

## Preliminary exp. on right issue would qualify for benefit of sec. 35D

**Summary – The High Court of Kerala in a recent case of Nitta Gelatine India Ltd., (the Assessee) held that Preliminary expenses incurred by assessee-company in connection with issue of right shares qualify for benefit of section 35D(2)(c)(iv)**

### Facts

- The assessee was a public limited company. In terms of the provisions contained in section 81 of the Companies Act, in July 1998, the assessee announced a rights issue of shares and accordingly shares were offered to its existing share holders. Many of them accepted the shares offered and the shares which were not accepted by the existing shareholders were subscribed by the promoters of the company themselves.
- In terms of the provisions contained in section 35D(2)(c)(iv), the assessee claimed amortization of the preliminary expenses incurred for the rights issue.
- The revenue authorities rejected assessee's claim on ground that subscription of shares issued by the company was confined to its existing shareholders only and not to general public.
- The Tribunal confirmed order passed by the authorities below.
- On appeal:

### Held

- From a reading of provision of section 35D(2)(c)(iv), it can be seen that where the assessee is an Indian company, the expenditure incurred by it in connection with the issue of its shares for public subscription, being underwriting commission, brokerage and charges of drafting, typing, printing and advertisement of prospectus, qualify for amortization as provided in the section. Companies incorporated in India are permitted to issue shares to its existing shareholders and such issue of shares is governed by section 81 of the Companies Act. This section provides that such shares shall be offered to the persons who, at the date of the offer, are holders of equity shares of the company, in proportion to the capital paid up on those shares at that date. It is also provided that after the expiry of the time specified for accepting the offer thus made by the company, if the offer is declined, the Board of Directors may dispose of the shares in such a manner as they think most beneficial to the company.
- In compliance with section 81 of the Companies Act, the assessee-company offered shares to its existing shareholders. Many shareholders accepted the offer and such of those shares which were declined to be accepted, were subscribed by the promoters of the company themselves. It is because of the fact that the subscription of the shares thus issued by the company was confined to

its existing shareholders, the authorities have declined the benefit of amortization, stating that the subscribers of the shares were only a section of the public and not the public itself.

- The interpretation adopted cannot be sustained. The term 'public' is not defined in the Act. In such a situation and when the term is to be understood in the context of a rights issue under section 81 of the Companies Act, to understand the scope of the term 'public' employed in section 35D(2)(c)(iv), it is permissible to refer to the relevant provision of the Companies Act.
- A reading of provision of section 67(1) of the Companies Act shows that any reference in the Companies Act or in the articles of a company offering shares to the public shall, subject to the provisions of the Companies Act, be construed as including a reference to offering the shares to any section of the public also. In other words, insofar as the Companies Act is concerned, the section of the public holding shares in a company would be treated as public, for the purposes mentioned in section 67. It is also clear from section 67, that the purposes of the section would include rights issue of shares under section 81 of the Companies Act also.
- Therefore, when the scope and purport of section 35D(2)(c)(iv) is examined, the Court is entitled to refer to the provisions of section 67 of the Companies Act and if so done, the inevitable conclusion is that the term for 'public subscription' employed in section 35D(2)(c)(iv) would include subscription by a section of the public, *i.e.*, the existing shareholders in a company as well. Any interpretation to the contrary would lead to a situation where the benefit of amortization would be available to public issue of shares and the same benefit would be denied when shares are issued by Companies on rights basis.
- Sum and substance of the above discussions is that the findings of the Assessing Officer confirmed by the First Appellate Authority and the Tribunal is unsustainable.
- In the result, assessee's appeal is allowed.