant to point out at this stage that the Department has not taken on appeal the issue of allowance of share issue expenditure further for the Assessment Year 1996-97 and, hence, finality has been reached with respect to the issue of expansions of the existing industrial undertaking and, consequently, the eligibility of the share issue expenditure in terms of Section 35D of the Act.

B 9. Thereafter the Assessing Officer has taken a different stand for the Assessment Years 1997-98 to 2004-05 with respect to the claim of share issue expenditure under Section 35D of the Act and has disallowed the said expenditure on the basis that the expenditure is capital in nature relying on *Brook Bond India Ltd. case* (supra)

C 10. In the aforesaid backdrop, the assessee again claimed amortization of expenditure under Section 35D of the Act for the Assessment Year 2001-02 which was disallowed for the same reason. However, the assessee's appeal before the CIT (A) succeeded as CIT(A) allowed that expenditure. The order of CIT(A) was affirmed by the Income Tax Appellate Tribunal (hereinafter referred to as 'ITAT') as well. However, the High Court has reversed the order of the ITAT thereby reinstating the view taken by the Assessing Officer and disallowed the amortization of the expenditure under Section 35D of the Act.

E 11. Insofar as claim of bonus is concerned, in the return filed by the assessee for the Assessment Year 2001-02 it was mentioned by the assessee that it had paid bonus to its employees to the tune of Rs.96,08,002/- in the said Financial Year and, therefore, it claimed deduction under Section 35(2AB) of the Act. However, invoking the provisions of Section 40A(9) of the Act the said expenditure is disallowed on the ground that it was not paid in cash to the concerned employees. Herein again CIT(A) allowed the expenditure and the same view was taken by the ITAT but the High Court has reversed the view of ITAT on this ground also. It is in the aforesaid backdrop that two questions were formulated in the judgment of the High Court which need to be addressed and answered by us.

G 12. Question No. 1: Whether expenditure incurred on issue of shares is eligible to be amortized under Section 35D of the Act?

H As already noted above, the Assessing Officer had allowed the claim of the assessee in this behalf for the Assessment Years 1994-95

and 1996-97. Such expenses which are incurred and amortization whereof is sought under Section 35D of the Act, it is allowed for a period of 10 years @ 1/10th each. This is so provided by Section 35D of the Act as it is clear from the reading of the said Section which is reproduced hereunder: A

“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),— B

(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 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:” C D E

13. In the Income Tax Return which was filed for the Assessment Year 1995-96 the assessee had claimed that it had incurred a sum of Rs.45,51,890/- towards the share issue expenses and had claimed 1/10th of the aforesaid share issue expenses under Section 35D of the Act from the Assessment Years 1995-96 to 2004-05. This claim of the assessee was found to be justified and allowable under the aforesaid provisions and on that basis 1/10th share issue expenses was allowed under Section 35D of the Act. When it was again claimed for the Assessment Year 1996-97, though it was disallowed and on directions of the Appellate Authority, the Assessing Officer made physical verification of the factory premises. He was satisfied that there was expansion of the facilities to the industrial undertaking of the assessee. It is on this satisfaction that for the Assessment Year 1996-97 also the expenses were allowed. Once, this position is accepted and the clock had started running in favour of the assessee, it had to complete the entire period of 10 years and benefit granted in first two years could not have been F G

A denied in the subsequent years as the block period was 10 years starting
from the Assessment Year 1995-96 to Assessment Year 2004-05. The
High Court, however, disallowed the same following the judgment of
this Court in the case of *Brook Bond India Ltd* (supra). In the said case
it was held that the expenditure incurred on public issue for the purpose
B of expansion of the company is a capital expenditure. However, in spite
of the argument raised to the effect that the aforesaid judgment was
rendered when Section 35D was not on the statute book and this provision
had altered the legal position, the High Court still chose to follow the said
judgment. It is here where the High Court went wrong as the instant
case is to be decided keeping in view the provisions of Section 35D of
C the Act. In any case, it warrants repetition that in the instant case under
the very same provisions benefit is allowed for the first two Assessment
Years and, therefore, it could not have been denied in the subsequent
block period. We, thus, answer question No. 1 in favour of the assessee
holding that the assessee was entitled to the benefit of Section 35D for
D the Assessments Years in question.

14. Question No. 2: Whether deduction on account of payment
of bonus to the employees of the assessee is not eligible under Section
36 of the Act, as it is hit by Section 40A(9) of the Act?

E As a fact it needs to be noted that in the Assessment Years in
question the workers of the assessee had raised a dispute of quantum of
bonus which had led to the labour unrest as well. Because of this the
workers had finally refused to accept the bonus offered to them. Faced
with this situation, the assessee had made the payment to the Trust to
comply with the requirement of Section 43B of the Act, as the said
provision makes it clear that deduction in respect of bonus would be
F allowed only if actual payment is made. Pertinently, the dispute could be
settled with the workers well in time and for that reason payment of
bonus was made to the workers on the very next day of deposit of the
said amount in the Trust by the assessee. This happened before the
expiry of due date by which such payment is supposed to be made in
G order to claim deduction under Section 36 of the Act. However, since
the payment was made from the Trust, the Assessing Officer took the
view that as the payment is not made by the assessee to the employees
directly in cash, it is not allowable in view of the provisions of Section
40A(9) of the Act. As pointed out above, though this view was not
accepted by the CIT(A) as well as ITAT, the High Court has found
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justification in the stand taken by the Assessing Officer. Here also we feel that the High Court has gone wrong in relying upon the provisions of Section 40A(9) of the Act. A

15. It is not in dispute that as per Section 36(1)(ii) of the Act expenditure incurred on account of payment in the form of bonus to the employees is allowable as business expenditure. This provision reads as under: B

“36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-

(i) C

(ii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission.” D

16. Section 43B, however, mandates that certain deductions would be allowed only on actual payment. This provisions, which is relevant for our purpose reads as under:

“43B. Certain deductions to be only on actual payment 4
Notwithstanding anything contained in any other provision of this Act, a deduction other- wise allowable under this Act in respect of- E

(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or] F

(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or] F

(c) any sum referred to in clause (ii) of sub- section (1) of section 36,] or] G

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment H

A corporation], in accordance with the terms and conditions of the agreement governing such loan or borrowing,] shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him.”

17. Section 40A(9) also needs to be noted at this stage, which is reproduced herein below:

C “40A(9). No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 (21 of 1860), or other institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or under clause (iv)[or clause (iva)] or clause (v) of sub-section (1) of section 36, or as required by or under any other law for the time being in force.”

E This Section deals with deductions in respect of the amount paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company etc. The condition is that such sum has to be paid for the purpose and to the extent provided by or under clause (iv) or clause (iva) or clause (v) of Sub-section(1) of Section 36. However, we are here concerned with the payment of bonus which is not covered by any of the aforesaid clauses of sub-section (1) of Section 36 but is allowable as deduction under clause (ii) of sub-section (1) of Section 36. Therefore, Section 40A(9) has no application. Insofar as the provisions of Section 43B are concerned, they are also not applicable inasmuch as clause (b) of Section 43B refers to the sum payable by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees. Thus, this provision also does not mention about bonus. With this we come to the provisions of Section 36 which enumerate various kinds of expenses which are allowable as deduction while computing the business income under Section 28 of the Act. The amount paid by way of bonus is one such expenditure which is allowable under clause (ii) of

sub-section (1) of Section 36. There is no dispute that this amount was paid by the assessee to its employees within the stipulated time. Embargo specified under Section 43B or 40A(9) of the Act does not come in the way of the assessee. Therefore, the High Court was wrong in disallowing this expenditure as deduction while computing the business income of the assessee and the decision of the ITAT was correct. A

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18. On both counts the order of the High Court is set aside and the appeals are allowed.

No costs.

Ankit Gyan

Appeals allowed.