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In the High Court Of Kerala

Case No : Income-tax Reference No. 168 of 1986

Commissioner of Income Tax APPELLANT

Vs

Madras Spinners Ltd. RESPONDENT

Date of Decision : 29-10-1993

Acts Referred:
Income Tax Act, 1961 — Section 36(1), 37

Citation : (1994) 120 CTR 392 : (1994) 207 ITR 35

Hon'ble Judges : Varghese Kalliath, J;K.J. Joseph, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; C.N. Ramachandran Nair, for the Respondent

Judgement

Varghese Kalliath, J.—This is a reference at the instance of the Revenue. The reference is u/s 256(1) of the Income Tax Act, 1961. The questions are these :

"1. Whether, on the facts and in the circumstances of the case, the expenditure of Rs. 9,69,563 incurred by the assessee on modernising its machinery is a revenue expenditure ?

2. Whether, on the facts and in the circumstances of the case and in view of Section 56(1)(ii) the assessee is entitled to claim deduction of the bonus in excess of the statutory limit ?"

2. The assessee is a textile manufacturing company. The assessee/company claimed expenditure of Rs. 9,69,563 incurred by it on modernising its machinery. The Income Tax Officer was of the view that this amount having been incurred by the assessee for installation of new machinery was of capital nature. He disallowed the claim. On appeal, the Commissioner of Income Tax (Appeals) did not agree with the Income Tax Officer and held that the expenditure incurred by the assessee on modernising its machinery was allowable as revenue expenditure. He allowed the claim. The Revenue filed an appeal before the Appellate Tribunal.

3. The Appellate Tribunal found that the expenses incurred by the assessee-company were for renovating and replacing the old and worn out machinery and were of a revenue nature. Further, the Tribunal said that, in view of the fiercely competitive nature of the present business, the need for modernisation of the machinery cannot be overemphasised and that the expenditure incurred by the assessee-company on modernising its machinery by replacing the old, worn out and unserviceable parts, in order to run its business smoothly, efficiently and profitably is allowable as revenue expenditure.

4. The question whether an expenditure incurred by the assessee is a revenue expenditure or an expenditure in the nature of capital expenditure is really a question of law. It depends upon the nature of the expenditure. We had occasion to consider this aspect of the matter a little elaborately in Income Tax References Nos. 105 and 106 of 1989. The facts and the nature of expenditure in those Income Tax references are similar to these herein. We were considering a case of modernising the machinery of a textile mill by renovation and replacement of worn out machinery. In considering those two Income Tax references, we have referred to certain cases of the Supreme Court, including Empire Jute Co. Ltd. Vs. Commissioner of Income Tax, , Commissioner of Income Tax, Bombay City-I, Bombay Vs. Associated Cement Companies Ltd., Bombay, and Alembic Chemical Works Co. Ltd. v. CIT : [1989]177ITR377(SC) , and held that the question whether, in similar circumstances, the expenditure incurred in this case on the basis that the expenditure in question incurred by the assessee was for the better conduct and improvement of the existing business on a scheme of modernisation and not for a fresh and new venture and the object of modernisation was for facilitating the assessee''s trading operations and the conduct of the assessee''s business to be carried on more efficiently and to update the facilities on the line of the modern trends in the business and should therefore be held to be revenue expenditure. This case, Income Tax Reference No. 168 of 1986, was also heard along with the batch of cases, Income Tax References Nos. 105 and 106 of 1989, etc. The general question involved in those batch of cases was identical to the first question in this case. We are appending a copy of the judgment in Income Tax References Nos. 105 and 106 of 1989, etc., as part of this judgment.

5. We may also refer to Commissioner of Income Tax Vs. Madras Spinners Ltd., . This case was in respect of the same assessee for the assessment years 1974-75, 1978-79 and 1979-80. The nature of expenditure incurred was identical to the expenditure incurred in the case at hand. This court held that the expenditure incurred by the assessee is just to replace the old and worn out parts in order to make the unit function more effectively, that no new machinery or plant was installed and no new asset came into existence, and further found that the conclusion is inescapable that the expenditure incurred by the respondent assessee for modernising its machinery by replacing old, worn out and unserviceable parts in order to run its business smoothly and efficiently is only revenue expenditure. Further, the court said that the conclusion of the

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Tribunal is in accord with the decision of the Supreme Court in Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., . Finally, the Division Bench observed that no referable question of law arises out of the order of the Appellate Tribunal. Of course, the case decided by the Division Bench is an original petition for compelling a reference.

6. In the result, we hold that the first question referred has to be answered in the affirmative, in favour of the assessee and against the Revenue.

7. The second question relates to bonus. The Tribunal held that the customary bonus paid by the assessee to its employees on the occasion of Onam is not hit by Section 36(1)(ii) of the Income Tax Act and the same is governed by Section 37 of the Income Tax Act. An identical question has been considered on identical facts in Income Tax Reference No. 87 of 1986. We have held in that case that the proviso to Section 36(1)(ii) of the Income Tax Act was not considered properly and so we declined to answer the question and directed the matter to be enquired into afresh by the Tribunal.

8. In Commissioner of Income Tax Vs. Kerala Agro Industries Corporation, , this court held that bonus paid to an employee in a factory or other establishment to which the provisions of the Payment of Bonus Act, 1965, do not apply can be claimed as a deduction u/s 36(1)(ii) of the Income Tax Act, 1961, only if the conditions required under that provision are satisfied. The conditions are : (i) the amount of bonus should be reasonable with reference to the pay of the employee and the conditions of his service ; (ii) the profits of the business or profession for the previous year in question ; and (iii) the general practice in similar business or profession. All the three conditions enumerated in clauses (a) to (c) of the second proviso to Section 36(1)(ii) must be satisfied in order that the payment which is not required by the Bonus Act is regarded as reasonable so as to warrant the deduction u/s 36(1)(ii).

9. The order of the Tribunal reveals the specific aspect as to whether the bonus paid by the assessee may stand the test specified in Section 36(1)(ii) of the Income Tax Act read along with the proviso has not been adjudicated by the Tribunal. In these circumstances, we decline to answer the question. We direct the Tribunal to consider the matter afresh in the light of the decisions in Commissioner of Income Tax Vs. P. Alikunju, M.A. Nazir, Cashew Industries, , Commissioner of Income Tax Vs. Kerala Agro Industries Corporation, and Income Tax Reference No, 185 of 1985 (Commissioner of Income Tax Vs. P. Balakrishna Pillai, International Cashew Traders,) and Income Tax Reference No. 399 of 1985. Commissioner of Income Tax Vs. Kumar Industries,). The question referred is answered as above.

10. Reference is disposed of as above.

11. A copy of this judgment under the seal of this court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.

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