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Court : Income Tax Appellate Tribunal ITAT Jodhpur

Decided On : Jul-28-2006

Reported in : (2007)106ITD401(Jodh.)

Judge : R Syal, H O Maratha

Appellant : Pi Industries Ltd.

Respondent : Assistant Commissioner of Income

Judgement :

1. This appeal by the assessee arises out of the order passed by CIT(A) on dt. 21st Nov., 2003 in relation to the asst. yr. 2000-01.

2. First ground is against the confirmation of disallowance of the amount paid by the assessee under the approved voluntary retirement scheme (hereinafter called VRS) amounting to Rs. 1,06,57,907 by treating the same as capital expenditure. Briefly stated, the facts of the case are that the assessee claimed VRS expenses at Rs. 1.06 crores and in its books of account the said amount was treated as deferred revenue expenditure by claiming its 1/4th as deduction at Rs. 26,64,477. However, in the computation of income the entire amount was claimed as deduction. The AO did not accept the claim of the assessee for deduction under Section 37(1). He took note of the provisions of new Section 35DDA inserted by the Finance Act, 2001, w.e.f. 1st April, 2001 to conclude that no provision was available in the relevant assessment year for allowing deduction of the VRS amount. Resultantly an addition of Rs. 1.06 crores was made, which came to be

confirmed in the first appeal.

3. We have heard both the sides and perused the relevant material on record. There is no dispute about the fact that the assessee evolved VRS, the object of which as per the text of scheme itself, copy placed at p. 13 onwards of the paper book, was to achieve optimum manpower utilization, to improve the average age mix of the employees and to improve the overall skill in the company. The learned Chief CIT granted approval under Section 10(10C) on 8/12th Sept., 2000, a copy of which has been placed at p. 12 of the paper book. It is clear that the assessee claimed deduction at 1/4th of the total amount in its books of account and the entire amount was reduced while computing the total income. At this juncture we do not find any illegality in claiming the entire amount as deduction in the computation of income by claiming 1/4th in the books of account for the reason that it is the nature of the expenditure which has to be considered while allowing deduction and not the treatment given by the assessee in its account books. This aspect has not been disputed by the AO. However, the AO made disallowance on the ground that the entire amount was capital expenditure and the provisions of Section 35DDA introduced by the Finance Act, 2001 made it clear that the deduction was permissible in 5 annual instalments and the position prevailing prior to this section did not empower the assessee to claim any deduction. The learned CIT(A) went a step forward by considering Circular F. No. 200/79/2000-ITA-I, dt. 23rd Jan., 2001 [(2001) 248 ITR (St) 257] regarding the admissibility of ex gratia amount paid by the assessee for gaining enduring benefit or advantage under VRS. At the outset we note that this circular talks of the laying down of the test of enduring benefit as useful tool in considering the ex gratia amount, prima facie, as a capital expenditure. This circular has not conclusively directed the AOs to consider the VRS amount as capital expenditure in all cases.

What it refers to is the 'prima facie' view, which may, when tested on the touchstone of the factual position prevailing in each case, turn out to be a stepping stone or a rolling stone. When we consider the objectives of the scheme, as discussed above, it becomes patent that this scheme was introduced with a view to improve the overall skill level in the company by achieving optimum manpower utilization. How the advantage sought to be gained by the assessee with the

introduction of the scheme can be said to fall in the realm of capital expenditure when no enduring benefit was achieved by the assessee? The only aim was to facilitate the carrying on of the business more efficiently and more profitably while leaving the fixed capital untouched. The Hon'ble Supreme Court in the case of *Empire Jute Co. Ltd. v. CIT* has held that "there may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by the assessee which brings a case within the principle laid down in this test. What is material to consider is the nature of the advantage is in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future." Adverting to the facts of the case we find that by introducing the VRS the assessee sought to carry on its business more efficiently and profitably and did not obtain any advantage in the capital field in as much as its fixed capital remained untouched.

4. It is further observed that the aforementioned circular became the subject-matter of consideration by the Hon'ble Madras High Court in the case of *Madura Coats v. Dy. CIT and Anr.* in which the petitioner applied for the declaration of the above circular as invalid. After considering all the aspects of the matter the Hon'ble High Court held it to be invalid and ultra vires in the following terms: In the circular dt. 23rd Jan., 2001 there is a positive direction to treat an ex gratia payment to an employee under voluntary retirement schemes as capital expenditure, which direction is certainly adverse to the assessee. Therefore, to the extent that the circular is against the interests of assesseees, it is liable to be held ultra vires.

5. There is another interesting aspect as to the applicability of the circular to the instant case. We find that the assessment year under consideration is 2000-01 whereas the circular is dt. 23rd Jan., 2001.

The learned CIT(A) has held that this circular is applicable to the assessee. We are not inclined to accept the Departmental view for the reason that the law to be applied is always the one that is in force as on the first day of April of the assessment year. If a circular is issued on or after the 1st April of the relevant assessment year, that cannot be held to be operative. The Hon'ble Madras High Court in the case of CYT v. S. Palaniswamy considered a similar situation in which the notification amending the Rules allowing depreciation on buses at 40 per cent came into effect on 24th July, 1980. The assessee claimed depreciation at this rate as against the ITO's opinion that the earlier rate of 30 per cent was to be applied.

The Hon'ble High Court held that since this notification came into effect after 1st April, 1980 being the first day of the relevant assessment year, the same cannot be held to be applicable in asst. yr.

1980-81. Similar opinion has been expressed, as to the applicability of circular by the Full Bench of the Hon'ble Kerala High Court in CYT v.B.M. Edward, India Sea Foods . From the foregoing legal position it becomes abundantly clear that at any rate the said circular, coming into force on 23rd Jan., 2001, cannot be held to be applicable to the asst. yr. 2000-01, being the assessment year under consideration.

6. Now we turn to consider the applicability or otherwise of Section 35DDA, which has been taken note of by the AO in coming to the conclusion that the deduction was not allowable. Primarily we find that this section provides for amortization of expenditure incurred under VRS and states that $\frac{1}{5}$ th of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year in which the assessee incurs such expenditure and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years. This section has been inserted by the Finance Act, 2001, w.e.f. 1st April, 2001. The notes to the Finance Act, 2001 provide as under: New provisions for amortization of expenditure incurred under voluntary retirement scheme.

33.1 The Act has introduced a new Section 35DDA in the IT Act regarding amortization of expenditure incurred under voluntary retirement scheme. The

section provides that the expenditure incurred by way of payment of any sum to an employee at the time of his voluntary retirement, in accordance with any scheme of voluntary retirement, would be allowable as deduction over a period of five years.

33.2 The payments made in accordance with any scheme or schemes of voluntary retirement are only covered within the purview of the said section. Such payments are normally in the nature of ex gratia payments and are made over and above the regular terminal benefits like pension, gratuity, leave encashment etc., in respect of which normal provisions of the Act will apply.

33.3 The amendment will take effect from 1st April, 2002 and will, accordingly, apply in relation to the asst. yr. 2002-03 and subsequent years.

From me above it is clear that this section has been inserted prospectively and is applicable to the asst. yr. 2002-03 and thereafter. There is no indication to suggest, even remotely that this section would be the subject-matter of consideration in asst. yr.

2000-01, which is under consideration. Thus it becomes manifest that the insertion of the Section 35DDA has to be ignored altogether and the legal position prevailing anterior to this amendment has to be considered." 7. The Hon'ble Bombay High Court in CIT v. Bhor Industries Ltd. considered the facts in which that assessee claimed deduction of Rs. 10.02 crore for the payment under the VRS in respect of its plant at Borvile but the AO restricted the addition to Rs. 33.40 lakhs and disallowed the balance amount of Rs. 9.68 crores as excess claim. Eventually when the matter travelled to the Hon'ble High Court, it was observed that the said expenditure was incurred by the assessee to save expenses and was not referable to any income yielding asset. By accepting the assessee's claim it was held that the entire amount must be allowed in its entirety in the year in which it was incurred and it could not be spread over a number of years even though the assessee had written it off in its books over a period of years.

8. The Hon'ble Madras High Court also had an occasion to consider similar controversy in CIT v. Simpson & Co. Ltd. where it was held that the amount paid to

employees under the VRS was an allowable deduction as the expenditure was incurred on the grounds of commercial expediency and the expenditure was laid out wholly and exclusively for the purposes of the business of the assessee. Similar view has been expressed by the Hon'ble Calcutta High Court in the case of CIT v. Machinery Manufacturing Corporation Ltd. 9. From the legal position which emerges from the above judgments applicable in the pre 35DDA period, it becomes clear that the expenditure of VRS deserves deduction in entirety in the year in which it is incurred. Since the assessee paid the amount in the year in question, which has not been disputed by the Revenue, in our considered opinion the entire amount is deductible as claimed by the assessee. By overturning the impugned order on this score, we allow deduction for the full amount of Rs. 1,06,57,907 in this year.

10. The only other ground is regarding the charging of interest under Section 234B which the learned CIT(A) did not entertain by observing that no appeal lies against such charging of interest. Suffice it to say that the learned CIT(A) was not justified in not considering this ground in view of the decision of the Hon'ble Supreme Court in Central Provinces Manganese Ore Co. Ltd. v. CTT . As the charging of interest under Section 234B is consequential, the same is directed to be decided accordingly.

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