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18 April 2020

Employment generation incentive and expenditure on abandoned business expansion plans

The Bangalore Bench of the Tribunal has held that deduction under Section 80JJAA of the Income-tax Act is available even if the additional employees satisfy the condition relating to days of employment in the succeeding year and not in the initial year. The Tribunal has also held that expenditure for abandoned business expansion plan being capital in nature is not allowable as a deduction.

Facts of the case:

Issue 1 - Deduction under Section 80JJAA of the Income-tax Act, 1961 (Act)

Texas Instruments (India) Private Limited (the taxpayer)¹ is in the business of software development. The taxpayer had hired 287 new employees during the Financial Year (FY) 2006-07. These new employees had joined on or after 12 June 2006, and hence, could not have been put to service for more than 300 days during the FY 2006-07. The said 287 new employees had worked for more than 300 days during the FY 2007-08 relevant to Assessment Year (AY) 2008-09.

For AY 2008-09, the taxpayer had claimed a tax deduction under Section 80JJAA of the Act amounting to INR 75,722,069.

The Assessing Officer disallowed the deduction under Section 80JJAA of the Act on the following basis:

- Software professionals are highly skilled workers and the nature of work performed by them were highly skilled. The term 'workmen' for the purposes of Section 80JJAA of the Act, as per the Assessing Officer, was the definition as per Industrial Disputes Act, 1947. The skilled work contemplated by the definition of workmen in the Industrial Disputes Act, 1947, is ordinary skill and therefore the workmen of the taxpayer cannot be considered as 'workmen' for the purpose of Section 80JJAA of the Act; and
- If the condition for grant of deduction under Section 80JJAA of the Act is not satisfied in the first year of employment of new employees, then the additional wages paid to such new employees will not be allowed in the second and third year also. These 287 employees did not work for more than 300 days in AY 2007-08 (being the first year). Hence, the wages paid to these new employees in AY 2008-09, do not qualify for deduction under Section 80JJAA of the Act.

On appeal, the Commissioner of Income-tax Appeals [CIT(A)], upheld the disallowance by the Assessing Officer on the basis that, if the condition of 300 days is not satisfied in the first year, then the additional wages will not be allowed in second and third year.

Aggrieved by the order passed by CIT(A), taxpayer preferred an appeal before the Income-tax Appellate Tribunal (ITAT).

¹ IT(TP)A No.169/Bang/2014 and IT(TP)A No.149/Bang/2014

Issue 2 – Expenditure incurred for abandoned business expansion plans

The taxpayer in FY 2006-07 was planning expansion of its business premises and in that regard employed consultants and contractors for planning, designing and constructing the new building. However, towards end of FY 2006-07, the taxpayer decided to abandon the expansion plan. Accordingly, the entire expenditure incurred towards the expansion of the building premises was written off in the profit and loss account for FY 2006-07.

Subsequently, in FY 2007-08 relevant to the current appeal, certain additional claims of INR 6,104,942 were made against the taxpayer towards planning, designing, architecture fees. Further, the taxpayer paid damages of INR 38,110,000 to the contractor in-charge for putting up business premises. The taxpayer claimed a tax deduction for these expenses on the basis that the same was incidental to carrying on business of the taxpayer.

The Assessing Officer disallowed the claim of the taxpayer on the basis that the expenditure was capital in nature and cannot be allowed as a deduction.

On appeal, the CIT(A) upheld the disallowance by the Assessing Officer.

Decision of the ITAT:

Issue 1 - Deduction under Section 80JJAA of the Act

- The ITAT, with respect to qualification of employees as 'workmen' relied on the decision of the Bangalore ITAT in the taxpayer's own case, which upheld that employees in the software industry can be said to be 'workmen'. The Bangalore ITAT in that case has held that software industry has also been notified as industry for the purpose of Industrial Disputes Act, 1947, by the state of Karnataka, and that the employees employed in software development industry render technical services and not services in the nature of supervisory or management character.
- The ITAT, with respect to the condition of number of 300 days being satisfied in subsequent year, referred to the decision of the Bangalore ITAT in the case of Bosch Ltd.². It held that it has to be seen in each year that the employee has worked for at least 300 days and that such workman was not a casual workman or workmen employed through contract labour.

It would not be proper to say that, if the deduction is refused in the first year of employment for new employee then, for the next two succeeding years also, the benefit of deduction will not be available. Such an approach defeats the purpose of Section 80JJAA. Accordingly, if in the first year of employment, the additional wages paid is not allowed deduction for the reason that the workman did not work for 300 days or more, but if he works in next two years for more than 300 days each, then the deduction under Section 80JJAA has to be allowed.

The ITAT has also referred to the amendment introduced by Finance Act, 2018 allowing such deduction under Section 80JJAA of the Act in subsequent year (if the new employee satisfies the condition of number of days in the subsequent year). The ITAT has held that the benefits should be available prior to the said amendment also.

Issue 2 – Expenditure incurred for abandoned business expansion plans

- The ITAT followed the Bangalore ITAT judgement in the taxpayer's own case for the earlier year i.e. FY 2006-07 and held that the claim was in the nature of a capital expenditure.

² Bosch Ltd. vs ACIT (2016) 74 taxmann.com 161 (Bangalore ITAT)

The earlier decision of the Bangalore Tribunal had held that the judicial precedents³ relied upon by the taxpayer, related to the expenditure which was in the nature of revenue incurred with the object of enhancing profitability and the efficiency of the existing business. It had held that expenditure incurred in the revenue field for expansion of an existing unit is allowable, whereas the expenditure on capital account cannot be allowed as a revenue expenditure. It mentioned that in the taxpayer's case, the expenditure was incurred to bring into existence a capital asset and hence, not allowable.

- The ITAT also observed that the judicial precedents⁴ relied upon by the taxpayer were dealt with and distinguished by the Assessing Officer.
- With respect to claim for damages, the ITAT held that though it was in connection with not engaging contractor in future for other contracts, it could not be regarded as having no nexus with the capital work in progress written off. Hence, deduction could not be allowed and the expenditure was rightly held as capital expenditure.

Observations:

Issue 1 - Deduction under Section 80JJAA of the Act

- The ruling deals with the provisions of Section 80JJAA of the Act, prior to the amendment introduced for availability of deduction in cases where the condition relating to employment (for minimum number of days), is satisfied in the succeeding year of new employment. This ruling will thus strengthen the claim of taxpayers for years prior to amendment in Section 80JJAA of the Act.
- Interestingly, as per the amended provisions, if a new employee is employed in the first year for less than minimum period, but satisfies the condition in the immediately succeeding year, then, he is deemed to have been employed in the succeeding year. As per the current ruling, with respect to years prior to amendment, it appears that the deduction will be available only for the remaining years for which the condition is satisfied in comparison to the amended provisions whereby the benefit may be available for three years.
- It may be noted that the specified minimum period of employment which was earlier 300 days now stands reduced to 240 days and, in specified industries, to 150 days.

Issue 2 – Expenditure incurred for abandoned business expansion plans

- Write-off of expenditure for abandoned expansion plans / projects has been a litigative issue. This ruling emphasises the requirement to justify the nature of expenditure based on facts for abandoned expansion plans / projects as being revenue in nature. Taxpayers should evaluate and consider the impact of the above ruling while claiming expenditure for abandoned expansion plans / projects.

³ Indo Rama Synthetics (I) Ltd. vs CIT (333 ITR 18) (Del HC); Binani Cement Ltd. vs CIT [2015] 60 taxmann.com 384 (Cal HC); DCIT vs Mukund Ltd. ITA No. 2708/Mum/2009 (Mum ITAT); CIT Vs Idea Cellular Ltd. [2016] 76 taxmann.com 77 (Bom HC)

⁴ Empire Jute Mills Ltd. vs CIT 124 ITR 1 (SC); CIT vs ACC Ltd. 172 ITR 257 (SC); ACIT vs Sutlej Industries Ltd. 94 TTJ 108 (Delhi ITAT); Excel Industries Ltd. vs Dy. CIT 86 TTJ 840 (Mumbai ITAT); CIT vs Graphite India Ltd. 221 ITR 862 (Calcutta).



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