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Pro-Operative Expenses - Whether allowable or not ?



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Any new business has to incur certain preoperative costs before its actual commencement of business. There is no separate provision for admissibility of such expenses. Limited allowance is available for certain category of expenses. For instance for preliminary expenses u/s [35D](#) barring which the assessee generally has to capitalize such expenses. However, there remains an option to claim allowance of certain preoperative expenses under the head income from other sources if the assessee could establish the nexus of expenses incurred with income earned during preoperative stage. The Delhi bench of the ITAT recently delved with the subject of allowance of deduction of preoperative expenses under the head income from other sources in *Asstt CIT v. L S Cable India (P.) Ltd.* [IT Appeal No. 1257 (Delhi) of 2012, dated 9-2-2017]. In this case the assessee, a manufacturing company which had not set up its business in the relevant year made a claim for deduction of preoperative expenses such as audit fees, salaries, staff welfare expenses, legal and professional expenses and bank charges u/s [57](#) on the pretext of certain case laws. And it has been inferred from these case laws that expenses for maintaining the corporate identity are generally to be admissible under the law.

The Delhi bench in their order after referring to the six cases on which the assessee had placed reliance wrote as under:

"We have carefully gone through the orders of the authorities below and the decisions cited before us. There is no appeal by the assessee so far as the confirmation of the additions to a tune of Rs. 49,15,674. Only the Revenue challenged the deletion of Rs. 21,09,962 the expenditure incurred on account of audit fees, salaries, staff welfare expenses, legal and professional charges, other financial charges and bank charges. The Assessing Officer does not speak anything against the genuineness of these expenditure. Only ground of disallowance of these expenses is on the ground that they relate to the period prior to the commencement of the business by the assessee. On this aspect the decisions relied upon by the assessee and enumerated (*supra*) are applicable on all fours. The sum and substance of these decisions is that the company had to file various statements and returns and has to perform various functions to retain its status as a company and had to incur certain expenditure, and such expenditure is allowable as deduction. While respectfully following the ratio of the above decisions, we find that the order of the learned Commissioner of Income-tax (Appeals) is in conformity with the settled position of law as such does not warrant any interference. We, therefore, uphold the same. "

Let us analyze the cases that are supposedly looked at in this judgment but not commented upon individually anywhere in the text.

1. CIT v. Rampur Timber & Turnery Co. Ltd. [\[1981\] 129 ITR 58/6 Taxman 241 \(All.\)](#)

The facts in this case are that the assessee had discontinued its business operation. In the relevant year it incurred certain expenditure namely, miscellaneous expenses, salary, legal expenses, travelling expenses, etc., which the Tribunal found were incurred for retaining the status of the company and for the profitable disposal of the assets of the company. The Tribunal found that there was a nexus between the character of the expenditure and the making or earning of income hence a deduction were to be allowed.

2. Nakodar Bus Service (P.) Ltd. v. CIT [\[1989\] 179 ITR 506/45 Taxman 290 \(Punj. & Har.\)](#)

In this case the Punjab & Haryana High Court followed the ratio of the decision held by the Allahabad High Court in *Rampur Timber & Turnery Co. Ltd.* case (*supra*) for matching facts and other considerations. This again is a case of a company that had discontinued its business.

3. CIT v. Karanpura Collieries Ltd. [\[1993\] 201 ITR 498 \(Cal.\)](#)

In this case the assessee who went into winding up justified its claim for deduction of expenses under section 56/57 on the following plea:

" So long as a company is not formally struck off the Register of Companies, a company continues to have certain statutory obligations. The company has to file various statements and returns. For that purpose and also for the purpose of retaining its status as a company, it has to incur certain expenditure. Admittedly, the company was earning certain income from other sources. For that purpose, it might have been necessary to incur certain expenditure."

4. CIT v. Dwaraka Chit Funds (P.) Ltd. [\[1995\] 216 ITR 115/\[1996\] 84 Taxman 586 \(Mad.\)](#)

In this case also the expenses are given to have been incurred by the official liquidator of the assessee-company in the course of liquidation proceedings and the Court held that these expenses were incurred by the official liquidator wholly, exclusively and necessarily for the purpose of earning or making the income as contemplated under section 57(iii) of the Act.

Further the two decisions in *Karanpura Collieries Ltd. v. ITO* [\[1988\] 30 TTJ 548 \(Cal\)](#) and *ITO v. Dwaraka Chit Funds (P.) Ltd.* [\[1987\] 20 ITD 439 \(Mad.\)](#) referred to by the assessee are subordinate to the High Court decisions respectively reported in *Karanpura Collieries Ltd.* (*supra*). *Dwaraka Chit Funds (P.) Ltd.* (*supra*) so the facts remain static as in the above.

Therefore the facts in all the six cases referred to are exactly similar. In fact there are only four cases and not six, two being repeat cases citing ITAT order alongside Hon'ble High Court order when the reference of subordinate court does not warrant mention if HC judgement is cited in the same case. Additionally, these facts nowhere match to that in the case before the Delhi bench in *L S Cable India (P.) Ltd.* (*supra*). Ironically, No effort is made to weigh the facts and other considerations in the six (four) cases with that of the case of the assessee. In all the six cases the assessee carried stocks and assets and that it had to dispose it off to pay up its liabilities either through the liquidator or by itself and it is on that consideration the Courts held that the expenses incurred to carry on with such activity are incidental to the course of earning income or making income as contemplated under section 57(iii) of the Act. Whereas in the case before the Delhi bench the assets were to be acquired in the course of setting up of manufacturing business and quite reasonably therefore the expenses could not certainly be incurred for earning or making any income.

And the further considerate that the fact that the assessee is a company and therefore it had to incur certain expenditure for maintaining the corporate identify and to make certain compliances is not something that could alone decide on the admissibility of an expenses under the Act. This phrase is used by the Courts only with reference to the situations of winding up and closure of the business and therefore this cannot be applied to the case of a company which has not actually set up its business. Any expenditure incurred has to be allowable in accordance with law. And for s. 57(iii) application it is desirable that the expenditure must have direct nexus with the making or earning of income. If there is no nexus then no deduction could be

allowed. Only for the reason that the expenditure is to be incurred because the assessee holds corporate identity cannot be considered as yardstick for allowance of any expenditure under s. 57(iii). The decision of the Delhi Tribunal thus require reconsideration with reference to text "is in conformity with the settled position of law as such does not warrant any interference" when the facts in all the four cases are different from the facts of the assessee and ITAT is the final fact finding authority.

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