

**IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'B' NEW DELHI**

**ITA No.5549/Del/2010
Assessment Year: 2006-2007**

**M/s COSMIC KITCHEN PVT LTD
B-109, GREATER KAILASH, PART-I
NEW DELHI
PAN NO:AACCC5193K**

Vs

**ASST COMMISSIONER OF INCOME TAX
CIRCLE-3(1), NEW DELHI**

C L Sethi, JM and K G Bansal, AM

Dated: May 13, 2011

ORDER

Per: K G Bansal:

The only ground taken in this appeal, filed by the assessee, is that the learned CIT(A) erred in disallowing depreciation of Rs.2,70,744/- in respect of preoperative expenses allocated to fixed assets. It is also mentioned that he erred in holding that the expenses were revenue in nature and not linked with installation of various assets.

2. The facts of the case are that the assessee-company filed its return on 29.11.2006 declaring loss of Rs.30,94,980/-. The return was processed u/s 143(1) of the Income-tax Act, 1961, on 13.10.2007. A notice u/s 143(2) dated 10.10.2007 was served on the assessee for making scrutiny assessment. It was found that .the assessee is engaged in the business of manufacturing and trading in cakes, pastries, biscuits, bread, other bakery products, chocolate products, confectioneries and allied foods products. These products are directly supplied to institutional customers. It is also operating a resto named "Choko la".

2.1 On perusal of the accounts and notes thereto, it was found that .the assessee company commenced commercial operations from 13.10.2005. In view thereof, the assessee was requested to file the details of pre-operative expenses. According to the details submitted, expenditure of Rs.16,93,153/- was incurred before 13.10.2005, the details of which are as under:-

S.No.	Particulars of Expenses	Up to 13.10.2005
1.	Admn. & General Expenses	66,829
2.	Conveyance	5,604
3.	Electricity, Gas & water	73,069

4.	Kitchenware	12,131
5.	Net Consumption of material	1,98,082
6.	Occupation cost/rent	9,09,194
7.	Payroll costs	4,25,169
8.	Transportation charges	3,075
	Total	16,93,153

2.2 As the expenses had been incurred prior to commencement of business, the assessee was requested to state as to why the claim of depreciation of Rs.2,70,744/- , in respect of pre-operative expenses should not be disallowed. It was submitted that the expenses have been incurred for the purpose of setting up the assets of the company and, therefore, these have been allocated to various assets in the ratio of the cost of the asset to the total cost. However, the Assessing Officer did not accept this contention. It has been held that the expenses are revenue in nature and not linked to any asset used for the purpose of business after 13.10.2005. Therefore, the deduction of depreciation on these expenses was disallowed. The learned CIT(A) confirmed this finding by mentioning that the assessee has not been able to substantiate that the expenses were incurred for acquisition of any fixed asset. U/s 32 of the Act, the deduction for depreciation can be granted only in respect of specified assets subject to the condition that the expenditure is incurred for its cost.

3. Before us, the learned counsel drew our attention towards the findings of the Assessing Officer and the learned CIT(A). Our attention has also been drawn towards major expenses, being administrative and general expenses of Rs.73,069/-. Net consumption of material of Rs.1,98,082/-, rent of Rs.9,09,194/- and personnel's salary of Rs.4,25,169/-. It is submitted that electricity, gas and water charges, consumption of material charges, and kitchenware expenses of Rs.12,131/- were incurred in the course of trial production. The rent is in respect of premises in which the equipments have been set up. It was submitted before the lower authorities that prior to commencement of business on 13.10.2005, all the activities were centered around putting up various fixed assets to bring them to working condition. Thus, the only activity carried out upto this date, was to put up the plant and other fixed assets so that the business of manufacture of various food products may be carried out. Since these expenses were incurred for putting up the assets, they were required to be capitalized towards the cost. The rent was in respect of the land on which assets were installed for carrying out the business. The expenses on electricity, gas and water were incurred for running various assets in the construction period. Coming to the legal issue, it is submitted that depreciation u/s 32 of the Act is allowed on actual cost of the asset, which means the actual cost to the assessee. This cost should be construed in ordinarily commercial manner. Thus, it will include the cost incurred to bring the asset to the running condition. It was further submitted that expenses such as legal charges and stamp duty in the case of land, architect fees in case of building, wages and salary paid for installation of machinery and interest on borrowed capital used for purchase of machinery upto the date of installation thereof are capital expenses. From the above, it would transpire that any expenditure on putting up fixed asset will amount to the cost of fixed asset. It was also submitted that AS-10 regarding "accounting for fixed assets" issued by the ICAI specifies the components of cost of a fixed asset. Thus, the purchase price of an asset includes import duties, levies, non-refundable taxes and any other cost directly

attributable to the asset for bringing it to the working condition. The examples given in AS-10 are site preparation, initially delivery and handling cost, installation cost, such as laying foundations, and professional fees for architects and engineers. The preliminary project expenditure, indirect expenditure relating to construction and other indirect expenditure not related to construction have been included in the cost of the asset. Accordingly, it is argued that the expenses are required to be capitalized and that the allocation has been made by the assessee on a reasonable basis in the ratio of cost of the asset to the total cost.

3.1 In reply, the learned DR referred to the findings of the Assessing Officer and the learned CIT(A) that all the expenses are revenue in nature. The assessee has not been able to bring any evidence on record that any of the expenditure was related to a particular asset. In fact, the expenditure has been allocated to the assets on a proportionate basis. The assessee has also been dealing in soft drinks in the precommencement period. Therefore, it is argued that the expenses cannot be allowed to be capitalized.

3.2 In the rejoinder, the learned counsel submitted that the assessee is not dealing in software. It is manufacturing various food items and selling them institutional customers.

4. We have considered the facts of the case and submissions made before us. The facts are that the assessee has incurred expenditure of Rs.16,93,153/- in the pre-commencement period, which has been debited under 8 heads, the details of which have already been furnished. Prima facie all the expenses are revenue in nature. The assessee has not been able to link any of the expenditure with a particular fixed asset. However, its case is that in this period, it was only engaged in putting up fixed assets on rented land. Since the expenses were incurred for setting up fixed asset, they had to be capitalized. The assessee has capitalized the expenses in the ratio of the cost of the asset to the total cost, which is a reasonable basis. On the other hand, the of the learned DR is that in absence of any corelation of any expenditure with any fixed assets, the expenses which are of revenue in nature, cannot be capitalized.

4.1 Section 43(1) defines "actual cost" to mean actual cost of the asset to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

4.2 In the case of *CIT Vs. Food Specialties Limited, (1982) 136 ITR 203 (Delhi)*, it has been mentioned that it seems that the Tribunal was not wrong in holding that the expenditure of test runs was a capital expenditure. Therefore, expenses involved in purchase of milk and determining that the factory was in proper working condition and making adjustment does not seem to be anything more than steps in setting up and finalization of the factory, which is the capital asset. After tests have been carried out, it can be said that the factory had been set up and it is ready for commercial production. Therefore, the expenses can be said to have been incurred as cost of the plant and machinery. When comparing the facts of the case, it can be said that the expenses incurred on kitchenware and consumption of material during trial run are to be capitalized towards the cost of plant and machinery.

4.3 In the case of *Challapalli Sugars Limited Vs. CIT (1975) 98 ITR 167 (Supreme Court)*, it has been held that interest of Rs.2,38,614/- incurred on borrowed capital

for purchase of plant and machinery, accruing to the date of installation of the machinery is a capital expenditure, on which depreciation and development rebate are admissible. From this decision it can be said that if an expenditure which is otherwise of revenue in nature, has been incurred towards acquisition of a capital asset, it will be the cost of the asset provided it has been incurred upto the date of installation of the asset. However, it is also clear that there should be a direct nexus between expenditure and putting up of the asset, which is missing in this case. Therefore, the ratio of this decision does not advance the case of the assessee.

4.4 In the case of *CIT Vs. Lucas-TVS Limited (No.2), (1977) 110 ITR 346*, one of the questions before the court was – whether, on the facts and in the circumstances of the case, it has been rightly held that the sum of Rs.1,30,768/- representing indirect expenditure on salaries, rent, lighting, etc. and allocated to various assets formed part of the capital asset for the eligibility of depreciation allowance and in relation to the cost of the machinery was eligible for development rebate also? The facts of the case are that the assessee-company acquired land near Madras and erected buildings, plant and machinery etc. It also took on lease adjoining land for its use from integral coach factory. After completing the work of erecting the factory to certain stage, the production commenced on 01.12.1962. The accounts of the assessee were closed for the first time on 30.11.1962, during which it incurred total expenditure of Rs.5,86,509/- relating to salaries, rent, lighting etc. This expenditure was capitalized and allocated to the capital assets in the ratio of direct cost of the assets. Depreciation allowance and development rebate were claimed. The Assessing Officer held that the expenses amounting to Rs.1,30,768/- were in no way connected with installation of assets. Therefore, he excluded this amount and recomputed the cost of assets. The Hon'ble Court mentioned that the question is covered by the decision of Supreme Court in the case of *Challapalli Sugars Limited Vs. CIT (supra)* and *CIT Vs. Hindustan Petroleum Corporation, (1975) 98 ITR 167*, in which it has been held that accepted accountancy rule for determining cost of fixed assets is to include of expenditure necessary to bring such assets into existence and to put them in working condition. Therefore, the question was decided in favour of the assessee and against the revenue. Having considered the facts of the case, we are of the view that they are similar and, therefore, the ratio of this case is applicable. As the aforesaid decision directly covers the issue at hand, we do not think it necessary to go into the case of *Sangroor Vanaspati Limited Vs. CIT (2007) 288 ITR 222 (Punjab & Haryana)*.

4.6 In a nutshell, it is held that the expenses incurred by the assessee are required to be capitalized in the light of the decision in the case of *Food Specialties Limited and Lucas-TVS Limited (no.2) (supra)*. We are also of the view that the proportionate method employed by the assessee is fair and reasonable.

5. In result, the appeal is allowed.

(This order was pronounced in open court on 13.5.2011.)