

Expenses being in nature of revenue exp. to be allowed despite different treatment in books of account

Summary – The Mumbai ITAT in a recent case of Olive Bar & Kitchen (P.) Ltd., (the Assessee) held that where assessee had setup three new business units and claimed pre-operative expenses incurred by way of salaries and wages, PF and ESI contribution, travelling expenses, and like other general administrative expenses, since assessee had commenced its business activity in relevant previous year and impugned expenditure were revenue in nature and were incurred wholly and exclusively for expansion of existing business of assessee, same was to be allowed

Where assessee had made suo moto disallowance of expenses under section 14A read with rule 8D, however, Assessing Officer made further disallowance holding that assessee had only disallowed direct expenses under rule 8D(2)(i) and expenses under provision of section 8D(2)(iii) were not considered, since details of expenses filed by assessee showed that suo-moto disallowance included expenses coming under purview of rule 8D(2)(iii) as well, impugned further disallowance was unjustified

RoC fees paid for increase in authorised capital for issuance of bonus shares was revenue expenditure allowable under section 37(1)

Facts

- The assessee was engaged in the business of running restaurants and related activities. During year, the assessee had expanded its existing business by opening three more restaurants at different places and treated pre-operative expenses incurred under the head, 'pre-operative expenses' like salaries and wages, travelling expenses, restaurant rent, repairs and maintenance and like other general administrative expenses which were incurred wholly and exclusively in connection with business under the head 'capital work-in-progress' in its books of account. But, when it came to computation of total income, the expenses in the nature of revenue were treated as revenue expenditure and claimed as such. Further, it had also made certain *suo moto* disallowance under section 14A. The assessee had also claimed RoC charges paid for increase in authorised share capital of the company.
- The Assessing Officer disallowed the pre-operative expenses capitalised in books of account, but claimed as revenue expenditure in computation of total income under section 37(1). He also made addition towards disallowance of expenditure incurred in relation to exempt income under section 14A read with rule 8D. Similarly, he had disallowed RoC charges paid for increase in authorised share capital of the company.
- On appeal, the Commissioner (Appeals) held that although pre-operative expenses were capitalised in books under the head 'work-in-progress', but facts remained that the said expenditure claimed in statement of total income as revenue expenditure under section 37(1), were purely revenue expenditure, which are incurred wholly and exclusively in connection with expansion of the existing

restaurant business. The management, the control and the funds utilised were common. Therefore, the same could not be treated as pre-operative expenses, which came under the provisions of section 35D so as to amortise over a period of years. Insofar as disallowance of expenditure incurred in relation to exempt income, the Commissioner (Appeals) held that the Assessing Officer had rightly disallowed expenses by applying rule 8D(2)(iii) at the rate of 0.5 per cent of the average value of investment as the assessee made *suo moto* disallowance in respect of direct expenses under rule 8D(2)(i), but failed to disallow other administrative expenses under rule 8D(2)(iii). Insofar as disallowance of RoC fees paid for increase in authorised capital, the Commissioner (Appeals) observed that the assessee had paid fees for increase in authorised capital and the same was deducted from securities premium account instead of routing through profit and loss account. Thus, the total amount of reserves used up were included in issue of bonus shares, therefore, there was no merit in the contention of the assessee that when bonus shares were issued, expenditure incurred for increase in authorised capital was revenue in nature. Thus, same could not be allowed.

- On cross appeal:

Held

- The first issue that came up for consideration from the assessee as well as the revenue appeal is disallowance of preoperative expenses treated as capital in books of account, but claimed as revenue in statement of total income under section 37(1).
- During the year under consideration the assessee had expended its existing business by opening three more restaurants at different places. The assessee has treated expenditure incurred in connection with the establishment of restaurants under the head 'capital work-in-progress' in its books of account. But, when it comes to computation of total income, the expenses in the nature of revenue are treated as revenue expenditure and claimed as such. The Assessing Officer disallowed pre-operative expenses on the ground that a particular expense cannot have two treatments, *i.e.*, one in the books of account and the other in computation of total income. According to the Assessing Officer, pre-operative expenses can be deducted as per the provisions of section 35D(1)(ii) to the extent as indicated therein. It is the contention of the assessee that it is in the business of running restaurants and it has commenced its business during the year under consideration. Though, the commercial operations has not been taken place in respect of three new restaurants, the commencement of its business activities is not in doubt. The assessee further contended that all expenditure incurred in connection with setting up of new units which are in the nature of capital expenditure has been debited to capital work-in-progress. Even revenue expenditure incurred in connection with a particular unit has been treated as capital work in progress in its books of account. But, when it comes to computation of total income revenue expenditure has been claimed as deduction under section 37(1), because the assessee has commenced business activities.
- There is no dispute with regard to the nature of expenditure claimed by the assessee as revenue expenses in its statement of total income. The assessee has incurred various revenue expenditures like salaries and wages, PF and ESI contribution, travelling expenses, repairs and maintenance, staff room expenses and like other general administrative expenses. It is also not in dispute that the

assessee had not commenced commercial operations of the particular new units established during the year under consideration. Therefore, once particular expenditure is revenue in nature, for the purpose of determination of income, what is relevant is - Whether a particular expenditure has been incurred wholly and exclusively in connection with business and such expenditure has been incurred for the business in the relevant period or not. It is not relevant as to how the assessee shows a particular income or expenditure in the books of account. Separate computation of income and expenditure would be justified only when several distinct business are carried on and not when the separate business activities were carried out by same person and one set of account is maintained for all set of activities. In this case, it is not in dispute that the assessee has maintained one set of books of account for its business activity even though it has separate units in different places. Further, it is also not in doubt that pre-operative expenses claimed in statement of total income are in the nature of revenue expenses. Therefore, when the assessee has commenced its business activity in the relevant previous year and also incurs certain expenses which are revenue in nature, there is no reason for the Assessing Officer to treat said expenditure as capital expenditure merely for the reason that the assessee has given different treatment for such expenditure in its books of account and statement of total income.

- The Assessing Officer was erred in disallowing deduction claimed towards pre-operative expenses in statement of total income under section 37(1) even though the said expenditure has been treated as capital expenditure in books of account. The Commissioner (Appeals), after considering relevant facts has rightly deleted addition made by the Assessing Officer. Therefore, there is no error in the findings of the Commissioner (Appeals) and hence, the findings of the Commissioner (Appeals) is upheld and appeal filed by the revenue is dismissed.
- The next issue that came up for consideration from assessee's appeal is disallowance of expenses incurred in relation to exempt income under section 14A read with rule 8D(2). The Assessing Officer had disallowed expenditure incurred in relation to exempt income by invoking rule 8D(2)(iii) at the rate of 0.5 per cent of average value of investments. According to the Assessing Officer, though the assessee has disallowed direct expenses under rule 8D(2)(i), but expenses coming under the provisions of rule 8D(2)(iii) has not been considered; therefore, he opined that disallowance is necessary under rule 8D(2)(iii) at the rate of 0.5 per cent of average value of investments. It is the contention of the assessee that it has already *suo moto* disallowed expenses incurred in relation to exempt income like 50 per cent salary of DK, conveyance and other expenses. However, further disallowance by invoking rule 8D(2)(iii) amounts to double disallowance which is incorrect.
- Although the Assessing Officer has accepted the fact that the assessee has made *suo moto* disallowance without verifying whether disallowance made by the assessee are direct expenses or other expenses which falls under the provisions of rule 8D(2)(iii), made further disallowance by applying 0.5 per cent of average value of investments. The assessee has filed details of expenses disallowed as per which, the expenses disallowed by the assessee are coming under the purview of rule 8D(2)(iii). Therefore, further disallowance of expenses by applying rule 8D(2)(iii) at the rate of

0.5 per cent amounts to double disallowance which is not permissible in law. Therefore, the Assessing Officer is directed to delete addition made under section 14A read with rule 8D(2)(iii).

- The next issue that came up for consideration is disallowance of RoC charges paid for increase in authorised capital. The Assessing Officer has disallowed a sum on the ground that fees paid for increase in authorised capital is capital in nature which cannot be allowed as deduction under section 37(1). The Assessing Officer has taken support from the decision of Supreme Court in the case of *Brooke Bond India Ltd. v. CIT* [\[1997\] 91 Taxman 26/225 ITR 798](#), wherein it was clearly held that amount paid for increase in authorised share capital is in the nature of capital expenditure which cannot be allowed as deduction under section 37(1). It is the contention of the assessee that although the Supreme Court has considered it as capital in *Brooke Bond India Ltd. (supra)*, but the Apex Court in its subsequent judgment in the case of *CIT v. General Insurance Corpn.* [\[2006\] 156 Taxman 96/286 ITR 232](#) considered the issue and held that when RoC fees is paid for increase in authorised capital for issuance of bonus shares, the said expenditure constitute revenue expenditure.
- The Assessing Officer has disallowed fees paid for increase in authorised capital by following the ratio laid down by Supreme Court in the case of *Brooke Bond India Ltd. (supra)* where it was categorically held that RoC fees paid for increase in capital is capital expenditure in nature. But, the Supreme Court, in its subsequent judgment in the case of *General Insurance Corpn. Ltd. (supra)* has considered similar issue and after considering the ratio of its earlier decision in *Brooke Bond India Ltd. (supra)* had given a categorical finding that if expenditure is incurred in connection with the issuance of bonus shares, then the said expenditure constitute revenue expenditure. The assessee has filed necessary details to prove that it has paid RoC fees paid for increase in authorised capital for issuance of bonus shares. But, one is not aware whether the said particulars are part of assessment proceedings before the Assessing Officer or not. Therefore, the issue needs to be re-examined by the Assessing Officer in the light of the decision of Supreme Court in the case of *General Insurance Corporation Ltd. (supra)*. Hence, the issue is set aside to the file of the Assessing Officer who is directed to consider the issue on the basis of working furnished by the assessee.