

(2010) 09 DEL CK 0022
In the Delhi High Court
Case No : ITR No. 289 of 1990

Commissioner of Income Tax

APPELLANT

Vs

Modi Industries Ltd.

RESPONDENT

Date of Decision : 14-09-2010

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 30, 31, 32, 33

Citation : (2011) 339 ITR 467 : (2011) 197 TAXMAN 76

Hon'ble Judges : Reva Khetrapal, J;A.K. Sikri, J

Bench : Division Bench

Advocate : Prem Lata Bansal, for the Appellant; Ajay Vohra, Kavita Jha, Akansha Aggarwal and Somnath Shukla, for the Respondent

Judgement

A.K. Sikri, J.—Following question is referred for the opinion of this Court by the Income Tax Appellate Tribunal ("the Tribunal" in short) on the application of the Commissioner u/s 256(1) of the Income Tax Act (hereinafter referred to as "the Act").

Whether, on the facts and in the circumstances of the case, the ITAT was correct in law in holding that expenses claimed by the assessee in respect of transformer, pumping set, mono block and consultancy charges for selection of boiler and construction of cells were not capital in nature?

2. In the assessment year in question i.e. assessment year 1982-83 the assessee had claimed the deductions on account of "Repairs of Plant and Machinery". According to the assessee it had incurred an expenditure of Rs. 26,50,090/- on such repairs in its Banaspati Unit. The Assessing Officer (AO) disallowed the expenditure to the extent of Rs. 8,12,894/- holding the same to be capital in nature and therefore inadmissible. The details of these expenses are as under:

(a) Amount paid to M/s. J.B. Singh, Contractor, for fabrication and erection charges of Cell-room. Rs. 50,375 (b) Amount paid to M/s. Anurag Construction Co. for dismantling of old PCC & RCC work in Cell-room. Rs. 16,830 (c) Amount

paid to M/s. Ajanta Builders for construction of weigh-bridge Railway Siding. Rs. 36,377 (d) Amount paid to M/s. Anurag Construction Co. for dismantling of PCC in Cell-room. Rs. 10,747 (e) Amount paid to M/s. Crompton Graves Ltd. for two No. Transformers. Rs. 2,77,886 (f) Cost of pumping Set with 20 HP Motor 1. Rs. 10,948 (g) Construction of Cell Rooms. Rs. 2,67,712 (h) Expenses incurred on project report for information of Vanaspati paid to Techno-Chem Equipment Manufacturers (P) Limited Rs. 63,000 (i) Cost of Electric Motors 75 HP Rs. 36,694 (j) Cost of Motor 20 HP Rs. 6,443 (k) Consultancy charges for selection of boiler paid to M/s. Dalal Consultants & Engineers (P) Ltd. Rs. 7,000 (l) Mono block pump with HP Motors Rs. 9,746 (m) Cost of heating system for Deedriser Rs. 19,126 Rs. 8,12,894

3. The CIT (A) sustained the disallowance in respect of items a, b, d, e, f, k and l amounting to Rs. 3,05,560. In respect of other items namely c, h, i, j and m, CIT (A) held that those were revenue expenses and were therefore allowed. Thus, out of Rs. 8,12,894 disallowed by the AO, he allowed deduction of Rs. 5,07,234. In further appeal preferred by the assessee, all the remaining items of expenditure are also allowed by the Tribunal treating the same as the revenue expenditure. It is in this back-drop aforesaid question is referred for opinion.

4. The expenditure on these items can be put in two categories namely:

(i) Expenditure incurred on dismantling of old PCC and RCC work of cell room and construction of cell room; and

(ii) Expenditure incurred on purchase of two transformers, one pumping set and one mono block HP motors. 5. We may, at the outset, point out that the CIT (A) while treating the expenditure on the aforesaid items as capital expenditure has not undertaken any detailed discussion nor any reasons are given in support of his opinion that the expenditure was of capital nature. Similar omission is by the Tribunal as well. Order of the Tribunal only records that the expenditure is apparently revenue in nature and CIT (A) should have allowed them. Otherwise, the Tribunal also does not indicate as to why according to it the expenditure is revenue in nature. It was for this reason we heard the learned Counsel for both the parties in detail, insofar as the nature of the aforesaid expenditure and the circumstances in which this expenditure was incurred by the assessee, is concerned.

5. Submission of Ms. P.L. Bansal, learned Counsel appearing for the Revenue, was that the cell room was demolished and new room in place thereof was constructed. It was clearly a value addition to the property and capital asset was created. The expenditure thereon should, therefore, be treated as the capital expenditure. She, likewise argued that by purchasing transformers, pumping sets and mono block pump with HP motor, the new assets were created which were essential for the running the plant. According to her, these were obvious expenditure of capital in nature.

6. On the other hand, Mr. Ajay Vohra, learned Counsel who appeared for the

assessee, submitted that expenditure mentioned in Para (i) above pertaining to cell rooms cannot be classified as capital in nature since no new asset came into existence. Cell room was already in existence and the appellant merely carried out repairs of the same by dismantling some worn out portions of the cell rooms and putting up new construction. The same cannot, it was submitted, lead to the conclusion that a new asset building was brought into existence. It is argued that the cell rooms are not an independent plant but merely a part of the larger plant and is used for a specific hydrogenation process, which itself is a part of Vananspati Oil manufacturing process. He referred to a recent judgment of this Court in the case of Commissioner of Income Tax-IV Vs. Delhi Press Samachar Patra (P.) Ltd., wherein the assessee carried out repairs to the factory building, which was constructed in the year 1975. The nature of expenditure represented water proofing of roofs, reinforcement of old beams in which steel bars and plasters had corroded, relaying of worn out flooring of print shop, repairing of roads, repairing and replacement of workers' wash rooms, boundary walls and gates, repairing and reconstruction of cooling tower areas, repairing of cement sheets, and laying of fiber coated sheets, repairing of AC chiller rooms, etc. The said expenditure was claimed by the assessee as allowable "current repairs", but was disallowed by the Assessing Officer on the ground that the same represented capital expenditure. The CIT (A) confirmed the action of the AO. On further appeal by the assessee, the Tribunal deleted the addition observing that the expenditure on repairs, reinforcement, replacement, etc. was carried out in the existing building which did not bring into existence any new asset. On Revenue's appeal, the Court while affirming the findings of the Tribunal observed as under:

5. The Tribunal, after examining the facts of the case, came to the conclusion that the expenditure was incurred on repairs, reinforcement, replacement of dilapidated beams, pillars, walls etc. of the existing press building and that the assessee did not bring into existence any new asset over and above the existing building. The Tribunal also observed that the assessee had been incurring such expenditure in the past as and when the need arose and it was towards preserving and maintaining the existing asset. The Tribunal also noted several decisions of the Supreme Court including that of The Commissioner of Income Tax, Madurai, Vs. Saravana Spinning Mills Pvt. Ltd., The Tribunal also noted that the Department doubted the nature of the expenditure considering the magnitude of the expenditure incurred in the current year compared to the expenditure in the earlier years. The Tribunal observed that the authorities below had acted on the presumption that a part of the building had been demolished and that the items had actually been used for erection of a new structure. However, the Tribunal also observed that for this conclusion, the Department could not bring on record any evidence to justify the stand that the expenditure was actually for erection of a new building or asset. The Tribunal also noticed that the contention of the assessee that it had undertaken major repairs to put the dilapidated columns, beams, roofs etc. in its original position, which had become dangerous and unsafe for the workmen and hindered the normal

operation of the business, was not controverted by the departmental representative nor had any evidence to the contrary been produced before the Tribunal or the authorities below. It was ultimately concluded that employing the test indicated in *Saravana Spinning Mills (Supra)*, the assessee had incurred the said expenditure only to preserve and maintain the existing asset and that the expenditure was not of a nature which brought into being a new asset or created a new advantage of an enduring nature. Consequently, the Tribunal deleted the disallowance.

(emphasis supplied)

7. Reading of the aforesaid judgment would bring forth the principle that if a part of the structure becomes dilapidated and repairs/reinforcement of some parts of the said structure was required, it would be treated as "current repairs". However, on the other hand, if a part of the building is demolished and new structure is erected on that place, it has to be treated as capital expenditure, as in that case totally new asset is created even if it may be a part of the building.

8. When we apply this principle to the facts of the present case, it is difficult to accept that the expenditure incurred on cell room was in the nature of "current repairs". From the items of expenditure, it is clear that after completely demolishing the old cell room, entire new cell room is erected. The case relates to the Assessment Year 1982-83. Keeping in view the money spent on this cell room in that year, it is obvious that money spent was not merely on repairs of the cell room, but for constructing a new cell room. The entire PCC and RCC work in the cell room was dismantled. For this dismantling alone, a sum of Rs. 16,830 was paid to one contractor and further sum of Rs. 10,747 was paid to another contractor. Further sum expended on the construction by the assessee was Rs. 50,375 and Rs. 2,67,712. By no stretch of imagination, such a huge expenditure could have been incurred on repairs of the cell room, going by the prevailing rates in the year 1982-83. Payment of this amount for construction in the year 1982-83 would clearly evince that it was for the construction of new cell room. Even the nomenclature of the entry, given by the assessee itself is "fabrication and erection charges of cell room". Thus, it was nothing but a complete demolition of the old cell room and construction/erection of new cell room in its place.

9. We may usefully refer to the judgment of the Supreme Court in the case of *The Commissioner of Income Tax, Madurai, Vs. Saravana Spinning Mills Pvt. Ltd.*, which was relied upon by Ms. Bansal, learned Counsel for the Revenue. The Apex Court explained what "current repairs" of plants and machinery u/s 31(i) of the Income Tax Act would mean, in the following manner:

11. An allowance is granted by Clause (i) of Section 31 in respect of amount expended on current repairs to machinery, plant or furniture used for the purposes of business, irrespective of whether the assessee is the owner of the assets or has only used them. The expression "current repairs" denotes repairs

which are attended to when the need for them arises from the viewpoint of a businessman. The word "repair" involves renewal. However, the words used in Section 31(i) are "current repairs". The object behind Section 31(i) is to preserve and maintain the asset and not to bring in a new asset. In our view, Section 31(i) limits the scope of allowability of expenditure as deduction in respect of repairs made to machinery, plant or furniture by restricting it to the concept of "current repairs". All repairs are not current repairs. Section 37(1) allows claims for expenditure which are not of capital nature. However, even Section 37(1) excludes those items of expenditure which expressly falls in Sections 30 to 36. The effect is to delimit the scope of allowability of deductions for repairs to the extent provided for in Sections 30 to 36. To decide the applicability of Section 31(i) the test is not whether the expenditure is revenue or capital in nature, which test has been wrongly applied by the High Court, but whether the expenditure is "current repairs". The basic test to find out as to what would constitute current repairs is that the expenditure must have been incurred to "preserve and maintain" an already existing asset, and the object of the expenditure must not be to bring a new asset into existence or to obtain a new advantage. In fact, in the present case, in the balance sheet the assessee, viz, M/s Saravana Spinning Mills has indicated the above expense as an item incurred for purchase of a New Asset. In our view, the High Court had erred in placing reliance on the report of SITRA in coming to the conclusion that the textile mill is a plant u/s 31(i). As stated above, each machine in a segment has an independent role to play in the mill and the output of each division is different from the other "Repair" implies the existence of a part of the machine which has malfunction. If the argument of the assessee herein before us is to be accepted it would result in absurdity and it would make the provisions of Section 31(i) completely redundant. According to Shri R. Venkataraman, learned senior counsel for the assessee, the textile plant consists of about 25 machines. One of such machines is the Ring Frame. If the argument of the assessee is to be accepted, it would mean that periodically one machine out of 25 would be replaced, and on that basis, from time to time, each of these 25 machines in the textile plant would be entitled to claim allowance u/s 31(i). In our view, the A.O. was right in holding that each machine including the Ring Frame was an independent and separate machine capable of independent and specific function and, therefore, the expenditure incurred for replacement of the new machine would not come within the meaning of the words "current repairs". In the present case, it is not the case of the assessee that a part of the machine (out of 25 machines) needed repairs. The entire machine had been replaced. Therefore, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" in Section 31(i).

10. The Supreme Court was, thus, categorical that "current repairs" refer to expenditure effected to preserve and maintain an already existing asset and the object of expenditure must not be to bring a new asset into existence or to obtain a new advantage.

11. No doubt, it was also clarified by the Supreme Court that in case part of a machine, which has become obsolete, is replaced, then it would be "current repairs". However, the nature of expenditure in the present case falls within the description given by the Supreme Court in the aforequoted portion.

12. Since we hold that the expenditure incurred on the cell room is in the nature of capital expenditure, it cannot be allowed as business expenditure u/s 37(1) of the Act. At most, the assessee would be entitled to depreciation thereupon.

13. Insofar as purchase of pumping sets, Mono block pump with HP Motors and two transformers is concerned, they were not stand alone equipments, but were the part of bigger plant. Therefore, it would be treated as replacement of those parts when they are not used independently and the expenditure would be liable to deduction u/s 37(1). Gujarat High Court in the case of Commissioner of Income Tax Vs. Udaipur Distillery Co. Ltd., wherein it was held that purchase of transformers in replacement of existing transformer, which could not be used independently, falls within the category of revenue expenditure and hence, is an allowable deduction u/s 37(1) of the Act. These expenditure are, thus, treated as Revenue expenditure.

14. The upshot of the aforesaid discussions would be to answer the question partly in favour of the assessee and partly in favour of the Revenue. The Tribunal was correct in allowing the expenses in respect of transformers, pumping sets, Mono block pump with HP Motors as revenue expenditure, but erred in allowing expenses on the construction of cell room as revenue expenditure. The question stands answered accordingly.