

(1998) 02 KL CK 0015

In the High Court Of Kerala

Case No : Income-tax Reference No. 87 of 1995 & Income-tax Reference No. 88 of 1995

Commissioner of Income Tax

APPELLANT

Vs

Co-operative Sugars Ltd.

RESPONDENT

Date of Decision : 18-02-1998

Acts Referred:

Income Tax Act, 1961 — Section 256

Citation : (1999) 235 ITR 343

Hon'ble Judges : Om Prakash, C.J.; J.B. Koshy, J

Bench : Division Bench

Advocate : P.K.R. Menon and N.R.K. Nair, for the Appellant; B.S. Krishnan P.R. Raman and K. Anand, for the Respondent

Judgement

Om Prakash, C.J.—Pursuant to the direction u/s 256(2) of the Income Tax Act, 1961 (briefly, the Act), the Income Tax Appellate Tribunal referred the following question relating to the assessment year 1983-84 for the opinion of this court :

"Whether, on the facts and circumstances of the case, the Tribunal was justified in holding that the expenditure incurred by the assessee under the head "Machinery maintenance" is revenue in nature and is an allowable deduction ?"

2. The assessee-company, engaged in the business of manufacture and sale of sugar and molasses, claimed the following expenditure as revenue expenditure under the head "Factory maintenance" :

Items Amount (Rs.)

1. High velocity juice heater 1,20,000
2. Sugar grader 95,000
3. Centrifugal machinery 18,87,853
4. Juice sulphiter 2,23,200

5. Vacuum filter drum 3,35,260

6. Pumps 91,800

7. Meters 45,916

Total 27,49,029

3. The Assessing Officer rejected the claim of the assessee holding that the entire expenditure was capital in nature. In support of his view, the Assessing Officer held that the sugar plant of the assessee consisted of several independent components, viz., juice heater, juice sulphiter, vacuum filter drum, centrifugal machinery, sugar crystalliser, sugar grader, etc ; that each unit is a separate entity by itself which could perform assigned task of each stage of operation and processing ; that none of such components is part of other machinery ; that the assessee replaced the entire machinery, viz., juice heater, sugar grader, centrifugal machinery, juice sulphiter, vacuum filter drum, pumps, meters, etc. ; that it is not a case of replacement of accessories of such components ; that the assessee received benefits of enduring nature from the replacement of each equipment independent in itself ; that a new asset by purchasing each such machinery has come into existence and, therefore, the expenditure incurred by the assessee on the acquisition and installation of such assets cannot be said to be expenditure incurred on repairs or replacement of some of the accessories of such independent equipment. The Assessing Officer was of the view that if the expenditure were incurred on repairs or replacement of accessories of each of such equipment, then that would have been revenue expenditure. But, on the facts and in the circumstances of this case, each equipment acquired by the assessee during the year in question, can be said to be only an addition to the existing factory. He, therefore, treated the entire expenditure aggregating to Rs. 27,49,029 as capital expenditure.

4. On appeal, the Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer in this behalf."

5. The assessee carried the dispute further in appeal to the Income Tax Appellate Tribunal, before whom counsel for the assessee contended that there could not be a sugar plant without juice heater, sugar grader, juice sulphiter, vacuum filter drum, centrifugal machinery, pumps, meters, etc., and, therefore, all such equipments are integral parts of the entire sugar plant. This is how, it was contended before the Appellate Tribunal that the sugar mill is an integrated machinery comprising several components. The submission proceeded on the footing that without the equipment in question, the sugar, which is the end-product of the assessee's sugar mill, could not be produced and, therefore, it cannot be said that each equipment was independent by itself. It is not disputed by the Assessing Officer that all such equipments, before they were replaced by new ones, were in existence in the sugar mill of the assessee.

6. On these facts and submissions, the Appellate Tribunal held that each

machinery, though has distinct function, is an integral part of the sugar plant ; that sugar manufacturing process is a continuous process and unless the sugarcane juice as such or in a different form passes through all the requisite components, the sugar, which is the end product of the sugar mill, cannot be produced ; that none of the machinery purchased by the assessee during the relevant year to replace the old ones, can produce sugar by itself ; that sugar can be produced only when all the machinery, which are integral parts of the entire sugar plant, function in harmony and, therefore, the expenditure was incurred only on the maintenance of the sugar mill--a profit earning apparatus.

7. The Appellate Tribunal negated the approach of the Assessing Officer and the Commissioner of Income Tax (Appeals), who were of the opinion that each machinery, on which expenditure was incurred, was independent and new machinery, which replaced the old ones, were simply additions to the old ones.

8. The question for consideration is as to how to approach to solve the ticklish question as to what is the distinction between capital and revenue expenditure. In *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224 (PC), Lord Pearce unable to lay down a clear test to make a distinction between capital and revenue expenditure, said (page 264) ;

"The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a common sense appreciation of all the guiding features which must provide the ultimate answer ..."

9. In *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) , the fact matrix, in brief, was that the appellant, a company engaged in the manufacture of antibiotics and pharmaceuticals, was granted a licence for the manufacture of penicillin in June, 1961. By the year 1963, it had already made an outlay of more than Rs. 66 lakhs for setting up a plant for the production of penicillin. There was moderate yield in initial years. With a view to increasing the yield, the appellant entered into an agreement in 1963 with Meiji, a reputed Japanese enterprise engaged in the manufacture of antibiotics, whereunder Meiji, in consideration of a "once for all payment" of certain amount, agreed to supply to the appellant "the sub-cultures of Meiji"s most suitable penicillin producing strains" in know-how, inter alia. The appellant was to keep the technical know-how confidential and secret. For the assessment year 1964-65, the appellant claimed deduction of certain amount as revenue expenditure. The Appellate Tribunal rejected the claim of the appellant holding that the expenditure was capital in nature. The view of the Appellate Tribunal was also affirmed by the High Court.

10. Reversing the decision of the High Court, the Supreme Court exploding the myth that the expenditure incurred on know-how is of enduring nature, said (page 390) :

"It would, in our opinion, be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of durability and permanence to the technical know-how at any particular stage in this fast-changing area of medical science. The state of the art in some of these areas of high priority research is constantly updated so that the know-how cannot be said to be the element of the requisite degree of durability and non-ephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeon-holing an outlay such as this as capital"

11. Reversing the decision of the High Court, the Supreme Court, on the fact situation, observed as under (page 388) :

"The business of the assessee from the commencement of its plant in 1961, it is undisputed, was the manufacture of penicillin. Even after the agreement, the product manufactured continued to be penicillin . . . there was no material for the Tribunal to hold that the area of improvisation was not a part of the existing business or that the entire gamut of the existing manufacturing operations for the commercial production of penicillin in the assessee's existing plant had become obsolete or inappropriate in relation to the exploitation of the new sub-cultures of the high yielding strains of penicillin supplied by Meiji and that the mere introduction of the new biosynthetic source required the erection and commissioning of a totally new and different type of plant and machinery ... the mere improvement in or updating of the fermentation process would not necessarily be inconsistent with the relevance and continuing utility of the existing infrastructure, machinery and plant of the assessee."

12. Having so found, the Supreme Court concluded (page 391) :

". . . that the financial outlay under the agreement was for the better conduct and improvement of the existing business and should, therefore, be held to be revenue expenditure."

13. The question for consideration is when the expenditure incurred on know-how on the basis of "once for all" payments was held to be expenditure as revenue in nature by the Supreme Court, could it be said in the case at hand that the expenditure incurred on several machinery to make the sugar mill functionally sound, was capital in nature ?

14. In *Alembic Chemical Works Co. Ltd.* : [1989]177ITR377(SC) , the Supreme Court observed as under (page 386) :

"The idea of "once for all" payment and "enduring benefit" are not to be treated as something akin to statutory conditions ; nor are the notions of "capital" or "revenue" a judicial fetish. What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business"

15. The Supreme Court again observed as follows (page 384) :

"In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is well nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation"

16. From the above reproduced observations, it is nothing but clear that the answer to the question whether a given expenditure is capital in nature or revenue in nature, will depend on the facts and circumstances of each case. Both the Assessing Officer and the Commissioner of Income Tax (Appeals) took the view, in the instant case, that each equipment, on which the expenditure was incurred by the assessee, was independent in nature. On the facts and in the circumstances of the case, the view so taken by them is not at all correct. It may be true that sugarcane juice processed through each equipment may undergo some change, but the end-product of the sugar mill would be available only after the entire processing is complete and that would be complete only after the completion of the processing, through all the machinery on which the expenditure was incurred by the assessee. Simply because each equipment changes the form or shape of the sugarcane juice, that does not mean that sugar is produced by each equipment or machinery. This being so, there is a basic fallacy in the approach of the Assessing Officer and the appellate authority.

17. Before us, learned senior standing counsel argued that a considerable expenditure was incurred by the assessee on each machinery and some of the machinery were replaced after about 17 years of service and, therefore, the expenditure so incurred was capital in nature, inasmuch as the machinery acquired, constituted an asset of an enduring benefit. The sugar mill is a gigantic plant. The Assessing Officer should not have been swayed by the extent of expenditure, incurred on major components purchased for replacing the old ones. The vital question is whether the sugar mill can work in the absence of machinery, expenditure incurred on which is claimed by the assessee. This question has to be answered in the negative. For the manufacture of sugar, all the machinery claimed are necessary. No doubt, the expenditure was incurred on the principal components of the sugar mill, still, however, it would be wrong to hold each machinery as an independent unit. All machinery put together complete the sugar plant. We, therefore, entirely agree with the view taken by the Appellate Tribunal.

18. Learned senior standing counsel submits that expenditure incurred on substantial replacement is capital in nature. Depending on the facts and circumstances of a given case, such propositions cannot be disputed. But, in the case in hand, it does not hold to be good. No doubt, expenditure was incurred on substantial replacement, but the fact remains that the sugar plant was there and the same plant existed even after replacement and, therefore, it is wrong to say that any new asset of enduring nature has come into existence. Whether or not a new asset has come into existence--this question has to be considered vis-a-vis the integrated sugar plant and not vis-a-vis each integral part of it. When

expenditure incurred on technical know-how on consideration of "once for all payments" was held to be the expenditure as revenue in nature in the case of Alembic Chemical Works Co. Ltd. : [1989]177ITR377(SC) , we see no reason why expenditure incurred on purchasing of new machinery to ensure sound functioning of the sugar mill to replace the old ones, should not be held as revenue expenditure.

19. We, therefore, answer the above referred question in the affirmative, that is, in favour of the assessee and against the Revenue.