



## Amortisation of certain preliminary expenses cannot be claimed on the basis of share premium since it is not capital employed in the business of the company - Supreme Court

### Background

Recently, the Supreme Court in the case of *Berger Paints India Ltd.*<sup>1</sup> (the taxpayer) held that the 'share premium amount' collected by the company on its subscribed issued share capital is not the part of 'capital employed in the business of the company' for the purpose of Section 35D of the Income-tax Act, 1961 (the Act). Therefore, the amortisation of certain preliminary expenses under Section 35D of the Act, cannot be claimed on the basis of the amount received towards share premium.

### Facts of the case

- The taxpayer, a limited company, is engaged in the business of manufacture and sale of various kinds of paints. For the Assessment Year 1996-97, the taxpayer filed its income-tax return, which was processed by the Assessing Officer (the AO) under Section 143(1B) of the Act.
- Subsequently, a notice was issued by the AO to the taxpayer under Section 143(2) of the Act, which called upon the taxpayer to explain as to on what basis the taxpayer had claimed in the return a deduction under the head 'preliminary expenses' being 2.5 per cent of the 'capital employed in the business of the company' under Section 35D of the Act.
- In response to the notice, the taxpayer contended that it had issued shares on premium, which was a part of the capital employed in their business, and on this basis, it was entitled to claim a deduction under Section 35D of the Act.

- The AO was of the view that the expression 'capital employed in the business of the company' did not include the 'premium amount' received by the taxpayer on share capital, therefore, disallowed the deduction calculated on the same.
- The Division Bench of the High Court, in this case, observed that the capital employed in the business of the company is the aggregate of three distinct components, namely, share capital, debentures and long-term borrowings. The premium collected by the company on the issue of shares was neither a long-term borrowing nor akin to a debenture. Explanation to Section 35D(3) of the Act does not include the reserve and surplus of the company as a part of the capital employed in the business of the company. Thus, the premium on the issue of its share capital would not constitute a part of the 'capital employed in the business of the company' for purposes of deduction under Section 35D.

### Supreme Court's decision

- The Supreme Court observed that it is in agreement with the view taken by the High Court in the taxpayer's case, and that it correctly explains the meaning of the expression 'employed' in sub-section (3)(b) of Section 35D read with Explanation (b).
- The 'premium amount' collected by the company on its subscribed issued share capital is not, and cannot be said to be the part of 'capital employed in the business of the company' for the purpose of Section 35D(3)(b) of the Act. Therefore, the taxpayer is not entitled to claim any deduction in relation to the amount received towards premium from its various shareholders on the issued shares of the company.

<sup>1</sup> *Berger Paints India Ltd. v. CIT* [2017] 79 taxmann.com 450 (SC)

- If the intention of the Legislature was to treat the amount of 'premium' collected by the company from its shareholders while issuing the shares to be the part of 'capital employed in the business of the company', then it would have specifically said so in the Explanation (b) of sub-section (3) of Section 35D of the Act. Further, non-mentioning of the words does indicate the legislative intent that the Legislature did not intend to extend the benefit of Section 35D to such sum.
- These reasons are in conformity with the view taken by the Supreme Court in the case of Allahabad Bank Ltd.<sup>2</sup>, wherein the question arose as to whether an amount received by the taxpayer-bank in cash as 'premium' from its various shareholders on issuing share on premium is liable to be included in their paid-up capital for the purpose of allowing the taxpayer to claim rebate<sup>3</sup>.
- In the case of Allahabad Bank Ltd., the Supreme Court held that 'share premium account' was liable to be included in the paid-up capital for computing rebate. One of the reasons to allow such inclusion with the paid-up capital was that such inclusion was permitted by the specific words in the Explanation. However, such is not the situation in the present case.
- The Companies Act, 1956 provides in its Schedule V - Part II (Section 159) a form of Annual Return, which is required to be furnished by the company having share capital every year. Column III of this form deals with the capital structure of the company, providing the break-up of 'issued shares capital break up'. This column does not include in it the 'premium amount collected by the company from its shareholders on its issued share capital'. This is indicative of the fact that such amount is not considered a part of the capital unless it is specifically provided in the relevant section.
- Similarly, Section 78 of the Companies Act which deals with the 'issue of shares at premium and discount' requires a company to transfer the amount so collected as premium from the shareholders and keep the same in a separate account called 'securities premium account'. It does not provide that such amount is treated as part of the capital of the company employed in the business for one or other purpose, as the case may be, even under the Companies Act.
- Therefore, 'premium' collected by the taxpayer on its subscribed share capital is not 'capital employed in the business of the company' within the meaning of Section 35D of the Act. Accordingly, the company cannot claim the deduction of the said amount under Section 35D of the Act.

## Our comments

The deduction of the certain preliminary expenditure under Section 35D, is limited, *inter alia*, to the 'capital employed in the business of the company'. The issue with respect to what constitutes the 'capital employed in the business of the company' under Section 35D, has been a matter of debate before the Courts/Tribunal.

The Bangalore Tribunal in the case of Subex Ltd.<sup>4</sup> held that the share premium cannot be regarded as part of the issued share capital while computing 'capital employed' for the purpose of allowing deduction under Section 35D of the Act. However, foreign currency convertible bonds are treated as 'debentures' and can be considered as part of 'capital employed' for allowing deduction under Section 35D of the Act.

Similarly, in the present case, the Supreme Court has held that the premium collected by a company on the share capital did not tantamount to '*capital employed in the business of the company*' within the meaning of Section 35D(3) of the Act. Therefore, the company cannot amortise certain preliminary expenses under Section 35D, on the basis of share premium. The Supreme Court has given emphasis to the plain and literal reading of the provisions of the Act.

This decision will impact those companies who have issued shares at a higher premium and want to claim preliminary expenditure under Section 35D of the Act. Further, such preliminary expenditure cannot be claimed as deduction under any other provision of the Act.

<sup>2</sup> CIT v. Allahabad Bank Ltd. [1969] 2 SCC 143 (SC)

<sup>3</sup> Under Paragraph D of Part II of the first Schedule to the Finance Act, 1956

<sup>4</sup> Subex Ltd. v. CIT [2016] 156 ITD 938 (Bang)

[www.kpmg.com/in](http://www.kpmg.com/in)

#### Ahmedabad

Commerce House V, 9th Floor,  
902 & 903, Near Vodafone House,  
Corporate Road,  
Prahlad Nagar,  
Ahmedabad – 380 051  
Tel: +91 79 4040 2200  
Fax: +91 79 4040 2244

#### Bengaluru

Maruthi Info-Tech Centre  
11-12/1, Inner Ring Road  
Koramangala, Bangalore 560 071  
Tel: +91 80 3980 6000  
Fax: +91 80 3980 6999

#### Chandigarh

SCO 22-23 (1st Floor)  
Sector 8C, Madhya Marg  
Chandigarh 160 009  
Tel: +91 172 393 5777/781  
Fax: +91 172 393 5780

#### Chennai

No.10, Mahatma Gandhi Road  
Nungambakkam  
Chennai 600 034  
Tel: +91 44 3914 5000  
Fax: +91 44 3914 5999

#### Delhi

Building No.10, 8th Floor  
DLF Cyber City, Phase II  
Gurgaon, Haryana 122 002  
Tel: +91 124 307 4000  
Fax: +91 124 254 9101

#### Hyderabad

8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad 500 034  
Tel: +91 40 3046 5000  
Fax: +91 40 3046 5299

#### Kochi

Syama Business Center  
3rd Floor, NH By Pass Road,  
Vytilla, Kochi – 682019  
Tel: +91 484 302 7000  
Fax: +91 484 302 7001

#### Kolkata

Unit No. 603 – 604,  
6th Floor, Tower – 1,  
Godrej Waterside,  
Sector – V, Salt Lake,  
Kolkata 700 091  
Tel: +91 33 44034000  
Fax: +91 33 44034199

#### Mumbai

Lodha Excelus, Apollo Mills  
N. M. Joshi Marg  
Mahalaxmi, Mumbai 400 011  
Tel: +91 22 3989 6000  
Fax: +91 22 3983 6000

#### Noida

6th Floor, Tower A  
Advant Navis Business Park  
Plot No. 07, Sector 142  
Noida Express Way  
Noida 201 305  
Tel: +91 0120 386 8000  
Fax: +91 0120 386 8999

#### Pune

703, Godrej Castlemaine  
Bund Garden  
Pune 411 001  
Tel: +91 20 3050 4000  
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.