Exp. incurred on renovation of leased premise to be treated as capital expenditure

Summary – The Mumbai ITAT in a recent case of Alpha Plus Technologies (P.) Ltd., (the Assessee) held that where assessee acquired leased premises in a semi-finished state which could not be used for its purposes, i.e., development of software, expenditure incurred by assessee for first time for installing work stations, electric cables, proper flooring, furniture and fixture, computers, etc. in said premises to achieve its functional utility would be regarded as part of set-up cost and as capital expenditure

Facts

- The assessee-company was engaged in the business of development of software products and providing regulatory content services for BFSI sector. It set up its business in a leased premises, by transferring its furniture and fixture from its erstwhile premises and incurred expenditure towards installation of work stations, furniture and fixture, flooring, electric wiring, false ceiling, painting, etc.
- As the lease, which did not have any renewal clause, was for a period of 24 months, beginning from 18-12-2010, assessee had debited the proportionate expenditure in its operating statement for the year.
- The Assessing Officer held that the expenses were capital in nature and only depreciation under section 32 would be allowed thereon.
- The Commissioner (Appeals) confirmed the order of the Assessing Officer.
- On second appeal:

Held

- The premises had been acquired in a semi- finished state; it requiring further work being performed thereon to make it fit for use. Surely, an occupier would do so in the manner he deems fit and proper. This explains the expenditure on flooring, electric wiring, work stations, etc. A premises in a raw or semi-finished state could not be used by the assessee for its purposes, *i.e.*, the development of software, requiring, besides skilled human resource and intangible assets, all the necessary physical infrastructure. It is not the case of the premises being used by the assessee earlier, making changes only to enable a better user, wherein again it shall have to be seen, if any asset or advantage of an enduring nature enures as a result of the said expenditure. Total renovation is, after all, only capital expenditure. How could, for example, the assessee work without work stations, electric cables, proper flooring, etc., which is required as much as (say) furniture and fixture, computers, etc. Why, even expenditure on plastering and painting, normally regarded as maintenance expenditure, where for the first time, would have to be regarded as a part of the set-up cost - the premises being made ready only for its intended user. The same, together with the furniture and fixture and plant and machinery (comprising computer systems, etc.) forms part of the capital structure or the profit-making apparatus - each with a distinct purpose/function, required for operating in the manner deemed fit and proper. It is neither necessary nor required to isolate the expenditure incurred in relation to building, housing the work operations, for a separate treatment, merely because the same is not owned. The character of expenditure, after all, depends on its nature, *i.e.*, whether for maintenance or sustenance of an asset or advantage, already acquired or obtained, or towards acquiring or obtaining the same.

- True, the building is not owned by the assessee, who has only a right of occupancy in its respect, but then that is precisely what Explanation 1 to section 32(1), incorporated in the statute book with effect from 1-4-1988, seeks to explain and clarify, making ownership not necessary, so that capital expenditure would nonetheless be regarded as subject to depreciation despite being in or in relation to a building not owned by the assessee. In other words, Explanation 1 to section 32(1) is an enabling provision, extending the allowance of depreciation on a capital asset not owned by the assessee by carving an exception for a building for which it holds a right of occupancy. This would also meet the argument of the assessee, made relying on the decision in the case of *CIT* v. *Dr. A. M. Singhvi* [2008] 302 ITR 26/168 Taxman 136 (Raj.), of the redundancy of such expenditure on the expiry of the lease inasmuch as electric fittings, flooring, ceiling, panelling, etc. get - in whole or in part, attached to the building and are not removable. Implicit in the argument is a tacit admission of the life of these assets, forming part of the building, exceeding in terms of the period of user the term of the lease arrangement. That consideration, appealing at first blush, inasmuch as the expenditure is rendered unproductive or of no use after the time period of the lease, is misleading. The same in fact is applicable to any capital expenditure for that matter. It is incurred on an assessment of the cost-benefit analysis, formal or non-formal, with benefits likely to arise over future. Future is always uncertain, so that it could be that the assets or the rights acquired by incurring the expenditure remain no longer beneficial in view of the changed circumstances, *viz.*, market conditions, technological obsolescence, etc. A machinery for example, is bought to produce an item X. Soon after, another product Y, technically superior and/or cost/price efficient, hits the market, displacing X there from, even as the firm had by then exhausted only a fraction of the productive capacity of the machinery. The machinery is, as a result, rendered otiose, and is to be discarded. While this represents one scenario, it may be rendered largely redundant or operative at a much lower capacity utilization level, et. el. The discarded machinery though remains on the books of the assessee, also forming part of its block of assets and, accordingly, depreciation would continue to be exigible thereon (section 43(6)(c)). Prior to the introduction of the concept of block of assets, terminal depreciation was allowed under such circumstances. Any monies realized on the sale of such machinery, no longer viable and discarded, or its' scrapping, gets reduced from its written down value (WDV) of the relevant block of assets. All such fittings/materials as are embedded in the building, which cannot be used at a different place and, therefore, is to be discarded (*viz.*, work stations), shall, in the facts and circumstances, continue to be subject to depreciation. Surely, it is not for the revenue to comment or assess as to why such expenditure, unsustainable in terms of the productive time with reference to the lease period, assuming so, was incurred in the first place. That is the business decision of the assessee as a businessman. Why, he may be confident of recouping the cost and, in fact, generating profit, over the lease term, or of bargaining an extension at the end of the term, etc. The fact of the matter is that if any asset forming part of block of assets gets discarded, depreciation thereon on its unabsorbed cost continues to be available till the same gets totally charged or realized by way of sale/scrap, etc. In other words, the circumstances adversely impacting the realization of the benefit/advantage envisaged from the capital expenditure, even if unrealized - in whole or in part, would not render it as of revenue nature, and the law provides for a complete absorption of such expenditure, i.e., as that which does not suffer from such an impact.

- The next limb of the assessee's argument is that it is not a lease but a leave and license arrangement. It does not matter whether what the assessee holds *qua* its work premises is a lease hold right, or is a leave and license arrangement. This is in view of Explanation 1 to section 32(1), which is broadly worded, and clearly states of a lease or other right of occupancy. Lease is a transfer under the Transfer of Property Act, while a leave and license arrangement is definitely not. But, surely, the leave and license arrangement gives the assessee a right of occupancy, so that the precise nature - in the technical sense, of the said right, is of little moment.
- Then again, it is open to be argued and, in any case, a consideration, that the lease or the right of occupancy is only for 24 months. *Explanation* 1 (*supra*) does not provide any stipulation with regard thereto, *i.e.*, the said period, and which in the admitted facts of the case subsists for 20 months after the end of the relevant year, *i.e.*, going by the current arrangement. The assessee may well be able to secure its renewal. The same, in any case, *i.e.*, irrespective of extension, is not to be confused with the nature of the expenditure incurred - capital or revenue. In other words, the fallacy in the argument lies in determining the nature of the expenditure based on or with reference to the period of the right of occupancy. The two are independent of each other. In the instant case, it has already been indicated that the entire expenditure is in the nature of a set-up cost of the business. Even assuming, for which there is nothing on record to suggest so, that the business was already set up at the previous location, dislocation is disruptive of its business and would accordingly be required to be set up again. To the extent this entails additional expenditure, the same only implies a higher capital expenditure inasmuch as the capital work or assets discarded (at the old location) cannot be put to use again. Such discarded assets shall, however, continue to be subject to depreciation under law.
- In view of the foregoing, the assessee's claim cannot be acceded to and the treatment accorded by the revenue is to be upheld.