IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH "G" DELHI)

BEFORE SHRI G.E. VEERABHADRAPPA, HON'BLE VICE PRESIDENT AND SHRI A.D. JAIN, JUDICIAL MEMBER

ITA Nos. 2223, 2224 & 2443(Del)2010
Assessment years: 2001-02, 2002-03 & 2003-04

Income Tax Officer, Ward 7(1), New Delhi.	V.	M/s. S-Net Freight (India)P.Ltd., A-250, Lane No.6, NH-8, Mahipalpur Extn., New Delhi.

ITA No.867(Del)2010
Assessment year: 2002-03

M/s. S-Net Freight (India)P.Ltd. A-250, NH 8, Mahipalpur Extn. New Delhi.	V.	Income Tax Officer, Ward 7(1), New Delhi.
(Appellant)		(Respondent)

Department by: Ms. S. Mohanty, DR
Assessee by: Shri Suresh Ram Chandani, Advocate

ORDER

PER A.D. JAIN, J.M.

ITA No. 2223(Del)2010:

This is Department's appeal for assessment year 2001-02, taking the following ground:-

"The learned Commissioner of Income Tax (Appeals) erred in law and on the facts and circumstances of the case, in deleting the addition of `8,52,643/- made on account of depreciation on leasehold building treating the same as capital expenditure by the AO and directing to allow 100% depreciation."

2. The assessee is in the business of Air Freight, Ocean Freight, and Land Transport or any business of Freight Contractors and Agents, forwarding packing, hauling and transport agents and to arrange for the transportation of goods, wares and merchandise of every kind, nature and description by all means of transport by air, land, sea and inland waterways. In the original return filed for the year under consideration, the assessee claimed a loss of ` 54,17,818/-. The return was processed u/s 143(1) of the I.T. Act and the loss claimed was accepted. Subsequently, it came to the notice of the AO that income chargeable to tax had escaped assessment on account of wrong claim of depreciation. As such, a notice u/s 148 of the Act was issued. In response, the assessee filed a return declaring the same loss, as declared in the original return. The AO asked the assessee as to why it should be allowed 100% depreciation on the leasehold improvements, when such depreciation was available @ 10% in terms of section 32 of the Act.

3. The assessee submitted that it did not own any office building; that leasehold improvement in the form of temporary erection had been done in the office premises taken on lease by the assessee company and that the assessee was entitled to 100% depreciation thereon u/s 32 of the Act.

4. In the assessment order, the AO held that Explanation (1) to section 32(1) had wrongly been sought to be invoked by the assessee; that the said Explanation states that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of section 32(1) shall apply as if the said structure of the work is a building owned by the assessee; that as such, the Explanation only specifies that the assessee company would be eligible for depreciation on the leasehold improvements; that it nowhere specifies the rate of depreciation ; that the depreciation rates for the relevant year are specified in Old Appendix I of I.T. Rules which was applicable for the

assessment years 1988-89 to 2002-03; that in respect of any structure or work by way of renovation or improvement in, or in relation to a building referred to in Explanation (1) to section 32(1)(ii), the percentage to be applied will be the percentage specified against sub-item (1), (2) or (3) of item 1 as may be appropriate to the class of building in or in relation to which the renovation or improvement is effected; that where the structure is constructed or the work is done by way of extension of any such building, the percentage to be applied would be such percentage as would be appropriate, as if the structure or work constituted a separate building; and that therefore, in case the construction of structures and extensions is carried out in a building taken on lease for business purposes, the rate of depreciation to be applied is 10%.

5. In this manner, the AO treated the expenditure on the leasehold building as a capital expenditure and allowed depreciation @ 10% thereof, as against that claimed @ 100%.

6. By virtue of the impugned order, holding that the expenditure in question had been incurred on wooden partition, cabin making, interior work, fixing of door locks, fixing of glass partition, walls, etc., not

constituting capital expenditure, the ld. CIT(A) directed the AO to allow 100% depreciation to the assessee.

7. Aggrieved, the Department is in appeal.

8. Challenging the impugned order, the ld. DR has contended that the ld. CIT(A) has erred in deleting the addition of ` 8,52,643/- made on account of depreciation on leasehold building treating the same as capital expenditure; that the ld. CIT(A) has erred in directing the AO to allow 100% depreciation, while ignoring the observations of the AO in the assessment order, to the effect that as per the law, the assessee was entitled to depreciation @ only 10%. Reliance has been placed on "Uttar Bharat Exchange Ltd. v. CIT", 55 ITR 550(Del), where the assessee had taken on lease, for a period of 2 years, the first and second floors of a hotel building, with an option for removal at the end of the period and was directed to erect shades, partitions and other temporary structures for carrying on his exchange business, but was not allowed to remove these structures at the end of the lease and the assessee spent a sum of ` 17,917/- in all during the years 1954-55, 1955-56 and 1956-57 for erecting such structures and claimed the amount as business expenditure in the respective years, but his claim was disallowed, holding that the expenditure was essentially one of a capital

nature and its nature was not changed by the fact that the lease was in the first instance only for a period of two years; and that it could also not be treated as an addition to the rent merely because the lessee had no right to remove them.

9. The learned counsel for the assessee, on the other hand, has strongly supported the impugned order. It has been contended that while rightly directing the AO to allow depreciation to the assessee @ 100%, the ld. CIT(A) has taken into consideration the fact that the lease was for a limited period and improvements were qua terminus with the leasing period; that the ld. CIT(A) has also duly taken into account that the expenditure was in the nature of freight, wooden partition, interior work and no capital asset could be assumed to have come into existence; that therefore, the nature of the expenditure was definitely of a revenue nature; that during the assessment itself, the assessee had made its claim u/s 37 of the Act, which had wrongly been rejected by the AO by observing that since the assessee company had itself treated the expenditure to be capital in nature in its return, its contention to treat the expenditure as a capital expenditure could not be accepted . Reliance has been placed on the following case laws:-

1. DSP Meryill Lynch Ltd. v. JCIT, 102 ITD 337(TBOM);
2. CIT v. M/s. Hi Line Pens Pvt. Ltd., judgment dated 15.9.08, passed by the Hon'ble Delhi High Court in ITA No. 1202/2006(copy placed on record); and
3. DCIT v. Chaya Lakshmi Creations (P)Ltd., order dated 30.6.2010, passed by the Hyderabad Bench of the Tribunal, in ITA Nos. 250 to 252/Hyd/2010 (copy placed on record.

10. It has been contended that therefore, there being no error whatsoever therein, the order of the ld. CIT(A) be upheld while dismissing the appeal filed by the Department.

11. We have heard the parties and have perused the material on record. Undisputedly, the lease in question was for a limited period. The improvements were qua terminus for the period of lease. The expenditure incurred by the assessee was on wooden partition, cabin making, interior work, fixing of door locks, fixing of glass partition, walls, etc. As to how this expenditure constituted capital expenditure, was nowhere elaborated upon by the AO in the assessment order.

12. In "DSP Meryill Lynch Ltd." (supra), following "Kedarnath Jute Mfg. Co. Ltd. v. CIT", 82 ITR 363(SC), it was held that accounting entries do not decide matters for the purpose of computation of income under the Income Tax Act; that it is the substance that has to be looked into; that an income does not cease to be income or an expense does not cease to be expense only for the reason that the assesssee has passed a wrong accounting entry in its books of account.

13. In "M/s. Hi Line Pens Pvt. Ltd."(supra), the expenditure incurred by the assessee was towards false ceiling, fixing tiles, replacing glasses, wooden partitions, replacement of electric wiring, earthing, replacement of GI pipes etc., in respect of a rented premises taken by the assessee on lease for its business purposes, to make the premises, in use for a long time, useable. It was held by the Hon'ble High Court that the Tribunal had rightly found the assessee to have carried out repairs and had not brought about any new asset, nor was it the intention of the assessee to bring about any new capital asset; that the expenses were towards repairing the premises taken on lease so as to make it more conducive to its business activity.

14. In "Chaya Lakshmi Creations (P)Ltd." (supra), holding the expenditure to be a revenue expenditure, it was held, inter alia, as follows:-

"After incurring the expenditure the assessee has not obtained any new enduring benefit. No capital asset came into existence. The assessee continued to exhibit feature films in the very same premises probably with a little more profit. Admittedly the seating capacity was not increased after the expenditure. However, it may be little more attractive and comfortable for cine goers. Therefore, the expenditure incurred by the assessee is only for carrying on the business of exhibiting feature films. Therefore, it is not correct to say that the assessee has obtained any enduring benefit because of this expenditure. The assessee can use the premises taken on lease only during the lease period as found by the AO. After expiry of the lease period, the assessee has to leave the entire thing as it is and handover the same to the lessor. The nature of work undertaken by the assessee is to carry on the business and not to obtain any asset. Furthermore, as already observed, no capital asset of enduring nature came into existence. In other words, the assessee has not acquired any asset/income earning apparatus. It is well settled principles of law that the expenditure incurred for acquisition of an asset is capital expenditure and expenditure incurred in the process of earning profit is revenue expenditure. In the case before us, the assessee

incurred the expenditure in order to attract more customers and make the customers comfortable. Therefore, it is obvious that the assessee has to incur the expenditure, in order to carry on the business and in the process of earning profit and, therefore, the expenditure is of revenue in nature."

15. In the present case, as observed by the ld. CIT(A), the assessee made its claim u/s 37 during the assessment proceedings, though it had claimed depreciation to start with. The ld. CIT(A) held that the AO was wrong in rejecting the claim of the assessee. In this regard, "M/s. Hi Line Pens Pvt. Ltd."(supra), has rightly been pressed into service. Therein, it has been held, besides the above, that the repairs all kind carried out therein like in the present case, were expenses incurred for repairs for making the premises more conducive to the assessee's business activities and its expenses did not bring about any new capital asset.

16. Apropos "Uttar Bharat Exchange Ltd."(supra), it is not of much aid to the Department. In that case, the assessee could not, at the expiry of the lease, remove the structures constructed by it at the end of the lease. It, however, in the present case, has noted by the learned CIT(A) at page 22 of

the impugned order, clause 5 of the Lease Deed specifically provides that "……..on termination of the lease the assessee will be entitled to take away such fittings and fixtures……"

17. Moreover, "M/s. Hi Line Pens Pvt. Ltd."(supra), has also been rendered by a Division Bench of the Hon'ble High Court, as is the case with "Uttar Bharat Exchange Ltd."(supra), but "M/s. Hi Line Pens Pvt. Ltd."(supra), is the later of the two decisions.

18. In view of the above, finding no merit in the grievance sought to be raised by the Department in this regard, the ground taken is hereby rejected.

ITA No. 2224 (Del)2010:

19. This appeal filed by the Department for the assessment year 2002-03 raises an issue identical to the one taken by the Department for assessment year 2001-02 in ITA No. 2223(Del)2010 (supra). The following ground has been taken:-

> *"The learned Commissioner of Income Tax (Appeals) erred in law and on the facts and circumstances of the case, in deleting the addition of `9,43,993/- made on account of depreciation on leasehold building treating the same as capital expenditure by the AO and allowing depreciation @ 10%".*

20. The facts herein are, mutatis mutandis, exactly similar to those present in ITA No. 2223(Del)2010 (supra). Therefore, our findings in ITA No. 2223(Del)2010 (supra) are squarely applicable, mutatis mutandis hereto also. Accordingly, following our discussion on the issue in ITA No. 2223(Del)2010 (supra), the ground raised by the Department is rejected for this year also.

ITA No.867(Del)2010:

21. This is assessee's appeal for assessment year 2002-03, taking the following grounds:-

"On the facts and in the circumstances of the case CIT(Appeals) erred in:

1. *Confirming the disallowance of Rs. 1,01,500/- made by the AO on account of payment for the interior work;*

2. *Stating that an opportunity was allowed to the appellant during the appellate proceedings to produce evidence in regard to above even though no such evidence was called for;*

3. *Confirming the denial of appellant's claim for set off of brought forward losses of A.Y. 2001-02;*

4. *In holding that the appellant does not fulfill the conditions laid down in sec. 79 of the Income Tax Act even though the transfer of shares by subscribers were in conformity to legal compliance."*

22. Apropos ground Nos. 1&2, the AO disallowed an amount of ` 1,01,500/- paid by the assessee to Qadir Carpenters against interior works, due to non-production of bills. The ld. CIT(A) confirmed the disallowance.

23. Before us, it has been contended that the assessee could not produce before the Taxing Authorities, the bills with regard to the expenditure incurred towards wooden work and decoration of office at Bombay, since the Branch Manager, Mr. Varghese had resigned and the payment was routed through his impressed account, the record whereof untraceable hitherto. Now the record has been traced out and the bill is being filed by way of additional evidence.

24. The learned DR has opposed the admission of the bill by way of additional evidence. We, however, are not in agreement with the Department's stand. The bill of ` 1,01,500/- shows "wooden work and decoration of new office building, cabin and work expenses", at Bombay. It has been approved by "George V". George V has been stated to be the Branch Manager, Mr. Varghese, who had resigned and whose impressed account, the payment had been routed through. The records of this account have been stated to be untraceable earlier and they have now been traced out as per the learned counsel. As such, we admit this bill in evidence and, in

these circumstances, remit the matter to the file of the AO for decision afresh on taking into consideration this bill tendered by the assessee.

25. Ground Nos. 1&2 are, therefore, for statistical purposes, treated as accepted.

26. So far as regards ground Nos. 3&4, the AO disallowed the assessee's claim of set off of loss of assessment year 2001-02 against the income of assessment year 2002-03, by invoking the provisions of section 79 of the I.T. Act. The ld. CIT(A) upheld the AO's order.

27. The learned counsel for the assessee has filed a synopsis in this regard and has contended that M/s. S-Net Freight (India)P.Ltd. is a company incorporated in Singapore, operating in the field of freight and logistics all over the country, through subsidiaries and associates; that GA GOSS(S)Pvt. Ltd. is one of the companies incorporated in providing such services; that both these companies agreed to set up a private limited company in India, to be a subsidiary of S-Net Freight Pvt. Ltd.; that they entered into a joint venture agreement in this regard; that the foreign companies cannot invest till an approval is obtained from the FIPB; that for such an approval, a company is required ; that it is therefore that a company is incorporated through their Indian nominees, with nominal share capital; that on receipt of

the necessary approvals, the investment is brought into India; that in the present case, the J.V. Partners had, towards this objective, as their direct nominees, Dr. Prem Chand Jain and Mrs. Dakshayani Reddy, through whom they held the shares beneficially during the period relevant to the assessment year 2001-02 and the company incurred a loss during the year; that in the subsequent assessment year, on getting the requisite approvals, the two companies themselves became the shareholders instead of through the nominees came to an end; that the essential requirement of the provisions of section 79 of the Act is that on the last day of the previous year the shares of the company carrying not less than fifty one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty one per cent of the voting power on the last day of the year or years in which the loss was incurred; that in the present case, 100% of the shares were, as on 31.3.2002, held by persons who beneficially held shares on the last day of March, 2001; that as on 31.3.2001, S. Net Freight (Holding) Pvt. Ltd. and G.A. GOSS (S)Pvt. Ltd. beneficially held shares carrying 100% of the voting power through their nominees, Dr. Prem Chand Jain and Mrs. Dakshayani Reddy; that the essential condition is that the shares should have been beneficially held by

certain persons; that the legislation has not used the words "shareholders" which would necessarily imply their being registered shareholders ; that on the other hand, such words have been used wherever such intendment was there, e.g., in section 2(22)(d) and section 47. Reliance has been placed on "CIT v. Swadeshi Match Co.", 139 ITR 833(Bom).

28. The learned DR, on the other hand, has strongly relied on the impugned order in this regard. It has been contended that the legal requirements were not followed by the assessee; that as rightly noted by the ld. CIT(A), as per section 79 of the Act, transfer shares by subscribers amounts to a change in the shareholding; and that therefore, brought forward loss could not be adjusted or carried forward when fifty one percent beneficiary shareholders were not the same in the two years, as per the provisions of section 79 of the Act.

29. In this regard, it is seen that section 79 of the Act provides as follows:-

> *"Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless – (a) on the last day of the previous year the shares of the company carrying not less than fifty one per cent of*

the voting power were beneficially held by persons who beneficially the shares of the company carrying not less than fifty one per cent of the voting power on the last day of the year or years in which the loss was incurred.

Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift.

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company."

30. The ld. CIT(A) has confirmed the assessment order on the issue by observing as follows:-

"The above contentions and arguments of the appellant have been carefully considered. The sum and substance of the appellant's arguments is that necessary legal requirements were followed by the appellant and foreign equity investment could not have been attracted by any other way except the way adopted by the appellant. It was the signatories and the trustees who actually later became subscribers through their nominees and the shares were transferred in their names only after necessary approvals were obtained. Therefore, the appellant's case is that the company had to abide by the relevant laws relating to foreign direct investments before the shares could be allotted to the foreign shareholders.

> *However, after considering the arguments of the appellant it is observed that it cannot be accepted that the nominees were used only as a legal necessity which could be acceptable as per the relevant provisions in order to facilitate the formation of the company by the foreign equity holders. In terms of sec. 79 the transfer of shares by subscribers to Memorandum and Articles have to be necessarily viewed as a change in the shareholding of the assessee company. Hence, it is held that the brought forward loss cannot be adjusted or a carried forward when 51% beneficial shareholders are not the same in the two years. Hence, for the reasons relied upon by the AO, the addition made by him is upheld and the loss is directed not to be carried forward. This ground is dismissed."*

31. Thus, as per the Taxing Authorities, section 79 of the Act provides that no loss incurred by closely held company in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than fifty one per cent of the voting powers were beneficially held by persons who beneficially held the shares of the company carrying not less than fifty one per cent of the voting power on the last day of the year or years in which the loss was incurred; and that the assessee had not fulfilled those prescribed condition.

32. The case of the assessee is that the investment by foreign companies is not permissible in the absence of approval from FIPB. It was for such a

purpose that a JV agreement was entered into between M/s. S-Net Freight (India)P.Ltd., and G.A. GOSS (S)Pvt. Ltd., both Singapore incorporated companies carrying on business in the field of freight and logistics, to set up a private limited company in India, as a subsidiary of M/s. S-Net Freight (India)P.Ltd. The company was incorporated through Indian nominees of the two companies, through whom the shares were held beneficially during assessment year 2001-02. In the subsequent year, the two companies themselves became shareholders, on getting the requisite approvals from FIPB. The shareholding pattern for assessment years 2001-02 and 2002-03 is given at page 17 of the Assessee's Paper Book ('APB' for short), as submitted before both the Taxing Authorities, as follows:-

SHAREHOLDERS FUND

SHAREHOLDERS NAME	A.Y. 2001-02 AS ON 31.3.01	PERCENT	A.Y. 2002-03 AS ON 31.3.02	PERCENT
Dr. Prem Chand John	1000	50%		
Mrs. Dakshayani Reddy	1000	50%	369260	74%
S-Net Freight (Holdings) Pte. Ltd.			129740	26%
G A GOSS (S) Pte. Ltd.				
TOTAL	2000	100%	4990000	100%

33. In the submissions before the ld. CIT(A) (APB 10 to 13), the issue was explained before the CIT(A), stating, inter alia, that the Foreign Exchange Management Act , provides Rules for foreign investment in India; that as per FEMA Rules, these are sectorial caps in which Automatic Route is not available and for which specific approval of Foreign Investment Promotion Board is required. In the instant case, the process started from 05.06.2000 and ended on 20.11.2001, i.e., F.Y. 2001-02 relevant to assessment year 2002-03; that the company had allotted shares to subscribers to the Memorandum of Association for ` 2,000/- only; that the further sum of ` 49.90 lakhs was contributed from the Foreign Shareholders as capital and the company's activities could only happen with this share capital and the whole infrastructure was built using that money; that the company had to abide by relevant laws of Foreign Direct Investment, before the shares could be allotted to the foreign shareholders; and that the subscribers to the Memorandum of Association were never intended to be the shareholders of the company at the outset.

34. These contentions of the assessee have nowhere been refuted by the ld. CIT(A) and he has only observed that it could not be accepted that the nominees were used only as a legal necessity. Now, once, the requirements

of the provisions were FEMA the facts are to be stringently followed and it has been so done, it was the requirement of the Foreign Direct Investment Laws which made the assessee to act in the manner discussed above. The provisions of section 79 of the I.T. Act, therefore, cannot be said to envisage the transfer of shares by the subscribers of the Memorandum of Articles of Association as a change in the shareholding of the assessee company. The provisions of FEMA have not been shown to be non-mandatory. In order to carry on business in India, foreign company need must abide by the provisions of the said Act. Moreover, the two shareholders indeed acted only as the nominees to enable the smooth passage of the other shareholder in the subsequent year. Therefore, we do not find ourselves at one with the observations made by the ld. CIT(A) in this regard. The contention of the assessee is, therefore, accepted, particularly keeping in view the observations in "Swadeshi Match Co." (supra), wherein it was held that "holding" within the meaning of Explanation II of para D of Part II of the First Schedule I of the Finance (No.2) Act, 1962 had not been defined and, therefore, it was possible to construe that the beneficial shareholding was included in it and vis-à-vis, that however, when a provision under consideration is a provision for giving enhanced benefit by way of additional

rebate to the assessee and both constructions are possible, then it is discernable to adopt the construction which will benefit the assessee; and that therefore, for the purpose of Explanation II, both legal ownership and beneficial ownership should be taken into account.

35. In view of the above, ground Nos. 3&4 are accepted.

ITA No. 2443(Del)2010:

36 . This is Department's appeal for assessment year 2003-04, raising the following ground:-

> *"Ld. Commissioner of Income Tax(Appeals) erred, in law and on the facts and circumstances of the case, in allowing the loss for the assessment year 2002-03 to be carried forward."*

37. The learned CIT(A) directed to allow carry forward of losses pertaining to the previous assessment year, i.e., assessment year 2002-03, as per law, subject to the assessee's fulfilling the prescribed conditions, if any. The loss pertaining to assessment year 2001-02 amounting to ` 54,17,818/- having not held to be carried forward to assessment year 2002-03, it is further carried forward to assessment year 2002-03 was disallowed.

38. This appeal is consequential to our decision on ground Nos. 3&4 taken by the assessee in its appeal in ITA No.867(Del)2010, for assessment year 2002-03. The set off of brought forward loss for assessment year

2001-02 has been allowed therein. It is, accordingly, allowed for assessment year 2003-04 also.

39. The ground raised by the Department is, therefore, rejected.

40. In the result, the Department's appeals in ITA Nos. 2223, 2224 & 2443(Del)2010 for assessment years 2001-02, 2002-03 & 2003-04 are dismissed and assessee's appeal in ITA No.867(Del)2010 for assessment year 2002-03 is partly allowed.

Order pronounced in the open court on 05.10.2011.

Sd/-	sd/-
(G.E. Veerabhadrappa)	(A.D. Jain)
Vice President	Judicial Member

Dated: 05.10.2011
*RM

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

True copy

By order

Deputy Registrar