

(2003) 10 RAJ CK 0016
In the Rajasthan High Court
Case No : IT Appeal No. 77 of 2001

Commissioner of Income Tax

APPELLANT

Vs

Udaipur Distillery Co. Ltd.

RESPONDENT

Date of Decision : 09-10-2003

Acts Referred:

Income Tax Act, 1961 — Section 32(1), 37(1), 43B

Citation : (2004) 186 CTR 39 : (2004) 268 ITR 451 : (2004) 1 RLW 657

Hon'ble Judges : Sunil Kumar Garg, J;Rajesh Balia, J

Bench : Division Bench

Advocate : K.K. Bissa, for the Appellant; N.M. Ranka, K.N. Joshi, Mahendra Gargieya, R.K. Yadav and Rajesh Joshi, for the Respondent

Final Decision : Dismissed

Judgement

Rajesh Balia, J.—At the time of the admission of this appeal u/s 260A of the IT Act, 1961, the substantial questions involved in this appeal were framed as under:

(1) "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the unpaid amount of bottling fee has, on furnishing of the bank guarantee to be treated as actual payment and accordingly allowing the deduction in respect of the same u/s 43B of the Act, even though the sum has not been actually paid before the due date of filing the return u/s 139(1) of the Act."

(2) "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in allowing the depreciation on research & development assets which related to the closed business of fast food division/unit of the assessee-company as such not used during the previous year ?"

(3) "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in deleting the addition of Rs. 2,77,887 being made treating the expenditure incurred in purchase of new transformer as capital expenditure even

when the old transformer still exists in the block of asset and not sold, discarded or demolished or destroyed ?"

2. The question No. 1 dwells on the claim of assessee-respondent for deduction of amount of bottling fee payable under the Rajasthan Excise Act, 1950 and relevant Rules framed thereunder, liability for which was incurred during the accounting period relevant to asst. yr. 1992-93, claim was made on the basis of accounts maintained on mercantile system

3. During the course of hearing, it transpired that the claim of deduction on account of liability incurred for paying bottling fee during accounting period relevant to the asst. yr. 1992-93, which is subject-matter of this appeal, has been sought to be denied on the ground that it being a fee unless it is actually paid, when it is payable, deduction in respect thereof cannot be allowed during the relevant assessment year when the liability was outstanding. For this purpose, the AO drew support from the provisions of Section 43B of the Act of 1961, as it existed w.e.f. 1st April, 1989.

4. Two-fold contentions were raised in support of claim of deduction before the Tribunal on behalf of assessee : firstly that bottling fee is not a fee in its technical sense as an impost and part of taxation scheme, but is a consideration receivable by the State for parting with its exclusive privilege to deal in potable liquor in all its manifestations and the same does not fall within the purview of Section 43B. Such liability which is of revenue in nature is allowable as deduction when such liability is incurred irrespective of its payment on due date. Alternatively, it was also urged that since the assessee was retired to furnish bank guarantee, in a pending litigation wherein the validity of liability was under challenge, the bank guarantee must be deemed to be actual payment so as to satisfy the condition of Section 43B.

5. But the Tribunal has decided the issue in favour of assessee on the latter contention and the first contention of the assessee has not been answered notwithstanding it was raised before the Tribunal. Under such circumstances, the assessee urged before us that even if the question No. 1 is decided against him, he is entitled to relief on second contention raised by him.

6. The second contention raised by him also raises substantial questions of law which goes to the root of the controversy and arises out of the Tribunal's order. The assessee is entitled to seek sustaining of Tribunal's order on the alternative ground which was urged before the Tribunal but was not decided by it.

7. In the facts and circumstances of the case we are satisfied that following substantial question of law also arises in this appeal for consideration and it is required to be decided for deciding the appeal on merits on the contentions raised by the parties before the Tribunal as well as before us :

(1A) "Whether, in the facts and circumstances of the case, bottling fees chargeable from the assessee under the Rules framed under the Rajasthan

Excise Act, 1950, and interest chargeable on late payment of bottling fees, amounts to tax, duty, cess or fees within the meaning of Section 43B of IT Act, 1961, so as to attract the said provisions while considering allowability of deduction of such expenses."

8. In D.B. IT Appeal No. 8/2002--CIT v. Udaipur Distillery Company Ltd. the respondent-assessee in this case also, in which same issues were raised in respect of asst. yr. 1988-89, this Court vide its judgment dt. 3rd Sept., 2003, has answered the question No. 1 holding that furnishing of bank guarantee cannot be treated equivalent to actual payment. Therefore, if the bottling fee is to be considered as "fee" in its technical sense, requirement of Section 43B are not fulfilled.

9. However, on newly framed question this Court has decided that looking to the nature of charges and provision of levy of taxation scheme under Article 265 and provisions of Rajasthan Excise Act, 1950, and after considering number of decisions of Hon'ble Supreme Court, bottling fee is not a fee in its technical sense as part of taxation but is a consideration for parting with exclusive privilege of State to deal in potable liquor founded on right of State to enter into contract in its exclusive right to trade and deal in potable alcohol and intoxicants, therefore, question was decided in favour of assessee and claim of assessee to deduction was found to be not falling within the ambit of Section 43B of the IT Act. It has to be considered as allowable revenue expenditure, if the accounts are maintained on mercantile basis, in the year when such liability has arisen.

10. Following, the aforesaid decision, it is held that liability incurred by the assessee during the period in question on account of bottling fee for bottling IMFL is not governed by Section 43B and is to be allowed as deduction notwithstanding such liability is discharged on a future date after the end of relevant accounting year, where accounts are maintained on mercantile basis.

11. The question No. 2 refers to allowances of assessee's claim to depreciation in respect of assessee's research and development assets relating to assessee's business. This question has also come up for consideration in D.B. IT Appeal No. 78/2003 in assessee's own case for different financial year which has been decided on 24th Sept., 2003 by holding that the finding reached by the Tribunal is correct and the assessee is entitled to claim depreciation in respect of assets belonging to the R&D division of the assessee's business which existed for the whole of the business of the assessee's which originally, included fast food division as well as R&D division merely because one of its business viz., the fast food division was not existing during the previous year relevant to assessment year in question. The assets still formed part of the assessee's business and did not cease to be the assets of the assessee which has been used for the purpose of its running business during the relevant accounting period and formed part of the block assets of the assessee's business, therefore, the depreciation in respect thereof is also allowable as deduction.

12. Following the aforesaid decision, we hold that the Tribunal was right that the assessee was entitled to claim deduction by way of depreciation on the assets which formed part of the research & development division and such claim to deduction cannot be disallowed merely because part of the assessee's business ceased to operate during relevant period when the assets were being used for remaining business of manufacture and sale of alcohols.

13. Coming to the third question, the assessee has claimed deduction of Rs. 2,77,867 as a revenue expenditure for replacing the old transformer by a new transformer as an essential part of the plant and machinery already installed. The said claim of the assessee was disallowed by the AO by treating it to be an expenditure of capital nature on two grounds, firstly, that this was purchased by a single bill and secondly, there was no replacement of transformer as part of existing plant because the old transformer is still lying in the block of assets of the assessee.

With the aforesaid observations, the AO has allowed depreciation for six months as the asset acquired in the second half of the previous year relevant to the assessment year in question.

14. In further appeal, the CIT(A) was of the opinion that the transformer is an addition of new assets and not the replacement of the old transformer because the old transformer is also included in the block assets at its WDV value. Therefore, it was held that the appellant had installed a new transformer and hence this has to be treated as capital expenditure. On this premise, the disallowance of the claim of the assessee was confirmed by the CIT(A).

15. However, the Tribunal after referring to the contentions made before it by the representative of the Revenue as well as of the assessee, found it to be a case of replacement of old transformer by the new for the smooth running of the existing plant. The Tribunal applied the principle that replacement of worn out parts of existing plant does not result in bringing new asset and found that cost incurred in purchase of transformer was a revenue expenditure in ordinary course of maintenance and repairs of its plant. It recorded its conclusion as under:

"Considering all the facts and circumstances of the case, the material on record and the legal position as emerging from the judicial pronouncement discussed above, we are of the view that the expenditure incurred on purchase of new transformer for replacement of the old transformer for efficient and smooth running of the assessee's channel distribution board of electrical circuit to be revenue expenditure the same is accordingly allowable as revenue expenditure."

However, it was further held by the Tribunal that in such a situation the depreciation already allowed, treating the same as capital expenditure, may be withdrawn.

16. Learned counsel for the Revenue has urged that since it is not in dispute that the old transformer is still lying in the block of assets of the assessee and,

therefore, it has to be treated as new asset as an addition to the block of assets already held by the assessee. Therefore, the Tribunal has erred in not holding that the expenditure to be of capital nature and in holding that it was part of repairs and maintenance by replacement of worn out part with the new one for efficient running of the existing plant.

17. We may notice that at no stage this contention has been controverted that the transformer by itself is not used as an independent plant and machinery but is only used as a part of the entire set up of plant. Only because the old transformer has not been disposed of and still with assessee as part of the block of assets held by the assessee, it cannot be treated as a replacement of old machinery. That must be a new machinery itself.

18. This contention is wholly fallacious. Whenever any part of the existing plant and machinery is worn out or becomes unusable or degenerates or notwithstanding, even if it can be used it may increase the cost factor, replacement of the same has been considered by consensus of judicial opinion to be part of existing plant and machinery and it has been treated as revenue expenditure laid in the ordinary course of business and not acquiring a new asset in the block of asset so as to be termed as capital expenditure.

19. The Supreme Court in Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., , approved the decision of the Madras High Court.

In the aforesaid case, the assessee which was carrying on the business of manufacture and sale of cotton yarn, spent Rs. 93,215 for introduction of the "Casablanca conversion system" in its spinning plant. Substantially, this involved replacement of certain roller stands and fluted rollers fitted with rubber aprons to the spinning machinery, removal of ring frames from certain existing parts, introduction, inter alia, of ball-bearing, jocke-pulleys for converting the original band-drivers to tape drivers and other additions and alterations in the drafting mechanism.

The assessee had claimed development rebate by treating it to be a capital investment in plant and machinery. The claim was denied by the AO on the ground that it is not capital in nature. Then, the assessee had filed an appeal before Tribunal, challenging the order of AO on the ground that a sum of Rs. 93,215 was spent for introduction of "Casablanca conversion system" and claimed development rebate on the ground that the amount spent was admissible u/s 10(2)(v) of the Indian IT Act, 1922 since as a result of the stress and strain of production over a long period there was need for change in the plant, and that the assessee had replaced old parts by introducing the Casablanca conversion system. The Tribunal had also denied the claim of the assessee for development rebate but held that the amount so spent could be allowed as an expenditure incurred for current repairs u/s 10(2)(v) of the IT Act. Notwithstanding, coming to this conclusion the Tribunal did not allow the expenditure of Rs. 93,215 as a revenue expenditure because the assessee has

not claimed it as a revenue expenditure.

On a reference made to the Madras High Court, the High Court had accepted the finding recorded by the Tribunal that by the introduction of the Casablanca conversion system no new machinery or plant was installed but the introduction of the system amounted to fitting of improved versions of certain minor parts and expenditure in that behalf was of revenue nature. It also held that the Tribunal had evidence before it from which it could be concluded that by introducing the Casablanca conversion system the assessee made current repairs to the machinery and plant. The High Court further observed that certain moving parts of the spinning machinery had to be replaced periodically because of "wear and tear", and when it was found that the old type of replacement parts were not available in the market, the assessee introduced the Casablanca conversion system, but thereby there was merely replacement of certain parts which were a modified version of the older parts. The High Court had also confirmed the order of the Tribunal and allowed deduction of the expenditure to be of revenue nature. Notwithstanding the assessee had not originally claimed it as a revenue expenditure. The judgment of Madras High Court is reported in Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., Significantly the Madras High Court observed that whether a new asset is brought into existence or a new advantage is derived, is a question of fact.

The Supreme Court affirmed the judgment of the High Court. The Court said that the rejecting a contention raised by the assessee, grant of relief to him on another ground is justified. It would be open to the Departmental authorities and the Tribunal, and indeed they would be under a duty to grant that relief. The right of the assessee to relief is not restricted to the plea raised by him. The replacement of old parts necessitated on account of wear and tear for efficient running of the existing plant and machinery is a revenue expenditure.

20. It must be noticed that in the case before Supreme Court notwithstanding the fact that introduction of Casablanca conversion system resulted in the change in the existing system of spinning plant altogether, yet it was found to be merely replacement and not an installation of new machinery because it has come through by replacement or modification of existing plant and because of the non-availability of old parts in the market. Therefore, even where it resulted in modification of existing system by replacing the old parts with new parts, it did not fall within the nature of capital expenditure.

21. In the present case, we are concerned with the transformer which is only one part of the entire plant set up of the assessee and is an essential part for running of the plant. This is an additional system of energy distribution or a substituted distribution system for running the plant.

22. The principle is also well settled that even if a purchase by itself may it be used independently be a capital investment, but if it is purchased as a part of plant in which it is used as a part of the existing plant and machinery, the same

may become a replacement of a part of existing plant by way of its maintenance and repairs on account of wear and tear. Purchase of an article by one bill and of a thing which may independently be used is not decisive of the question whether the fact that such an expense is capital expenditure or purchased article as a new asset to be used independent of existing plant and machinery. If it is purchased for installing a new instrument independently of any existing plant it may amount to acquisition of a" new capital asset. On the other hand, if it is purchased to be used for running of existing plant and machinery for its more efficient and smooth running it may amount to be a revenue expenditure. For example purchasing a car, in its entirety, a capital investment which includes every part of it and tyres. Subsequent purchase of tyres, batteries or a new carburetor to replace old one, for its more efficient use, will only be replacement of a part of old plant, notwithstanding such article is purchased by single bill and the old parts may not have been sold or discarded immediately and remain with the assessee and which had constituted as part of car, which still is a part of block of assets without excluding the price which such discarded parts may fetch from its written down value. In such event it may amount to a revenue expenditure. It depends on facts and circumstances of the case, depending on the purpose for which it has been purchased.

23. The Allahabad High Court considered this question about the replacement of the transformer in the case of Commissioner of Income Tax Vs. Kanodia Cold Storage, It held that replacement of worn out parts does not by itself bring in a new asset. In considering the nature of an expenditure one should consider the productive unit as a whole and not pick out parts therein which are new. If the productive unit to the assessee remains the same but a part of it which has become unsuitable for its use is replaced by something which makes it possible for the existing plant to function efficiently, the cost incurred on such replacement would be revenue expenditure. In that case, the assessee had made a payment of Rs. 14,742 to an electric supply undertaking towards cost of transformer and service line for replacing the existing line to enable it to have higher electric power for its cold storage business and claimed its deduction as a revenue expenditure. The Court said that:

"Where the productive unit set up by the assessee remains the same, but a part of it which has become unsuitable for its use is replaced by something which makes it possible for the existing set up to function efficiently, the cost incurred on such replacement would be revenue expenditure."

Applying the principle the Court held that:

"The expenditure was not in the nature of capital expenditure. The amount was, therefore, allowable as revenue expenditure in computing the income of the assessee."

In coming to this conclusion, the Allahabad High Court placed reliance on the decision of the Supreme Court in CIT v. Mahalakshmi Textile Mills Ltd. referred to

above.

24. In Commissioner of Income Tax Vs. N.P. Singh and Others a Division Bench of Patna High Court held that cost incurred on fitting of two new gear boxes to its steamer to be a revenue expenditure which were disallowed by the AO to be in the nature of capital expenditure. The Court said that:

"It was only an improvement in the operation of the existing business and its efficiency and profitability. Therefore, the expenditure incurred by the assessee was allowable as revenue expenditure."

25. Similar view was expressed by Kerala High Court in Commissioner of Income Tax Vs. Co-operative Sugars Ltd., . In the said case, the assessee was engaged in manufacture and sale of sugar and molasses. The sugar plant consisted of several components like juice heater, juice sulphiter, vacuum filter drum, centrifugal machinery sugar crystalliser, sugar grader, etc. Each machinery though had distinct function was integral part of sugar plant. All machinery put together complete sugar plant, therefore, the expenditure incurred on "machinery maintenance" does not result in acquisition of any asset of enduring nature and the expenditure incurred is allowable as revenue expenditure.

26. In coming to this conclusion, the Kerala High Court placed reliance on the decision of the Supreme Court in Alembic Chemical Works Co. Ltd. v. CIT : [1989]177ITR377(SC) . The Supreme Court had said in Alembic Chemical Works case (supra) that:

"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 subcultures of the high yielding strains of penicillin supplied by Meiji and that the mere introduction of 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, therefore, held to be revenue expenditure." "

The Court had approved the test that where acquisition of know-how which results in efficient running of the existing plant, and does not alter the basic nature of product manufactured by existing machinery notwithstanding the fact that, acquisition of such know-how was in consideration of one for all payment, it did not result in capital expenditure as by this transaction no new asset comes into existence, but it was for more efficient and more productive running of the existing business, and therefore, it was in the nature of revenue expenditure

necessary for conduct and improvement of the existing plant and same may be allowed as such.

27. In like manner, the Madhya Pradesh High Court in Commissioner of Income Tax Vs. Mohd. Ishaque, Mohd. Gulam, held that replacement of petrol engine by diesel engine in a jeep to reduce expenditure and augment profits of business does not result in acquisition of a new asset and no advantage of enduring benefit of the business was derived. The expenditure was incurred for running the business with a view to produce more profits and held expenditure to be revenue expenditure.

28. Similar view has been expressed by the Rajasthan High Court in CIT v. Manglam Cement Ltd. in D.B. IT Appeal No. 33/99 decided on 29th Sept., 1999. The Court held that the expenditure for acquisition of new gear box for the efficient running of the existing plant amounted to a revenue expenditure and not a capital expenditure as already held by the Tribunal.

29. Therefore, in view of the findings reached by the Tribunal that purchase of transformer was a case of replacement of old transformer for efficient and smooth running of the assessee's channel distribution board of electrical circuit to be revenue expenditure, in the circumstances cannot be held erroneous.

30. We are also of the opinion that merely because the old part of the machinery has not been sold out, and remained in possession of the assessee until it is disposed, cannot alter the nature of otherwise revenue expenditure into capital expenditure. Immediate disposal, of the old part or the replaced part before replacement takes place is not a condition precedent for holding the replacement to be a part, of maintenance and repairs cost of the plant and machinery nor the fact that same was acquired under a single bill can be of relevance to hold such expenses to be of capital nature.

31. Accordingly, we are of the opinion that the allowance of the cost of transformer as a revenue expenditure in its entirety as held by the Tribunal does not suffer from any effect. Obviously, once it is held to be a revenue expenditure, no depreciation can be claimed thereon.

32. In view of the aforesaid discussion, the appeal fails and is hereby dismissed.