



## Global Business Tax Alert

### Sharp Insights

**The Apex Court of India in the case of Berger Paints India Ltd<sup>1</sup>. has clarified that the term “capital employed in the business of the company” shall not include amount collected by the taxpayer on account of security premium on issue of share capital for claiming deduction under Section 35D of the Income Tax Act, 1961 (“the Act”).**

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**In this issue:**

[Background / Facts](#)  
[Issue for consideration before Apex Court](#)  
[Ruling of the Apex Court](#)  
[Conclusion](#)  
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[Contacts](#)

<sup>1</sup>Berger Paints India Ltd. v. Commissioner of Income-tax [2017] 79 taxmann.com 450

## Background / Facts

- The taxpayer filed its Return of Income ("ROI") for assessment year 1996-97.
- The ROI was selected for scrutiny by AO under section 143(3) of the Act.
- The taxpayer in its ROI claimed a deduction under Section 35D of the Act for Rs 703,306 towards preliminary expenses being 2.5% of the 'capital employed in the business of the company'.
- The AO was of the view that the expression 'capital employed in the business of the company' does not include the premium received on share capital. Hence, he recalculated the deduction under Section 35D of the Act for Rs 195,049 by reducing the share premium received by the taxpayer from capital employed in the business as claimed by the taxpayer in the ROI.
- Aggrieved by the order of the AO, the taxpayer filed an appeal before first appellate authority [Commissioner of Income Tax (Appeals) (CIT) (A)] who allowed the relief to the taxpayer.
- The revenue filed an appeal before the Tribunal against the order of the CIT (A) and Tribunal decided the case in favour of the revenue.
- High Court also concurred with the view of the Tribunal on taxpayer's further appeal to the High Court.

## Issue for consideration before Apex Court

Whether "premium" collected by the taxpayer on its subscribed share capital is part of 'capital employed in the business of the company' within the meaning of Section 35D of the Act.

## Ruling of the Apex Court

- The Apex Court observed that the expression 'capital employed in the business of the company' as defined in explanation (b) of sub section (3) of section 35 of the Act covers within its ambit, aggregate of the issued share capital, debentures and long term borrowings. Security premium has not been specifically included.
- The court concluded that had it been the intention of the legislature to treat the amount of premium as part of the share capital, they would have specifically stated so. Non-mentioning of the words, clearly indicates the legislative intent to not extend the benefit of Section 35D to such sum.
- Reliance was placed on its earlier decision in the case of Allahabad Bank Ltd.<sup>2</sup>, wherein the Court allowed the amount of share premium to be included in the 'paid-up capital' in that case since such inclusion was specifically permitted under the relevant provisions of the law.
- The Court also took note of the following:
  - Section 78 of the Companies Act "*issue of shares at premium and discount*" also requires a company to keep the amount collected as security premium in a separate account named as "*securities premium account*" and not treat it as a part of share capital account.
  - Annual Return Form<sup>1</sup> prescribed the Companies Act does not include in its "*issued share capital break up*", the premium amount collected by the company from its shareholders.
- Thus, the Court confirmed the order of the High Court, holding that the share premium amount received by the company cannot be considered as a part of "capital employed in the business of the company" for the purpose of Section 35D(3)(b) of the Act.

<sup>2</sup>Commissioner of Income Tax v. Allahabad Bank Ltd. [1969] 2 SCC 143

## Conclusion

The Apex Court has clarified the law regarding computation of deduction under section 35D and taxpayers may suitably consider the impact of this decision on any ongoing litigation. Separately, it is a moot question whether in view of the recent changes in the financial reporting standards i.e. Ind AS, whether there may be an opportunity for the Apex Court to revisit the said ruling in an appropriate case in the future.

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## Contacts

### Ahmedabad

19<sup>th</sup> Floor, Shapath - V  
SG Highway,  
Ahmedabad – 380 015.  
Tel: + 91 (079) 6682 7300  
Fax: + 91 (079) 6682 7400

### Coimbatore

Shanmugha Manram  
41, Race Course,  
Coimbatore  
Tamil Nadu - 641018  
Tel: + 91 (0422) 439 2801  
Fax: +91 (0422) 222 3615

### Kolkata

Bengal Intelligent Park Building  
Alpha, 1st floor, Block EP and GP  
Sector V, Salt Lake Electronics  
Complex,  
Kolkata - 700 091.  
Tel : + 91 (033) 6612 1000  
Fax : + 91 (033) 6612 1001

### Bangalore

Deloitte Centre, Anchorage II,  
100/2, Richmond Road,  
Bangalore 560 025.  
Tel: +91 (080) 6627 6000  
Fax: +91 (080) 6627 6010

### Delhi/Gurgaon

Building 10,  
Tower B, 7th Floor,  
DLF Cyber City,  
Gurgaon 122 002  
Tel : +91 (0124) 679 2000  
Fax : + 91 (0124) 679 2012

### Mumbai

Indiabulls Finance Centre,  
Tower 3, 28th Floor,  
Elphinstone Mill Compound,  
Senapati Bapat Marg, Elphinstone  
(W),  
Mumbai – 400013  
Tel: + 91 (022) 6185 4000  
Fax: + 91 (022) 6185 4101

### Chennai

No.52, Venkatanarayana Road,  
7th Floor, ASV N Ramana Tower,  
T-Nagar,  
Chennai 600 017.  
Tel: +91 (044) 6688 5000  
Fax: +91 (044) 6688 5050

### Hyderabad

1-8-384 and 385, 3rd Floor,  
Gowra Grand S.P.Road,  
Begumpet,  
Secunderabad – 500 003.  
Tel: +91 (040) 6603 2600  
Fax: +91 (040) 6603 2714

### Pune

106, B-Wing, 7<sup>th</sup> Floor,  
ICC Trade Tower,  
Senapati Bapat Road,  
Pune – 411 016.  
Tel: + 91 (020) 6624 4600  
Fax: +91 (020) 6624 4605



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