

(2002) 09 BOM CK 0018

In the Bombay High Court

Case No : IT Appeal No. 1399 of 2000 13 September 2002 & Income Tax A. No. 1399 of 2000

Commissioner of Income Tax

APPELLANT

Vs

Khimline Pumps Ltd.

RESPONDENT

Date of Decision : 13-09-2002

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (2002) 6 BomCR 444 : (2002) 4 BOMLR 876 : (2002) 178 CTR 284 : (2002) 258 ITR 459 : (2002) 4 MhLj 546

Hon'ble Judges : S.H. Kapadia, J;J.P. Devadhar, J

Bench : Division Bench

Advocate : R.V. Desai and P.S. Jetley, instructed by T.C. Kaushik, for the Appellant; N.S. Joshi, instructed by Udwadia Udeshi, for the Respondent

Final Decision : Allowed

Judgement

S.H. Kapadia, J.—Being aggrieved by the decision of the Tribunal dated 25th July, 2000 in Income Tax Appeal No. 335/MUM/97 for Assessment Year 1991-92, the Department has filed this Appeal u/s 260A of the Income Tax Act. The assessee has preferred Cross Objections under Order 41 Rule 22(1).

2. The substantial question of law which arises for determination of this Court is as follows :--

"Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that payment of Rs. 45 lakhs for purchase of the Unit was a capital expenditure and if it was a capital expenditure as held by the Tribunal then whether the Tribunal was justified in directing apportionment of the said amount as advance rent over a period of 71 years at the rate of Rs. 63,380/- per annum as rent relatable to each year?"

3. Since the above substantial question of law arises out of the Appeal filed by the Department and the Cross Objections filed by the assessee, they are heard

together and disposed of by this common judgment. The main grievance of the Department is that the Tribunal, having held Rs. 45 lakhs to be the capital expenditure, could not have directed "apportionment of the said amount as advance rent. Whereas, the grievance of the assessee is that the Tribunal erred in treating payment of Rs. 45 lakhs by the assessee as capital expenditure. According to the assessee, payment of Rs. 45 lakhs was a revenue expenditure u/s 37 as it was paid to secure the benefit of reduced rent. In this connection the assessee placed heavy reliance on the Judgment of the Supreme Court in the case of Commissioner of Income Tax v. Madras Auto Service (P) Ltd. reported in 255 ITR 468.

FACTS :

4. On June 30, 1970, an open plot of land bearing Plot No. 9 admeasuring 20300 sq. meters, in Kalva Industrial Area, Thane was leased out by MIDC to a Company known as M/s APV Equipments Ltd. for a period of 95 years commencing from 1st August, 1965 on payment of yearly rent of Re. 1/- and in consideration of payment of Rs. 1,62,400.00 as premium. Under the lease, it was provided that at the end of 95 years, the lessee would quietly deliver to the lessor the land and the lessee would be entitled to remove buildings, erections or structures put up by the lessee on the land. In other words, on expiry of 95 years, the lessee was required to deliver the land to MIDC and take away the buildings, constructions or erections. Under the lease, it was further provided that without the permission of the lessor, the lessee shall not assign underlet or part with possession of the premises. That, the Chief Executive Officer may, in his absolute discretion, refuse such consent or grant such consent, subject to conditions which he may impose as he may deems fit including the condition for payment of premium. Under Clause 7 of the lease, renewal was also provided for a further period of 95 years on payment of premium as may be decided by the lessor and as per the terms and conditions as the lessor may direct. M/s APV Equipments Ltd. went in liquidation. By Order dated 25th July, 1985 passed by the Bombay High Court in Company Petition No. 18 of 1984, M/s APV Equipments Ltd. was ordered to be wound up. By letter dated 20th September, 1989, the Deputy Official Liquidator informed MIDC that the assets of M/s AVP Equipments Ltd. have been sold to the assessee herein under the directions of the High Court on 23rd August, 1989. The Deputy Official Liquidator sought consent of MIDC for transfer of the premises to the assessee. The consent was granted by MIDC subject to payment by the assessee of an amount of Rs. 2000/- as and by way of transfer fee. Accordingly, on 21st January 1991, a Deed of Assignment came to be executed by Official Liquidator in favour of the assignee-assessed. The assignee-assessed was the highest offerer. The assessee offered Rs. 75 lakhs for purchase of the whole Unit consisting of the plot of land admeasuring 20300 sq. meters with building thereon and including plant and machinery and other movables described in the Schedule. As stated above, the plot was a lease hold plot. Under the Deed of Assignment, by way of recital, it is mentioned that the value of the land and buildings and plant and machinery stood bifurcated for the

purposes of payment of stamp duty into two parts -- Rs. 72 lakhs for land and building and Rs. 3 lakhs for plant and machinery. The assessee-Company filed its return of income on 31st December, 1991 for Assessment Year 1991-92 admitting a loss of Rs. 2,95,750/-. The assessee filed a revised computation statement and claimed Rs. 72,18,588/- as revenue expense being the cost of the land purchased from the Official Liquidator, High Court, Bombay. This claim was rejected by the AO. The AO found that the assessee had purchased the whole Unit for Rs. 75 lakhs. That, out of Rs. 75 lakhs, Rs. 45 lakhs related to acquisition of leasehold land, Rs. 27,18,588/- related to building and the balance related to machinery purchased by the assessee. The assessee contended before the AO that Rs. 45 lakhs were paid as advance rent. That, M/s APV Equipments Ltd. was entitled to use and occupy the property for 95 years on payment of Re. 1/- per annum. That, on expiry of lease period of 95 years the plot with building thereon had to be surrendered to MIDC. That, the assessee had merely substituted itself in place of M/s APV Equipments Ltd. This argument was rejected by the AO. The AO came to the conclusion that Rs. 45 lakhs were paid by Official Liquidator for purchase of leasehold rights and, therefore, it was a capital expenditure. In the penultimate paragraph, however, the AO made an observation stating that even if the assessee's arguments were to be accepted the entire amount of Rs. 45 lakhs could not be claimed as deduction. That, at the highest, the proportionate rent attributable to the year could be allowed. However, in the last paragraph, the AO once again reiterated that Rs. 45 lakhs constituted capital expenditure and accordingly the claim for deduction was disallowed. Being aggrieved, the assessee went in Appeal to CIT (Appeals). The Appeal was dismissed. Being aggrieved, the assessee carried the matter further in Appeal to the Tribunal. The Tribunal came to the conclusion that payment of Rs. 45 lakhs was a capital expenditure. However, in the last paragraph, the Tribunal opined that since the benefit of this expenditure of Rs. 45 lakhs would be exhausted in 71 years, a proportionate amount relatable to each year amounting to Rs. 63,380.00 per annum may be allowed as deduction on account of payment of rent for that year for 71 years. It is against this last paragraph of the impugned Order that the Department has filed the present Appeal whereas the assessee has filed cross objections on the main finding of the Tribunal that payment of Rs. 45 lakhs was capital expenditure. The impugned order is dated 25th July 2000. Hence, this Appeal u/s 260A of the Income Tax Act.

ARGUMENTS :

5. Mr. Desai, learned Senior Counsel appearing on behalf of the Department contended that the Tribunal made a fundamental error in directing deduction to be given at the rate of Rs. 63,380.00 per annum. He contended that having held that Rs. 45 lakhs was a capital expenditure, it was not open to the Tribunal to direct the Department to give benefit of the expenditure as such direction proceeds on the basis that Rs. 45 lakhs were paid as advance rent. Mr. Desai submitted that the impugned Order is self contradictory. That, if Rs. 45 lakhs was paid as capital expenditure, one fails to understand how the Tribunal could have

directed benefit of proportionate deduction. That, it was not permissible for the Tribunal to direct such proportionate deduction as it proceeds on the premise that Rs. 45 lakhs were paid as advance rent. He, therefore, submits that to the extent of the last paragraph of the impugned Order, the Department has filed this Appeal. That, if the last paragraph of the impugned Order is set aside then Department supports the rest of the Order. Mr. Desai relied upon several judgments in support of his submission that payment of Rs. 45 lakhs was capital expenditure. He submitted that the assessee had paid an amount of Rs. 75 lakhs to the Official Liquidator of M/s APV Equipments Ltd. That, this payment was for purchase of the whole Unit including right, title and interest in the leasehold property. He contended that even under the lease, the right, title and interest in the building continued to remain in the assessee after expiry of the lease period of 95 years. At this stage, it may be mentioned that at the time of the impugned Order dated 25th July, 2000 the remainder period of the lease is 71 years. He further submitted that even on the expiry of the period of lease, there is a clause of renewal. That, even under the lease, the lessee has a right to seek renewal of the lease. That, under the lease, the lessee has a right to assign the leasehold rights subject to permission of MIDC. In the circumstances, it was submitted that payment of Rs. 45 lakhs was a capital expenditure and, therefore, apportionment as directed by the Tribunal was for 71 years at the rate of Rs. 63,380/- per annum was not permissible u/s 37 of the Income Tax Act. He contended that, in this case, the leasehold rights were acquired for carrying on business and the leasehold rights were not acquired in carrying on business. He submitted that payment of rent was separate and distinct in this case from payment of Rs. 45 lakhs. He submitted that payment of rent at the rate of Re. 1/- could be revenue expenditure. However, he contended that payment of Rs. 45 lakhs was not a revenue expenditure.

6. Mr. Joshi learned counsel appearing on behalf of the assessee submitted that the assessee was claiming deduction u/s 37 of the Act. Mr. Joshi contended that u/s 30 of the Income Tax Act, it is clearly stipulated that in respect of rent, rates, taxes, repairs and insurance for premises used for business the amount paid for occupation of the premises by such assesseees was an item of deduction. He submitted that, in the present case, the lease between MIDC and M/s APV Equipments Ltd. was for 95 years. That, APV Equipments Ltd. had paid premium to MIDC of Rs. 1,62,400/- plus rent at the rate of Re. 1/- per annum. That, the lease was subject to certain restrictions viz. that the lessee has no right to assign without permission from MIDC and which permission was to be granted subject to payment of additional premium. That, even after expiry of 95 years, the stipulation was for renewal of the lease subject to increased premium. He further contended that payment of Rs. 45 lakhs can never be construed as premium on the facts and circumstances of this case. He submitted that, in this case, the normal rent would be much more than Re. 1/- per annum fixed under the lease. That, M/s. APV Equipments Ltd. paid premium of Rs. 1,62,400/- as it got the benefit of reduced rent. He further contended that Rs. 45 lakhs paid by this

assessee to the Official Liquidator of M/s APV Equipments Ltd. was paid as this assessee got the benefit of reduced rent. That, in normal circumstance, this assessee was required to pay rent at the higher rate. That, such rent at the higher rate would have come u/s 30(a)(i). That, in normal circumstances, this assessee would have incurred revenue expenditure on account of payment of rent but by paying a lumpsum amount of Rs. 45 lakhs, this assessee has paid advance rent for the remainder terms of the lease of 71 years and, therefore, the said amount of Rs. 45 lakhs constituted advance rent and, therefore, the assessee was entitled to deduction as revenue expenditure. Mr. Joshi further pointed out that this assessee paid to M/s APV Equipments Ltd. a total amount of Rs. 75 lakhs. However, the said amount of Rs. 75 lakhs was bifurcated into three parts viz. for plant and machinery for which the assessee paid Rs. 2,81,412/- lakhs; Rs. 27,18,588/- were paid for the building and Rs. 45 lakhs were paid for acquisition of leasehold rights. He contended that, before the Department, this assessee had conceded that payment of Rs. 27,18,588/- and payment of Rs. 2,81,412/- were for purchase of machinery and building and, therefore, these two payments constituted investment in capital assets. Mr. Joshi contended that, in fact, in respect of plant and machinery and the building the Department has allowed depreciation and, therefore, in this case, we are only concerned with the nature, character and purport of the payment of Rs. 45 lakhs for purchase of leasehold rights. He contended that no reasonable person could have got this huge land admeasuring 20300 sq. meters, for a rent of Re. 1/- per annum. He, therefore, contended that payment of Rs. 45 lakhs was not premium. It was advance rent. That, by the said assignment, this assessee got an advantage of reduction in rent which this assessee was required to pay if this assessee had taken the premises by paying the correct, proper rent prevailing in the market. He, therefore, submitted that this payment of Rs. 45 lakhs was to secure an advantage of reduced rent for next 71 years and, therefore, the payment of Rs. 45 lakhs should be treated as advance rent. He further contended that even if this Court came to the conclusion, that payment of Rs. 45 lakhs was not to secure advantage of reduced rent, still the said payment was made to save future revenue expenditure. He, therefore, contended that Rs. 45 lakhs constituted revenue expenditure. In support of his arguments, Mr. Joshi heavily relied upon the judgment in the Madras Auto Services Ltd (supra). He further contended that, in this case, the assessee has not acquired any benefit of enduring nature as the assessee was required to vacate and hand over the building to the lessor on expiry of the lease period. He, therefore, contended that Rs. 45 lakhs were paid only to get the benefit of reduced rent. He further contended that, under the Deed of Assignment, this assessee got three benefits viz. payment of lower rent; right to remove the structure at the end of the lease and the right to remove the plant and machinery. He contended that, in this case, the assessee has allocated an amount of Rs. 2,81,412/- for purchase of plant and machinery and Rs. 27,18,588/- for building for which the Department has treated the payment as investment in capital assets. Therefore, payment of Rs. 45 lakhs was only for this assessee obtaining the benefit of lower rent for

next 71 years so that this assessee could effect saving of revenue expenditure by way of reduced rent and, therefore, Rs. 45 lakhs should be treated as revenue expenditure. He further contended that payment of Rs. 45 lakhs can never be construed as premium. He contended that Official Liquidator cannot be equated with the private landlord. That the private landlord could insist on payment of premium, but the Official Liquidator was not in the dominant position and, therefore, payment of Rs. 45 lakhs can never be premium. That, this assessee had bought the Unit from the Official Liquidator and not from MIDC. That, only MIDC could have insisted on payment of premium. He, therefore, contended that Rs. 45 lakhs did not constitute premium.

FINDINGS :

7. As stated hereinabove, the Tribunal has come to the conclusion vide impugned order that payment of Rs. 45 lakhs was for purchase of the whole Unit and, therefore, it was a capital expenditure. However, in the last paragraph, without giving any reasons, the Tribunal opined that for benefit of proportionate amount relatable to each year, the rate of Rs. 63,380/- per annum may be allowed as deduction to the assessee for 71 years since the benefit would get exhausted over the said period. The Department has filed this Appeal only against this last paragraph of the judgment. We find merit in this Appeal filed by the Department. Having come to the conclusion that the payment of Rs. 45 lakhs was a capital expenditure, one fails to understand the basis on which the Tribunal has directed the Department to apportion the amount relatable to each year. This direction could have been given only if the Tribunal had come to the conclusion that payment of Rs. 45 lakhs was a revenue expenditure and that it was to save future revenue expenditure and that it was paid to secure the benefit of reduced rent. However, that is not so. The Tribunal itself has come to the conclusion that payment of Rs. 45 lakhs was capital expenditure. Having said so, the Tribunal could not have directed the Department to apportion the amount of Rs. 45 lakhs over a period of 71 years. The order is self contradictory. Therefore, we allow the Appeal filed by the Department.

8. Coming to the Cross Objections filed by this assessee, the main ground in support of the Cross Objections was that this payment of Rs. 45 lakhs was made to save revenue expenditure and, therefore, the said payment should be considered as revenue expenditure, in this case, M/s APV Equipments Ltd. was the lessee of MIDC. The lease was for 95 years. M/s APV Equipments Ltd. had paid Rs. 1,62,400/- as premium under the lease dated June 30, 1970. The lease commenced from 1st August, 1965. The yearly rent was Re. 1/-. M/s APV went in liquidation. Thereafter, this assessee purchased the entire Unit including land, building, plant and machinery for Rs. 75 lakhs. The Order passed in liquidation read with the Deed of Assignment shows that Rs. 75 lakhs were paid for the purchase of the whole Unit consisting of the land, building, plant and machinery. That, the bifurcation referred to above between land and building on one hand valued at Rs. 72 lakhs and plant and machinery on the other hand valued at Rs.

3 lakhs was only for the purposes of stamp duty. It is well settled that in order to ascertain the true character and purport of payment, the Court has to go by the substance of the transaction and not by the manner in which the assessee allocates the items for accounting purposes. On the facts and circumstances of the case, if one reads the terms of the lease, as discussed above, the Deed of Assignment and the order passed by MIDC permitting assignment, it is clear that the assessee bought the whole Unit for Rs. 75 lakhs. It is also clear that Rs. 45 lakhs were paid as a part of Rs. 75 lakhs. In the circumstances, the Tribunal was right in coming to the conclusion that Rs. 45 lakhs was a capital expenditure. Moreover, in this case, this assessee is an assignee. This assessee is not the original lessee. The original lessee was M/s APV Equipments Ltd. This assessee came on the scene when there was already in existence, the land as well as the building, including plant and machinery. That was not so when M/s APV Equipments Ltd. entered into lease for open land with MIDC as far back as 30th June, 1970. The original lessee M/s APV Equipments Ltd, paid the premium amount of Rs. 1,62,400/-. However, this assessee has paid Rs. 75 lakhs including Rs. 45 lakhs for the whole Unit. Therefore, the Department is right in saying that payment of Rs. 45 lakhs constituted capital expenditure, it has been vehemently argued on behalf of the assessee that on the facts and circumstances of the case, payment of Rs. 45 lakhs was not by way of premium and, therefore, it should be treated as revenue expenditure. However, the Tribunal has nowhere stated that payment of Rs. 45 lakhs was on account of premium. It is true that the AO has treated payments of Rs. 2,81,412/- and Rs. 27,18,588/- as investments in capital assets for purposes of depreciation. However, that was as per the assessee's own admission. As stated above, in such cases, allocation by the assessee in its book is not conclusive. We have to go by the substance of the transaction. The Tribunal came to the conclusion that, in this case, the expenditure was incurred for acquiring leasehold rights in which the assessee could carry on the business and that the expenditure was not incurred in trading. The Tribunal found that, in the present case, the expenditure was incurred to acquire the whole Unit. That, this payment was to secure an advantage for the enduring benefit of the trade. That, there were no special circumstances to treat this expenditure as revenue expenditure. Therefore, the Tribunal concluded that it was a capital expenditure. We agree with the decision of the Tribunal. However, the learned Counsel for the assessee has placed great reliance on the judgment of the Supreme Court in the case of Madras Auto Service (P) Ltd. (supra) in support of his case that this assessee has paid the amount of Rs. 45 lakhs as the assessee secured the benefit of reduced rent for 71 years. In the case of Madras Auto Service (P) Ltd. (supra), the assessee was a Company, carrying on the business of sale of motor parts. It's Head Office was at Madras. It had a Branch at Bangalore. Under the lease, the assessee obtained premises for 39 years at Bangalore. Under the lease, the lessee had the right to demolish the existing structure at its own expense and to construct a new structure at its own cost and appropriate to itself, all the material in the old existing structure, without paying to the lessor, any compensation for demolishing the existing structure. Under the

lease, permission was granted to the assessee to construct a new building to suit the purpose of their business. Under Clause 2, the assessee was required to pay Rs. 1,000/- per month for first 15 years, Rs. 1,500/- per month for next 10 years, Rs. 1,650/- per month for next 10 years and Rs. 2,000/- per month for the remaining years. Under the lease, the new construction was to remain the property of the lessor and on completion of the work, the lessee had the right to be a tenant for 39 years. Under the lease, the lessee had no right, title and interest in the new construction. That, the lessee was not entitled to compensation from the lessor for putting up the new construction in place of the old construction. Acting under the lease, the assessee invested Rs. 1,62,835/- in the previous year relevant to the Assessment Year 1968-69 and Rs. 50,937/- in the succeeding year for constructing a new building on the land. The assessee claimed the expenditure as capital loss. In the alternative, the assessee claimed deduction for the payments as business expenditure or as extra rent for the lease. The Tribunal held that the expenditure of the aforesaid amounts was for construction of a new building and, therefore, it was in the nature of business expenditure for proper carrying on of the business of the assessee. Therefore, the Tribunal treated these amounts as revenue expenditure. Being aggrieved, the Department carried the matter to the Supreme Court in Appeal. On facts, the Supreme Court found that by payment of the aforesaid amounts, no capital asset was brought into existence. That, the new construction continued to belong to the lessor. That, the new construction did not belong to the assessee. That, even on expiry of the lease, the new construction was to remain with the lessor and not with the assessee. That, the assessee, in that case, had no right, title and interest in the new construction. That, the expense was incurred by the assessee for the purposes of conducting the business profitably. That, in that case, the assessee got the business advantage of using modern premises at a low rent, thus saving considerable revenue expenditure for the next 39 years. On page 472, the Supreme Court has observed that saving in expenditure was saving in revenue expenditure in the form of rent. That, whatever substituted the revenue expenditure should be considered as revenue expenditure. That, the assessee had constructed a new building. However, the assessee had no right, title, or interest in the new building. That, the assessee was not paid the compensation by the landlord for constructing the new building. In that case, the Supreme Court found that the assessee did not get any capital asset by spending the aforesaid two amounts and that reduced rent was a substitute for revenue expenditure and, therefore, the expenses were treated as revenue expenditure. In our case, the present assessee paid Rs. 75 lakhs for the whole Unit. That, the assessee has got the benefit of right, title and interest in the building and, therefore, the assessee in this case has got the capital asset by spending the aforesaid amount, which was not so in the case before the Supreme Court. In the present case, the assessee was entitled to take away the building on expiry of the lease. In the present case, there is a clause of renewal of the lease. In the present case, no amount has been paid by the present assessee as premium, in the present case, the assessee has bought from the Official Liquidator, with the

consent of MIDC, the whole Unit. Therefore, on facts, the judgment of the Supreme Court has no application to the present case. Moreover, in the case before the Supreme Court in Madras Auto Service Ltd. (supra), the old construction was dilapidated. The assessee could not have carried on business in the old structure. Under the lease, in that case, the old structure was permitted to be demolished. That demolition was at the expense incurred by the assessed-lessee. That the assessed-lessee put up the new construction at his own cost. Therefore, u/s 30(a)(i), the assessee in the case before the Supreme Court was entitled to claim deduction as revenue expense as it had undertaken to bear the cost of repairs to the premises. u/s 30 in respect of rent, rates, taxes, repairs and insurance for premises, used for business purposes, deductions are allowed. One such deduction is in cases where the premises are occupied by the assessee as a tenant and such assessee is required to pay rent. Such rent would be revenue expense. Similarly, if such assessee undertakes to incur cost of repairs to the premises, then such assessee would be entitled to deduction because the expense for the repair would be a revenue expenditure. Therefore, we have to read the judgment of Supreme Court in the light of Section 30 of the Income Tax Act. In that matter, the assessee had to incur expense to repair/reconstruct the existing structure. He incurred the expenditure which was in the nature of revenue expenditure and consequently he got the benefit of reduced rent. Therefore, the Supreme Court has held that payment of reduced rent was a substitute for revenue expenditure. Therefore, the judgment of the Supreme Court has no application to the facts of our case. Therefore, there is no merit in the cross objections.

9. Accordingly we hold as follows :

(a) That payment of Rs. 45 lakhs by the assessee was a capital expenditure and, therefore, the Tribunal erred in directing the Department to apportion/spread over of the said amount for 71 years on proportionate basis, relatable to each other at the rate of Rs. 63,380/- per annum, for 71 years. Consequently, the direction to that extent in para 16 of the impugned Order is set aside. Therefore, the Appeal stands allowed.

(b) Consequently, the Cross Objections filed by the assessee stand dismissed.

10. Accordingly, the Appeal is allowed. No order as to costs.