

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX REFERENCE NO. 110 OF 1995

M/s. Mather & Platt (I) Ltd.,]
Bombay.] ... Applicant

Vs

The Commissioner of Income Tax,]
Bombay City - VI, Bombay.] ... Respondent

Mr. Atul K. Jasani i/b Sonal Doshi & Co. for the Applicant.

Mr. Suresh Kumar for the Respondent.

**CORAM : S.J. VAZIFDAR, &
M.S. SANKLECHA, JJ.**

TUESDAY, 18TH SEPTEMBER, 2012

JUDGMENT : [Per S.J. Vazifdar, J.]

1. This is a Reference under section 256(1) of the Income Tax Act, 1961, arising from the order of the Income Tax Appellate Tribunal in ITA No.5873/Bom/86 and ITA 6060/Bom/86, relating to the assessment year 1983-84. The applicant-assessee and the respondent-Department filed two separate reference applications each. The

Tribunal drew up a statement of case seeking the opinion of this Court on the following questions which were at the assessee's request :

“(i) Whether on the facts and circumstances of the case, the Tribunal was right in holding that the expenses incurred by the employee after reaching the place of destination including stay expenses was to be treated as disallowance u/s 39 read with Rule 60 ?

(ii) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that reimbursement of medical expenses form part of salary / remuneration for computing disallowance u/s. 40(c) ?

(iii) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that for quantifying disallowance u/s 40(c) expenditure incurred by the company towards the personal use of motor cars provided to

the Directors was to be considered and not the perquisite value as per rule 3 of the Income Tax Rules ?

(iv) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the the rent of Rs.16,91,250/- was to be treated as capital expenditure and that the assessee acquired a capital asset thereby disallowing the entire amount claimed to be revenue expenditure ?

(v) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the depreciation allowable u/s. 32 of the Act, should not be at the rates prescribed by the income-tax Rules, as amended with effect from 2.4.1983 ?

(vi) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the depreciation was not allowable in respect of payment of Rs.16,91,250/- which was treated as capital expenditure for acquiring a capital asset ?”

The Tribunal also sought the opinion of this Court on the following question at the request of the Department :

“Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the disallowance under rule 6-D should be worked out on each employee basis rather than on trip basis ?”

2. It is agreed between the parties that Question Nos.(i) and (ii) are liable to be answered in the negative and in favour of the assessee in view of the judgment of this Court in *Commissioner of Income Tax v.*

Gannon Dunkerly & Co. (1993) 114 CTR (Bom) 56 and *Ceat Tyres of India Ltd. v. Commissioner of Income Tax (1994) 121 CRT (Bom) 80*, respectively and that Question No.(iii) is liable to be answered in the affirmative in favour of the respondent in view of the judgment of this Court in *Commissioner of Income Tax v. British Bank of Middle East (2001) 251 ITR 217*. It is also agreed that Question No.(vii), which was referred on the Department's request, is liable to be answered in the negative in favour of the respondent in view of the judgment of this Court in *Commissioner of Income Tax v. Aorow India Ltd. (1998) 229 ITR 325*. The Reference in respect of Question Nos.(i), (ii), (iii) and (vii) is answered accordingly.

3. As Question No.(vi) is in the alternative to Question No.(iv), we will first deal with Question No.(v).

Re: Question No.(v):

4. The assessee filed a return of income on 26th June, 1983, declaring a total income of Rs.2,91,84,530/-. An assessment order was passed under section 143(3). The assessee had, *inter-alia*,

claimed depreciation at a higher rate on the ground that the taxation laws amendment rule applicable from 2nd April, 1983, was applicable to all pending assessments, irrespective of the assessment year. The Assessing Officer held that the CBDT had clarified in a letter dated 13th June, 1983, that it was well settled that in taxing matters, the substantive law applicable is to an assessment year. He held that the Income-tax (Fourth Amendment) Rules, 1983, came into force only on 2nd April, 1983 and would, therefore, have effect for the assessment year 1984-85 and the subsequent years and not for the assessment year 1983-84 or the earlier years. The Commissioner of Income-tax (Appeals) also rejected the assessee's claim for depreciation at the rates prescribed under the new Income-tax Rules which were effective from 2nd April, 1983, in view of the decision of the Special Bench of the Tribunal.

The Tribunal also, following the earlier decision of a Special Bench of the Tribunal in *Rajapalayam Mills Ltd. v. ITO (1986) 18 ITD 114 (SD)* upheld the order of the Commissioner of Income-tax (Appeals).

5. Section 32 of the Act, as it stood at the relevant time, provided for depreciation in respect of the items mentioned therein owned wholly or partly by an assessee and used for the purposes of the business or profession at such percentage on the actual cost thereof to the assessee or such percentage on the written down value thereof, as the case may be, and as may be prescribed.

6. The Income-tax (Fourth Amendment) Rules, 1983, came into force on 2nd April, 1983. Rule 2 provided the rates at which depreciation is admissible. The question that falls for consideration is whether the assessee was entitled to claim depreciation for the assessment year 1983-84, on the basis of these amended Rules which came into force on 2nd April, 1983.

7. In *Andhra Cements Co. Ltd. v. Commissioner of Income-tax (1998) 232 ITR 364*, a Division Bench of the Andhra Pradesh High Court considered a similar case. The relevant assessment year in that case included the assessment year 1983-84. The question that fell for consideration in that case was the same viz. whether the Tribunal was

right in holding that the assessee was entitled to depreciation at the higher rates for the assessment year 1983-84 as per the Income-tax (Fourth Amendment) Rules, 1983. The Division Bench answered the question in the negative and in favour of the Department. We are entirely in agreement with the judgment of the Andhra Pradesh High Court and we find it unnecessary to do anything more than to refer to the relevant observations therein. They read as under :

“The main argument of learned counsel for the assessee is, since the rules are substituted, they are deemed to have come into force with effect from April 1, 1983, though the Fourth (Amendment) Rules were brought into force on April 2, 1983 ; therefore, the Tribunal is right in holding that the assessee is entitled for higher rate of depreciation for the assessment year 1983-84.

The contention of learned counsel for the assessee cannot be accepted as it is a well-settled principle of law, as held by the Supreme Court in Karimtharuvi Tea Estate Ltd. v. State of Kerala (1966) 60 ITR 262 that (headnote):

“It is well settled that the Income-tax Act as it stands amended on the first day of April on any financial year must apply to the assessment of that year. Any amendments in the Act which come into force after the first day of April of a financial year, would not apply to the assessment for that year, even if the assessment is actually made after the amendments come into force.”

Therefore, whatever is the rate of tax as on April 1, of the financial year 1983-84 is applicable to

the assessment year 1983-84 though the assessment is made subsequent to the amendment. Since the higher rates of depreciation have been brought into force on April 2, 1983, they cannot be made applicable to the assessee for the assessment year 1983-84.

Construing the Income-tax (Fourth Amendment) Rules, 1983, the Calcutta High Court also expressed a similar view in S.P. Jaiswal Estates Pvt. Ltd. v. CIT (1994) 209 ITR 307 where it was held (headnote) :

“The Income-tax (Fourth Amendment) Rules, 1983, by which the higher rate of depreciation was laid down came into effect on April 2, 1983. Rates of depreciation are matters of substantive law. The new rates were intended to apply only from the assessment year 1984-85 since these were not in force on April 1, 1983, on which the assessment year 1983-84 began.””

Question 5 is, therefore, answered in the affirmative – in favour of the Department and against the assessee.

Re: Question Nos.4 and 6 :

8. These questions require the interpretation of the agreements relied upon by the assessee. It is necessary, therefore, to set out the facts in some detail.

A lease deed was executed between the assessee (therein called the lessees) and one Prataprai N. Kothari (therein and hereinafter called the lessor) under which the lessor leased a factory shed to the

assessee on the terms and conditions mentioned therein, for a term of thirty years, commencing from 1s March, 1982, at a rent of Rs.28,500/- payable half-yearly. The first payment of rent was to be made on 25th March, 1982 and subsequent payments were to be made on or before the 10th day of January and July each year. Clauses 4(a), 4(d), 5(b) and (c) of the deed read as under :

“4. Provided always and it is hereby agreed by and between the Lessor and the Lessees.

(a) That the Lessees shall at all times during the said term be at full liberty to transfer, assign, underlet or to give on leave and licence basis on such terms and conditions as the Lessees may in their absolute descretion deed fit and demised premises or any part thereof at such rent and/or charges, fee or compensation and subject to such terms and conditions as the Lessees may in their absolute descretion deem fit. It is however agreed that such underletting or giving on leave and licence basis will not be a period exceeding the period of the lease hereby fixed.

.....

(d) That the Lessor shall not, during the continuance of this lease sell, transfer or otherwise dispose of or charge or encumber the demised premises or any part thereof so as to prejudice or adversely affect in any way the Lessees's rights and interests under these presents and in the event of any advance rent being paid by the Lessee to the Lessor pursuant to clause V(b) hereunder, the Lessor agrees and undertakes not to sell, lease, transfer or otherwise dispose of or charge or encumber the demised premises or any part thereto to or in favour of any third party.

.....

5. Provided further and it is hereby agreed as follows :

(b) The Lessees shall, if so required by the Lessor, pay to the Lessor rent in advance Rupees Twenty Eight Thousand Five Hundred for such period as the Lessor may specify. The amount of such advance rent, if any, so paid shall be adjusted and set off by the Lessor against the rent hereby reserved for the period covered by such advance rent.

(c) In the event of the Lessees being required to pay to the Lessor rent in advance as provided in clause 5(b) above and the lessees paying such advance rent and thereafter if the Lessees apply to the Court of small causes for fixation of standard rent and if the said court decided that the rent hereby fixed is in excess of standard rent, then and in such event the lessor will not be bound to refund such excess rent but the period of the lease hereby fixed will at the expiration of the period thereof stand extended for such further period as may be necessary that such excess rent will be applied in or towards the payment of the rent for such extended period and on the expiration of such extended period the lease will stand determined. Provided further and it is hereby agreed by and between the Lessor and the Lessees that the said rent of Rs.28,500/- hereby agreed to be paid by the Lessees to the Lessor as aforesaid is fixed in accordance with the prevailing rate of rent in the locality and the Lessees after making necessary inquiries have agreed to pay the said rent to the Lessor.”

9. The importance and significance of clauses 4 and 5 set out above may not be apparent on a reading of the lease deed itself. The

deed may still convey a transaction of lease and nothing more between the parties. However, read with the other facts, which we will now refer to, it is clear to us that the intention between the parties was to enter into an agreement of sale of the property by the lessor to the assessee.

10. On the same day as the date of the lease, i.e. 29th March, 1982, the lessor by a letter, in exercise of the power under clause 5(b), called upon the assessee to pay him a sum of Rs.16,76,750/- being the advance rent for 29 years and 6 months. The assessee by a cheque also dated 29th March, 1982, made the payment alongwith a covering note which stated that the payment was towards advance rent and that the amount would be used for adjusting monthly rent from September, 1992 onwards at Rs.4,750/- per month.

The lessor also issued a receipt in the sum of Rs.28,500/- at the foot whereof the payment was described as pre-paid rent at Rs.4,750/- per month from March, 1982 to August, 1982.

11. We will presume that these facts may also, in certain

circumstances, indicate nothing more than a regular agreement of lease between the lessor and the assessee. It is not unusual that parties enter into an arrangement for the payment of rent in advance. The entire significance of the sub-clauses of clauses 4 and 5 set out above and the arrangement of the parties on the same day as the execution of the lease is disclosed by what transpired between the parties purportedly on the next day viz. 30th March, 1982. We use the word “purportedly” advisedly for it is clear to us that the document that we will now refer to though dated 30th March, 1982, was part of a single, composite transaction between the lessor and the assessee for the purchase of property by the assessee from the lessor. Suffice it to state at this stage that clause 5 is incapable of misleading anyone into believing that it conferred a genuine option to the lessor to demand payment of rent in advance. The demand for rent by the lessor and the payment thereof by the assessee on the same day demonstrates the same.

12. A document dated 30th March, 1982, was executed between the parties.

13. In saying that the document is dated 30th March, 1982, we do not suggest that it was, in fact, entered into after the lease deed and is a separate transaction. The entire transaction is one of a sale of the property. Recital (D) states that the assessee had requested the lessor to grant it the option to purchase and acquire the property and that the lessor had agreed to do so for the consideration and upon the terms and conditions stated therein.

Clause 1 states that the lessor granted the assessee an option to purchase and acquire the premises for a further consideration of Rs.2,90,000/-. Under clause 2(a), the assessee was to pay a sum of Rs.5,000/- upon the execution of this agreement. Clause 2(b) provided that the balance Rs.2,85,000/- would be adjusted and appropriated by the lessor against the advance rent paid by the assessee to him for or in respect of the left five years of the period reserved under the indenture of lease.

14. In effect, therefore, there was no further consideration of Rs.2,90,000/-. The amount was to be adjusted against the advance

rent paid as aforesaid. The position, therefore, is that the assessee was put in possession of the property under the indenture of lease dated 29th March, 1982. The nature of the agreement indicates that the assessee had virtually the entire control and dominion in respect of the property. It was entitled to deal with it as it pleased. The entire payment under the lease had also been made. The agreement dated 30th March, 1982, gave the assessee a right to purchase and acquire the premises purportedly for a further consideration of Rs.2,90,000/-. That consideration had, in effect, been paid for it was to be adjusted against the advance rent already paid. Very little remained to be done by the assessee to purchase the property except possibly to have the formal documentation in respect thereof drawn up and registered. It is in this context that it is necessary to see the other provisions of the other agreement dated 30th March, 1982. The remaining clauses of the second agreement dated 30th March, 1982, viz. clauses 3 to 7 read as under :

“3. The Company shall at any time after the expiration of 5 years but before the expiration of 6 years from the date of commencement of the said in Indenture of Lease have the option, to be exercised in the manner hereinafter provided, to purchase and acquire the demise premises.

4. The aforesaid option shall be exercised by the Company giving to Mr Kothari 60 days notice in writing in that behalf.

5. Upon the Company complying with the requirements of clauses 3 and 4 above, the option to purchase or acquire the demise premises shall be deemed to have been duly exercised by the Company.

6. Notwithstanding anything to the contrary contained herein or implied, the purchase and acquisition of the demise premises by the Company in exercise of the aforesaid option shall become effective only upon the expiration of 25 years from the date of commencement of the said Indenture of Lease (that is to say, on 1st of March 2007) and upon such expiration, the Company shall become the full and absolute legal owner of the demise premises and as such owner shall become entitled to full/and exclusive use occupation possession and enjoyment thereof for ever. Mr Kothari for himself and his heirs and legal representatives, hereby irrevocably agrees and undertakes to execute in favour of the Company, on or before 15th of March 2007, all such documents as the Company and its solicitors may require or consider necessary for fully and effectively transferring and assuring unto the Company the demised premises and all the right title and interest of Mr Kothari or his heirs and legal representatives, as the case may be, in to over or upon the demise premises. In the event of Mr Kothari or his heirs and legal representatives, as the case may be, failing or neglecting to do so within the aforesaid period of 15 days for any reason whatsoever, Mr Kothari for himself and his heirs and legal representatives hereby irrevocably empowers and authorises the Company to do and execute on his or their behalf, as the case may be, all/acts deeds and documents as the Company may consider necessary proper or usual for the purpose of fully and effectively transferring and assuring unto the Company the

demised premises and all the rights, title and interest of Mr Kothari or his heirs and legal representatives, as the case may be, in to over or upon the same.

7. Should the Company fail to exercise the aforesaid option to purchase or acquire the demise premises in accordance with the provisions of clauses (3) and (4) above, the Company shall vacate the demise premises on the expiration or sooner determination of the said Indenture of Lease as therein provided.”

15. The entire arrangement between the parties, seen as a whole, clearly indicates that the parties never intended entering into an agreement of lease. They intended to and did enter into an agreement of sale of the property by the lessor to the assessee. The documents properly construed established not merely an agreement to sell, but an agreement of sale of the property by the lessee to the assessee. The important aspects which establish the same are that on the same day, the entire consideration had been paid, the assessee had been put in possession with powers being conferred upon it which were akin to those exercisable by the owner of the property. This is clear from clause 4. Although the agreement dated 30th March, 1982, refers to a further consideration, only a paltry, token amount of Rs.5,000/- was paid under that agreement. The balance alleged further payment of Rs.2,85,000/- was to be adjusted against the advance rent for 5 years

already paid. The advance rent for 5 years was exactly Rs.2,85,000/-. Clauses 3, 4, 5 and the first part of clause 6 are really of no substance or effect whatsoever. They merely purport to confer upon the assessee, an option to purchase the property. It is inconceivable that a party, who has paid the entire consideration in advance, would not exercise the option. It was merely a feeble and an infructuous attempt at indicating that the sale had not taken place on 29th March, 1982 itself. The latter part of clause 6 merely safeguarded the assessee against any possible attempt by the lessor to take advantage of the situation and deny the assessee's right as an owner. It is obviously for this reason that the power was conferred upon the assessee to perfect it's title by doing all things necessary and executing all documents, deeds and writings as may be necessary in respect thereof. To reiterate, therefore, the arrangement between the lessor and the assessee constituted a sale of the property by the lessor to the assessee.

16. The Assessing Officer rightly denied the assessee, deduction in respect of the lease rent. The Commissioner of Income-tax (Appeals) upheld the order of the Assessing Officer in this regard. He, however,

held that the expenditure was in the nature of a premium or *salami* and as such, treated it as a capital expenditure. He further held that it would be reasonable to allow depreciation on this expenditure and directed the Assessing Officer to allow depreciation after capitalizing the expenditure.

17. The Tribunal, after analyzing the documents, held that the arrangement between the parties conferred the benefit of ownership upon the assessee without the actual sale during the current accounting year. The Tribunal observed that the assessee had the right of user of the property for a long period and also obtained a future right to exercise the option to purchase the property after five years from the date of commencement of the lease. The Tribunal held that the assessee had acquired a capital asset and the expenditure had to be treated as capital expenditure. The Tribunal, however, held that as per the terms of the lease deed, the lessee i.e. the assessee was not the owner of the premises and that, therefore, the assessee was not entitled to depreciation in respect of it as under section 32, a lessee is not the owner of the property. The Tribunal, accordingly, set aside the

decision of the Commissioner of Income-tax (Appeals) directing the Assessing Officer to allow depreciation to the lessee.

18. With respect, there appear to be contradictory findings by the Tribunal. On the one hand, the Tribunal held that the arrangement between the parties was to confer the benefit of ownership upon the assessee and that the assessee had acquired a capital asset and the expenditure in doing so had to be treated as capital expenditure. On the other hand, the Tribunal held that the assessee being a lessee under the agreement, cannot be said to be the owner of the property and was, therefore, not entitled to depreciation under section 32.

19. Section 32 of the Act indeed entitles an assessee, who is the owner of a property, to depreciation. As we have already held, the arrangement between the lessor and the assessee was, in effect, an agreement of sale of the property by the lessor to the assessee. The assessee is, therefore, the owner of the property having acquired the same on 29th March, 1982, itself and, in any event, by 30th March, 1982.

20. It was not seriously argued that for the purpose of the Income Tax Act, the assessee would not be entitled to the benefit of depreciation merely because the agreement was not registered. In any event, this point is covered in favour of the assessee by the judgment of the Supreme Court in *Mysore Minerals Ltd. v. CIT* (1999) 239 ITR 775.

21. As we have come to the conclusion that on a true and correct interpretation of the documents, the assessee is the owner of the property, it is not necessary to consider the judgment of the Supreme Court in *Commissioner of Income-tax v. O.P. Monga* (1986) 162 ITR 224, relied upon by Mr. Suresh Kumar, the learned counsel appearing on behalf of the Department in support of his submission that a lessee of a property, not being the owner thereof, is not entitled to depreciation.

22. In the circumstances, Question No.(iv) is answered in the affirmative, in favour of the Department and against the assessee.

Question No.(vi) is answered in the negative, in favour of the assessee and against the Department.

23. The Reference is, accordingly, disposed of.

M.S. SANKLECHA, J.

S.J. VAZIFDAR, J.