COMMISSIONER OF INCOME TAX, KOLKATA

v.

M/S. HOOGLY MILLS CO. LTD.

NOVEMBER 22, 2006

[S.B. SINHA AND MARKANDEY KATJU, JJ.]

Income Tax Act, 1961—Section 32—Depreciation—On capital expenditure—Purchase of an undertaking—Accrued and future gratuity liability of the vendor also taken over by the purchaser—Claim for depreciation on the gratuity liability by the purchaser-assessee—Claim allowed by Courts below—Plea of Revenue that the liability being a revenue expenditure and not capital expenditure, not entitled to depreciation—In appeal, held: The gratuity liability is a capital expenditure—Even it being capital expenditure, assessee not entitled to depreciation, because the liability does not fall under any of the categories mentioned in Section 32.

Words and Phrases—'Plant'—Meaning of in the context of Section 43 (3) of Income tax Act, 1961.

Respondent-assessee vide an agreement purchased an Undertaking and took over the accrued and future gratuity liability thereof. He claimed depreciation under Section 32 of Income tax Act on the gratuity liability as the same was a capital expenditure. Commissioner of Income Tax (Appeals), Tribunal as well as High Court allowed the claim of the assessee. In appeal to this Court, appellant-Revenue contended that the liability being a revenue expenditure and not capital expenditure, assessee was not entitled to the depreciation.

Allowing the appeal, the Court

HELD: 1. It cannot be said that the expenditure on the taking over the gratuity liability of the employees of the vendor is not capital expenditure but revenue expenditure. No doubt, qua the vendor, the gratuity liability is a revenue expenditure, which is allowable as revenue expenditure in the year in which it has accrued (if the assessee maintained its account on mercantile basis). However, qua the vendee the position would be different. In the present case, in the agreement between the vendor and the assessee, it is mentioned

A that the vendor shall purchase the Industrial Undertaking as a going concern for a price of Rs.2 crores and shall also take over the gratuity liability. It is well settled that an agreement has to be read as a whole. Hence the consideration for the sale was not only Rs.2 crores but in addition the gratuity liability of the vendor as well. Thus the entire amount of consideration is a capital expenditure because it is an expenditure incurred for acquiring an asset of an enduring nature. [267-F-H; 268-A-B; G-H; 269-A]

Metal Books Co. of India v. *Workmen,* 73 ITR 53 62-67 and *Bharat Earth* v. *CIT,* 245 ITR 428; *Sassoon David* v. *CIT,* 118 ITR 271, referred to.

C *Altherton* v. *British and Helsbury Employees Ltd.,* (1926) AC 205, referred to.

2. However, even if it is held that the expenditure on taking over the gratuity liability is a capital expenditure, yet no depreciation is allowable on the same because Section 32 of the Income Tax Act states that depreciation D is allowable only in respect of buildings, machinery, plant or furniture, being tangible assets, and know-how patents, copyrights, trade marks, licenses, franchises or other business or commercial rights of similar nature being intangible assets. The gratuity liability taken over by the respondent does not fall under any of those categories specified in Section 32 of Income Tax Act. Hence no depreciation can be claimed in respect of the gratuity liability E even if it is regarded as capital expenditure. In fact, depreciation cannot even be allowed on land because that too is not mentioned in Section 32. [269-B-E]

3. In the present case, the agreement of sale, separately mentioned the price of the land, building and the machinery. Had it been a case where the agreement to sale mentioned the entire sale price without separately F mentioning the value of the land, building or machinery, the matter could have been remitted to the Tribunal to calculate the separate value of the items mentioned in Section 32 and granted depreciation only on these items. However, in the present case, the agreement itself mentioned the value of the building, plant and machinery. Hence it is not necessary to remit the matter G to the Tribunal in this case. [269-E-G]

4. The word 'plant' had been given the deeming meaning vide Section 43(3) but even this deeming meaning does not include the gratuity liability. Hence, no depreciation can be granted on the gratuity liability taken over by the respondent assessee. [269-G-H]

H

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 5149 of 2006. A

From the Judgment and Order dated 26-6-2003 of the High Court of Calcutta in I.T. Appeal No. 404/2000.

K.P. Pathak. A.S.G., Chidananda D.L., B.V. Balaram Das, Gaurav Dhingra and Navaneet Baruah for the Appellant. B

Jaideep Gupta, Dipak Kumar Jena, Minakshi Jena, Pabitra Biswas and Indra Sawhney for the Respondent.

The Judgment of the Court was delivered by

C

MARKANDEY KATJU, J. Leave granted.

This appeal by special leave has been filed against the impugned judgment of the Calcutta High Court dated 26.6.2003 in ITA No. 404 of 2000.

Heard the learned counsel for the parties and perused the record. D

The respondent M/s. Hooghly Mills Co. Ltd. had by an agreement dated 24.3.1988 with the vendor, purchased an Undertaking and by the same agreement had also taken over the accrued and future gratuity liability of the vendor, which amounted to Rs.3.5 crores. The respondent assessee claimed that since this amount of Rs.3.5 crores towards gratuity is capital expenditure E hence it is entitled to depreciation on the sum under Section 32 of the Income Tax Act.

The CIT (Appeal) as well as the tribunal allowed the assessee's claim and their orders were upheld by the High Court by the impugned judgment.

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Learned counsel for the appellant contended in this appeal that the expenditure on the taking over the gratuity liability of the employees of the vendor is not capital expenditure but revenue expenditure. He has referred to Section 4(1) of the Payment of Gratuity Act, under which the liability of the employer to pay gratuity to its employees accrues as soon as the concerned G employee completes five years' continuous service, and such gratuity is payable on superannuation or retirement or resignation or death or disablement due to accident or disease.

In our opinion, this submission of the learned counsel for the appellant suffers from a fallacy. No doubt, qua the vendor, the gratuity liability is a H

A revenue expenditure, which is allowable as revenue expenditure in the year in which it has accrued (if the assessee maintained its account on mercantile basis) vide *Metal Books Co. of India* v. *Workmen,* (73 ITR 53 [62-67]), *Bharat Earth* v. *CIT* (245 ITR 428), *Sassoon David* v. *CIT,* (118 ITR 271), etc. However, qua the vendee the position would be different. In the present case, in the agreement dated 24.3.1988 between the vendor (Fort Gloster Industries Ltd.) and the assessee, it is mentioned that the vendor shall purchase the Industrial Undertaking w.e.f. 26.3.1988 as a going concern for a price of Rs.2 crores and shall also take over the gratuity liability. In clause 1(C) of the said agreement it is stated :

> "(C) The amount of consideration agreed to be paid by the purchaser to the vendor shall be apportioned amongst the following heads :

		(Rs. in Lacs)
(A)	Land	5
(B)	Buildings, structures, godowns sheds and all other constructions and properties of immovable nature at the said premises	35
(C)	Plant, Machinery and other movables	160
		200

In the same agreement it was also stated :

> "In addition to the consideration as mentioned in 1(A), the accrued and future gratuity liability of the taken over workers, junior and senior officers, on their retirement or otherwise on termination of their services payable under the Payment of Gratuity Act or otherwise including for the entire period of service with the Vendor shall be on Purchaser's account and shall be met by the Purchaser."

Thus in the same agreement of sale of the Undertaking it was not only mentioned that the vendee will pay to the vendor the sum of Rs.2 crores as a consideration but in addition to it will also take over accrued and future gratuity liability of the employees. It is well settled that an agreement has to be read as a whole. Hence the consideration for the sale was not only Rs.2 crores but in addition the gratuity liability of the vendor as well.

Thus the entire amount of consideration is a capital expenditure because

it is an expenditure incurred for acquiring an asset of an enduring nature, vide *Altherton* v. *British and Helsbury Employees Ltd.*, (1926) AC 205. Each case, however, has to be determined on its own facts and no hard and fast rule can be laid down therefor.

However, even if we reject the aforesaid submission of the learned counsel for the Revenue (as we are inclined to do) and hold that the expenditure on taking over the gratuity liability is a capital expenditure, yet in our opinion no depreciation is allowable on the same because Section 32 of the Income Tax Act states that depreciation is allowable only in respect of buildings, machinery, plant or furniture, being tangible assets, and know-how patents, copyrights, trade marks, licenses, franchises or other business or commercial rights of similar nature being intangible assets.

The gratuity liability taken over by the respondent does not fall under any of those categories specified in Section 32. Hence, in our opinion, no depreciation can be claimed in respect of the gratuity liability even if it is regarded as capital expenditure. The gratuity liability is neither a building, machinery, plant or furniture nor is an intangible asset of the kind mentioned in Section 32(1)(ii). Hence, we fail to see how depreciation can be allowed on the same. In fact, depreciation cannot even be allowed on land because that too is not mentioned in Section 32.

It may be mentioned that in the present case, the agreement of sale, dated 24.3.1988 separately mentioned the price of the land, building and the machinery.

Had it been a case where the agreement to sale mentioned the entire sale price without separately mentioning the value of the land, building or machinery, we would have remitted the matter to the tribunal to calculate the separate value of the items mentioned in Section 32 and granted depreciation only on these items. However, in the present case, the agreement itself mentioned the value of the building, plant and machinery. Hence it is not necessary to remit the matter to the tribunal in this case.

No doubt, the word 'plant' had been given the deeming meaning vide Section 43(3) but even this deeming meaning does not include the gratuity liability. Hence, in our opinion no depreciation can be granted on the gratuity liability taken over by the respondent assessee.

As a result, this appeal has to be allowed. The impugned judgment of

A the High Court as well as the Income Tax Authorities which have allowed depreciation on the gratuity liability are set aside and it is directed that the assessee is not entitled to any depreciation allowance on the gratuity liability nor on the value of the land in respect of the concern purchase by it. The appeal is allowed. No order as to costs.

B K.K.T. Appeal allowed.