

## Chapter IV: Allowance of Amortisation

### 4.1 Introduction

Sections 35D, 35DD and 35DDA of the Act provides for amortisation on preliminary expenses, expenditure in case of amalgamation or demerger and expenditure incurred under voluntary retirement scheme respectively. Present chapter deals with cases relating to amortisation where AOs did not apply relevant provisions correctly. Category wise details of mistakes in assessment are shown in Table 4.1.

**Table 4.1: Nature of mistakes with its tax effect**

Nature of Mistakes and Para Number of the Report	Cases	Tax effect (₹ in crore)
1. Claim of amortisation expenses u/s 35D (Para 4.2)	12	6.70
2. Claim of amortisation expenses u/s 35DDA (Para 4.3)	4	5.38
3. Claim of amortisation expense u/s 35ABB (Para 4.4)	1	15.47
<b>Total</b>	<b>17</b>	<b>27.55</b>

### 4.2 Mistake in claim of amortisation expenses under section 35D

Section 35D of the Act provides that where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31 March 1970, any expenditure specified in sub-section (2) thereunder, before the commencement of his business, or after the commencement of his business, in connection with the extension of his 'industrial undertaking' or in connection with his setting up a new unit, shall be allowed a deduction of an amount equal to one fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the business commences or the extension is completed or the new unit commenced production. The word 'industrial' was omitted by the Finance Act, 2008, from 01 April 2009 thus making the normal 'undertaking' like *service providers* eligible for deduction under section 35D for the expenses incurred from AY 10 onwards.

Further, the said expenditure is, *inter alia*, allowed at five *per cent* of the "capital employed" for the purpose of extension/new business, being the aggregate of share capital and long term borrowings (including debentures) having a tenure of minimum seven years.

Test check of assessment records in Andhra Pradesh, Chhattisgarh, Gujarat, Karnataka, and Tamil Nadu charges revealed that 12 assesseees irregularly claimed and were allowed amortisation expenses under section 35D which resulted in under assessment of income to that extent involving tax effect of ₹ 6.70 crore (See Box 4.1)

**Box 4.1: Illustrative cases on mistakes in claim of amortisation**

a. In Karnataka, CIT-III Bangalore charge, **M/s Subex Ltd.**, for AY 09, had acquired two foreign subsidiaries at an investment of ₹ 1,420.66 crore, by raising capital through issue of Global Depository Receipts (GDRs)<sup>19</sup> and Foreign Currency Convertible Bonds (FCCBs), having a tenure of only five years. The assessee incurred ₹ 57.79 crore as expenditure thereon and claimed deductions. AO allowed deduction of ₹ 11.37 crore<sup>20</sup> as amortisation. For the purpose of reckoning capital employed, only the value of GDRs was eligible, since FCCBs had lesser tenure than prescribed in the Act. Hence, the expenditure eligible for amortisation worked out to ₹ 58.64 lakh, being five *per cent* of ₹ 11.73 crore, the value of GDRs and thereby allowable deduction would be ₹ 11.73 lakh (being 20 *per cent* of ₹ 58.64 lakh) instead of ₹ 11.37 crore. Excess allowance of deduction resulted in over assessment of loss of ₹ 11.25 crore, involving potential tax effect of ₹ 3.82 crore.

b. In Gujarat, CIT-I Ahmedabad charge, **M/s Bhagwati Banquets & Hotels**, engaged in Hotel business (service sector), for AY 09 to AY11, claimed and was allowed deduction aggregating ₹ 3.51 crore, being one fifth of total of IPO expenses written off of ₹ 5.85 crore, the proceeds of which was used for putting up a new project at Surat. Since the assessee's business was in the nature of providing service (hospitality) and was not engaged in any 'industrial' activity as envisaged in section 35D(1)(ii) of the Act and the expenses claimed were relating to the period prior to AY 10, assessee was not eligible for the deduction. The mistake resulted in incorrect allowance of deduction of ₹ 3.51 crore involving tax effect of ₹ 1.62 crore including interest. AO did not accept (September 2012) audit observation stating that no definition of industrial undertaking was given in the provisions of 35D. The reply was not tenable as the word "industrial" was removed from the provision with effect from 01 April 2009 permitting assessee engaged in the business of any sector to avail the benefit u/s 35D.

Thus, AOs allowed irregular amortisation expenses under section 35D which resulted in under assessment of income.

### **4.3 Mistakes in claim of amortisation expenses u/s 35DDA**

Section 35DDA of the Act provides that where an assessee incurs any expenditure by way of payment to an employee under any voluntary retirement scheme, he shall be allowed deduction equal to one fifth of such expenditure for a period of five years beginning with the year in which such expenditure is incurred. While computing tonnage income of a tonnage tax company under section 115VG, provisions of section 30 to 43B shall apply as if every loss, allowance or deduction had been given full effect to for that previous year itself.

<sup>19</sup> Raising capital in international markets by issuing shares in foreign countries

<sup>20</sup> As against one-fifth deduction of ₹11.56 crore

During test check in Orissa, Rajasthan and West Bengal charges, we found that four assessee irregularly claimed and were allowed expenses towards amortisation under section 35DDA which resulted in under assessment of income to that extent involving revenue impact of ₹ 5.38 crore (See Box 4.2).

**Box 4.2: Illustrative case on mistakes in claim of amortisation u/s 35DDA**

In Rajasthan, CIT Kota charge, **M/s Chambal Fertilizers and Chemicals Ltd.** claimed and was allowed deduction of ₹ 60.42 lakh every year from AY 08 to AY 10, being one-fifth of ₹ 3.02 crore of the expenditure incurred on VRS expenses related to ISCL, India Steamship Ltd (shipping division) which was merged (amalgamated) with the assessee company from 01 September 2004 and the expenditure of ₹ 3.02 crore pertained to the period prior to merger of ISCL (shipping division) under the scheme of voluntary retirement. We observed that assessee company (resultant company) opted for tonnage tax scheme under Chapter XII G of the Act in respect of its shipping division from 01 April 2005 and as such the assessee was not entitled for amortisation of any expenses incurred on VRS being the income of its shipping division computed in the manner laid down under the section of 115VG. Irregular allowance of amortisation of VRS expenses resulted in under assessment of income of ₹ 1.81 crore (₹ 60.42 lakh per year from AY 08 to AY 10) involving tax effect of ₹ 68.38 lakh including interest. ITD accepted the observation and stated that remedial action u/s 148 was being taken.

Thus, AOs allowed irregular amortisation expenses under section 35DDA which resulted in under assessment of income.

#### 4.4 Other interesting case

Under section 35ABB of the Act, amortisation is allowed in respect of any expenditure of a capital nature, incurred for acquiring any right to operate telecommunication services either before the commencement of the business or thereafter in equal installments for each of the relevant previous years. For this purpose, in a case where the license fee is actually paid before the commencement of the business to operate telecommunication services, “relevant previous years” means the previous years beginning with the previous year in which such business commenced; in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent year or years during which the licence for which the fee is paid, shall be in force (See Box 4.3).

**Box 4.3: Illustrative case on incorrect allowance of amortisation**

In CIT-3, Mumbai charge, scrutiny assessment of a company, **M/s Idea Cellular Ltd.** for the AY 10, had claimed and was allowed deduction of ₹ 144.45 crore on account of amortisation cost under Section 35ABB in respect of fixed licence fees.

This included amortised cost of ₹ 34.23 crore in respect of licence fee of ₹ 684.59 crore paid for circles which had not yet commenced operations. In view of the provision ibid, deduction of ₹ 34.23 crore on account of amortisation of licence fees was not an allowable deduction. Omission to disallow the deduction resulted in under assessment of income of ₹ 34.23 crore with consequent short levy of tax of ₹ 15.47 crore including interest of ₹ 3.84 crore under Section 234B.

#### **4.5 Recommendation**

We recommend that CBDT may devise a mechanism to improve the quality of assessments and explore the possibility of capacity building for Assessing Officers for reducing the incidence of mistakes.

*The Ministry reiterated (May 2014) its comments to the recommendations made in Para 3.21 of this Report.*