

EY Tax Alert

Madras HC denies depreciation on toll road or toll bridge but allows amortization as per the CBDT Circular

Executive summary

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This Tax Alert summarizes a recent Madras High Court (HC) ruling in the case of L&T Infrastructure Development Projects Ltd. and LTIDPL INDVIT Services Ltd.¹ (Taxpayers) on allowability of tax depreciation under the Indian Tax Laws (ITL) on cost incurred for development of toll road and toll bridge (infrastructure facility) under a Build-Operate-Transfer (BOT) arrangement with a statutory authority.

The Taxpayers claimed tax depreciation on such cost by classifying the asset as "tangible asset" in the nature of "plant". However, there is divergence of judicial view on the issue. The Bombay HC² denied depreciation on such asset by holding that toll road does not belong to a concessionaire. However, the Delhi HC³ and Allahabad HC⁴ allowed depreciation, but by holding such asset to be "tangible asset" in the nature of "building". On the other hand, several Tribunals allowed depreciation by holding the right to collect toll as "intangible asset". Earlier, the CBDT⁵ had issued a Circular no. 9/2014 dated 23 April 2014 (Circular) expressing the view that although a taxpayer cannot claim depreciation on such asset since toll road does not belong to the taxpayer, the cost can be amortized evenly over the concession period (excluding the construction period).

¹ [TS-1043-HC-2022(Mad)]

² North Karnataka Expressway Ltd. [TS-679-HC-2014(BOM)]

³ Moradabad Toll Road Co. Ltd. [2014] (369 ITR 403)

⁴ Noida Toll Bridge Co. Ltd. [2013] 213 Taxman 333

⁵ Central Board of Direct Taxes - The apex administrative body for direct taxes in India

Amidst the judicial conflict, the Madras HC, in the present case, held that to claim tax depreciation, condition of ownership should be satisfied. In case of BOT arrangement, the ownership of underlying land or the infrastructure facility always remains with the Government and is never transferred to the concessionaire. Absent ownership of the infrastructure facility with the Taxpayers, the Taxpayers cannot claim depreciation on the cost incurred. Furthermore, toll road and toll bridge do not fall within the definitions of "plant" or "building" in the ITL. Although the definition of "building" includes roads and bridges, in the absence of ownership, the toll road/bridge does not fall within the scope of "building". Thus, it dissented from the view adopted by Delhi and Allahabad HCs.

The Madras HC also rejected the alternative claim of depreciation as intangible asset, as according to HC, meaning of the term "licenses" and "other business or commercial rights of similar nature" used in the definition of "intangible assets" should be inferred from the meaning of the words along with which they have been used (namely, know-how, patents, copyrights, trademarks, franchises), by applying the interpretation principle of *noscitur a sociis*. The Madras HC concluded that the CBDT Circular enunciated the correct legal position by denying depreciation but allowing amortization.

Background

- Infrastructure for public services, such as roads, bridges, tunnels, highways etc. (infrastructure facility) are developed by Government of India (GOI) or its agencies (e.g., National Highways Authority of India) with private sector participation in the development, financing, operation and maintenance of such infrastructure. The arrangement between GOI and the private sector generally takes the form of a concessionaire agreement granting right to collect toll to the concessionaire taxpayer for specified period under a Build-Operate-Transfer (BOT) arrangement in lieu of cost incurred by a taxpayer on construction and maintenance of the facility for the specified period.
- Under a BOT arrangement, generally, possession of land is handed over by GOI or its agencies to the concessionaire for the limited purpose of developing infrastructure facility, without actual transfer of legal ownership of land or the infrastructure facility. The concessionaire constructs, operates and maintains the infrastructure facility at its own cost, and in lieu thereof, GOI accords a right to such concessionaire

⁶ Circular No. 9/2014 dated 23 April 2014

⁷ [TS-679-HC-2014(BOM)] Refer EY Alert titled 'Bombay High Court denies depreciation on the road constructed under BOT arrangement' dated 13 November 2014. This decision was subsequently followed by Bombay HC in CIT v. West Gujarat Expressway Ltd. [2017] 390 ITR 398.

⁸ Moradabad Toll Road Co. Ltd. [2014] 369 ITR 403 Refer EY Alert titled 'Delhi High Court rules toll roads constructed under BOT arrangement as "building"' dated 18 November 2014. SLP against this order has been dismissed by SC in case of PCIT v. GVK Jaipur Expressway Ltd. [2018] 259 Taxman 429

⁹ Noida Toll Bridge Co. Ltd. [2013] 213 Taxman 333

¹⁰ Tamil Nadu Road Development Co. Ltd. (2021) (279 Taxman 125)

to collect toll from users of the facility. The period involved for construction, operation and maintenance and right to collect toll is called as the concession period. At the end of the concession period, the concessionaire is required to hand over the possession of the infrastructure facility to GOI or its agencies free of cost.

- There is no specific provision under the ITL on tax treatment of expenditure incurred by a concessionaire on construction of such infrastructure facilities. Considering the divergent judicial views on tax treatment of such expenditure, in 2014, the CBDT issued a Circular⁶ clarifying that such expenditure shall be amortized evenly over the concession period (after excluding the time taken for creation of the infrastructure facility).
- Under the ITL, depreciation is allowable on specified "tangible assets" and "intangible assets" used for the purposes of business. Under the provisions of the ITL, tangible asset includes assets like plant, building, furniture etc. The scope of the term "building" is explained in a wide manner to include road, bridges etc.
- Intangible assets, for this purpose, is defined to include know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, owned wholly or partly by a taxpayer.
- The Bombay HC⁷ in the case of North Karnataka Expressway Ltd. held that the toll road does not legally belong to the concessionaire; it is legally owned by GOI and its agencies, and hence, concessionaire cannot claim depreciation on the cost of construction incurred by it as a "building". As per HC, for claiming tax depreciation, satisfaction of the "ownership" of asset is a crucial condition, which is not met as the concessionaire has no "ownership" in the facility.
- On the other hand, the Delhi HC⁸, Allahabad HC⁹ and Madras HC¹⁰ have allowed tax depreciation on toll road as building. These HCs adopted the reasoning that the definition of building includes road. The toll road does not qualify as plant as it fails to fulfil the functional test of asset which is used to carry on business rather it is the place through which concessionaire carries on business.

- The Mumbai Tribunal¹¹ held that toll road constitutes plant as it is an essential tool to conduct business of a concessionaire and in absence thereof, there cannot be any business undertaken.
- Significantly, in none of the aforesaid decisions, the respective taxpayer put forth the claim of tax depreciation by treating the concessionaire right as an intangible asset, and hence, the courts did not have occasion to consider the alternative claim of intangible asset. However, various Tribunals¹² have so far allowed tax depreciation on toll road by treating right to collect toll as an intangible asset. These Tribunals held that right to collect toll is in nature of license or other business or commercial rights. Such right arises under the agreement in lieu of performing activities of developing, operating and maintaining infrastructure facility and incurring substantial expenditure. For this proposition, the Tribunals relied on Supreme Court (SC) ruling in the case of Techno Shares & Stocks Ltd.¹³ which has held that a stock exchange membership card can be regarded as an intangible asset, as such membership card allows the holder to participate in the trading session on the floor of the stock exchange. The SC regarded such membership card as satisfying the test of a "business or commercial right", or alternatively, a "licence" or akin to a "licence" which enabled the member to access the trading sessions. These Tribunal rulings distinguished North Karnataka Expressway (*supra*) ruling since the Bombay HC did not have an occasion to consider the alternative claim for depreciation as intangible asset.

Facts of the present case:

The Madras HC consolidated a batch of appeals involving various tax years in the case of two Taxpayers, on the common ground of tax treatment of expenditure incurred for construction of toll road or toll bridge in terms of a typical BOT arrangement. In the books of accounts, the Taxpayers amortized the expenditure equally over the concession period excluding the time taken for creation of the infrastructure facility. For tax purposes, the Taxpayers claimed tax depreciation by treating the infrastructure facility as plant. The claim of both the Taxpayers was initially accepted by the Tax Authority, however, subsequently in course of reassessment/revisionary proceedings, the Tax Authority denied tax depreciation as "plant" and instead allowed tax depreciation as "building".

The First Appellate Authority and the Tribunal took divergent views on the issue and both the Taxpayers and the Tax Authority filed appeals before the Madras HC. The appeals also involved jurisdictional issues around the validity of revision/reassessment but this Alert is restricted to the merits of the main issue before the Madras HC.

Issue before HC: Whether the Taxpayers were entitled to claim tax depreciation on toll road/toll bridge under BOT arrangements as tangible asset or as intangible asset? If they are depreciable as tangible assets, whether they can be characterized as "plant" or "building"?

Madras HC ruling

The Madras HC denied depreciation to the Taxpayers and instead granted amortization as per the Circular, by adopting the following lines of reasoning:

The Taxpayers are not owners of the infrastructure facility

- Ownership is a *sine qua non* for availing depreciation. Under BOT arrangement, the Taxpayers can never be regarded as owners of toll bridge or toll road. Such infrastructures are public properties; they can never be treated as private assets; and they are never intended to be transferred to the concessionaire.
- The Taxpayers are merely given a privilege/a right to collect tolls as a consideration (or deferred consideration) for developing and maintaining the infrastructure facility. No separate consideration is paid to the Taxpayers for such activities. The toll collection is a mechanism to recuperate the expenditure incurred by the Taxpayers, with a scope for making reasonable profit over the concession period. This also aligns with the accounting treatment adopted in books of account by the Taxpayers.
- It is true that the SC in the case of Podar Cement Pvt. Ltd.¹⁴ held that legal ownership of house property is not essential to determine ownership of income from house property and that for income tax purposes, it is sufficient that the taxpayer has dominion over the property and right to earn income from the property. However, this ruling was rendered in the context of taxability of income from house property wherein possession of house property was transferred *in praesenti* while transfer of legal ownership was deferred to a later point of time, once all payments towards the purchase cost of the property were made by the allottees to the housing board. This decision in the context of housing sites cannot be imported to the present case, as in the present case, there was never any intention to transfer the legal ownership of infrastructure facility to the concessionaire.

Toll road/toll bridge does not qualify as plant or building

- Neither toll bridge nor toll road are specifically covered by the definition of "plant" or "building" or

¹¹ Maharashtra State Road Development Corpn. Ltd vs. ACIT (2010) (128 TTJ 32) (Mum)

¹² Refer illustratively, Ashoka Info (P.) Ltd. v. ACIT [2010] 35 SOT 50 (Pune) (URO), ACIT v. Ashoka DSC Katni By-Pass Road Pvt. Ltd. [TS-715-ITAT-2018(PUN)], ACIT v. Progressive

Constructions Ltd. [2018] 92 taxmann.com 104 (Hyderabad - Trib.) (SB), ACIT v. Essel Sagar Damoh Toll Roads Ltd. [TS-641-ITAT-2019(Mum)]

¹³ (2010) (327 ITR 323) (SC)

¹⁴ (1997) (226 ITR 625) (SC)

“tangible assets” under the ITL. It is true that the definition of “building” in depreciation table includes, *inter alia*, road and bridge. But for claiming depreciation, it is necessary that the taxpayer should be owner of such asset. The taxpayer being a concessionaire does not have ownership right over toll road or toll bridge.

- Delhi HC ruling in case of Moradabad Toll Road Co. Ltd. (*supra*) has erroneously conferred depreciation by treating toll road as building, merely because “definition” of building under ITL for the purpose of tax depreciation includes “roads, bridges, culverts, wells, and tube wells”. The Delhi HC did not consider the aspect that taxpayer does not have ownership right over toll road/bridge.
- On the other hand, Bombay HC ruling in case of North Karnataka Expressway Ltd. (*supra*) correctly denied tax depreciation as building, as state or national highways cannot be owned by private entrepreneurs like the Taxpayers.

Toll road/toll bridge does not qualify as intangible asset:

- In the definition of intangible asset under the ITL, meaning of the term “licenses” and “other business or commercial rights of similar nature” should be inferred from the meaning of the terms which precede them (namely, know-how, patents, copyrights, trademarks, franchises), i.e., by applying the well-recognized principle of interpretation of *noscitur a sociis*.
- As per Maxwell's Interpretation of Statutes, “*Where two or more words which are susceptible of analogous meaning are coupled together, noscitur a sociis, they are understood to be used in their cognate sense. They take, as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general.*” The words must take the color from other words with which they are associated. Therefore, the Taxpayers had not acquired any intangible assets as defined under the ITL.

CBDT's Circular, although not binding, correctly clarifies the legal position

- The Circular provides for amortization of expenditure after noting that, under a typical BOT arrangement, ownership of land or infrastructure facility is not transferred to the taxpayer, and therefore, the taxpayer cannot be treated as an owner of the property for allowability of depreciation. The taxpayer only has a right to develop and maintain the infrastructure facility and to collect toll, without any ownership therein. The Circular, although not binding on HC, does correctly clarify the legal position and is also a *contemporanea expositio* of law.

Comments

The tax treatment of cost incurred by a concessionaire for construction of infrastructure facility in BOT arrangements has been a contentious issue. The present Madras HC ruling is significant since it is fully in favor of the Tax Authority. The Madras HC has upheld validity of CBDT Circular and denied depreciation even as “intangible asset”.

The reasoning of Madras HC's ruling to reject the Taxpayers' alternative claim as intangible asset is contrary to several Tribunal rulings and is open to debate. The Madras HC did consider the SC ruling in the case of Techno Shares (*supra*) which interpreted the expression “any other business or commercial right” broadly. Yet it preferred to follow the ratio of underlying Bombay HC ruling, which interpreted the expression narrowly by applying the principle of *noscitur a sociis* which was rejected by the SC.

The taxpayers within the jurisdiction of Madras HC will be bound by this ruling till it holds the field. It will be interesting to see how other HCs deal with the issue until it is finally decided by the SC.

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