

(2013) 10 KAR CK 0213
In the Karnataka High Court
Case No : IT Appeal No. 111 of 2007

Commissioner of Income Tax, Central Circle

APPELLANT

Vs

Kirloskar Computer Services Ltd.

RESPONDENT

Date of Decision : 30-10-2013

Acts Referred:

Citation : (2014) 270 CTR 331 : (2014) 221 TAXMAN 391

Hon'ble Judges : Rathnakala, J;N. Kumar, J

Bench : Division Bench

Judgement

N. Kumar, J.—This appeal is preferred by the Revenue, challenging the order passed by the Tribunal wherein it was held that, the expenditure incurred by the assessee is in the nature of a revenue expenditure and therefore, entitled to deduction of that expenditure u/s 37 of the income tax Act, 1961 (hereinafter referred to as "the Act" for brevity). Similarly, the interest paid on the loan borrowed for purpose of purchase of plant and machinery is also to be deducted u/s 36(1)(iii) of the Act. The assessee is a limited company carrying on the business and using facilities of telephonic connectivity for transfer of data in and out of the office. To improve this particular facility, it wanted to set up a V-SAT facility and paid site charges which are in the nature of licence fee for Bandwidth charges which are again in the nature of licence fee and DOT WPC fees, which is an annual fee. The amount that is paid is Rs. 76,90,000 for the entire period. The assessee claimed deduction of the said amount spent on the ground that it is a revenue expenditure. It also claimed deduction for payment of interest on the loan borrowed for setting up of the said facility. The Assessing Authority was of the view that the aforesaid amount spent was not a revenue expenditure, but it is in the nature of capital expenditure as a new facility was set up by the assessee. It also held that, as the interest was paid on the loan for setting up of the said facility, the assessee is not entitled to deduction of said interest. Aggrieved by the said order, the assessee preferred an appeal to the Commissioner of income tax (Appeals). The Commissioner of income tax (Appeals) upheld the order of the Assessing Authority and dismissed the appeal.

Aggrieved by the said order, the assessee preferred an appeal to the Tribunal. The Tribunal on a careful consideration of the material on record came to the conclusion that the assessee was using the telephone lines for receiving and sending the data. It switched over to the better proposition for improvement, i.e., communication between its clients in connection with receipt and sending data, after being processed. The assessee had to pay licence fee for the said new technology and therefore, it is in the nature of a revenue expenditure. It also held that the interest paid on the loan borrowed for setting up the said facility is also deductible and accordingly, it allowed the appeal, setting aside the order passed by the Assessing Officer as well the First Appellate Authority and permitted deductions. Aggrieved by the said order, the present appeal is filed by the Revenue.

2. The appeal was admitted to consider the following substantial questions of law:

1. Whether the Tribunal was correct in holding that the assessee who is carrying on the business of computer services had made an investment of Rs. 53,50,641 to start a telecom project should be treated as the business expenditure of the assessee even before the business in telecom had commenced?

2. Whether the Tribunal was correct in holding that a sum of Rs. 23,39,359 paid towards interest on plant and machinery purchased by the assessee should be treated as a revenue expenditure despite the same being added to the asset of the assessee?

3. The learned Counsel for the Revenue assailing the impugned order contended that the letter written by the assessee, which is extracted by the Tribunal in its order, clearly demonstrates that the assessee had set up a new project and for setting up a new project, he has incurred expenditure. Therefore, it is in the nature of a capital expenditure and the said expenditure is not liable to be deducted u/s 37 of the Act. Similarly, the interest paid the borrowed amount for setting up the new project is also not liable for deduction. The said investment made is of enduring benefit and therefore, it constitutes a capital expenditure.

4. Per contra, learned Counsel appearing for the assessee supported the impugned order.

5. The letter written by the assessee is extracted by the Tribunal in its order. A reading of the said order shows before commencing the V-SAT operation, the assessee was transferring the data through telephone line at the speed of 32 KBPS. Any advancement in this line can go up to 128 KBPS, but through cable network, which is humanly impossible to connect all the 18 cities. Subsequently the data transfer became very slow in the operational line. At that juncture, the assessee thought of increasing the capacity by way of V-SAT application through satellite network wherein the data can be transferred at much higher speed and the subscriber can contact any of the customers on a local call basis. Thereafter they have set out the expenditure incurred in setting up the V-SAT application facility, which shows a sum of Rs. 6,88,041.25 paise was spent for foreign travel;

a sum of Rs. 76.90 lakhs was spent towards DOT fees and charges; a sum of Rs. 23.89 lakhs towards financing cost and the assessee claimed deduction of the aforesaid amount. The Assessing Authority proceeds on the assumption that the assessee has set up a new project for the first time in which, the assessee did not have any prior experience. They have entered into an agreement with HFCL Satellite Communications Limited, a service provider in the area of V-SAT communications and they have incurred the aforesaid expenditure. Therefore, it is a new project and not a part of the existing project or a business carried on by the company with advanced technology.

6. The amount spent resulted in advantage of enduring benefit and therefore, the said expenditure is in the nature of a capital expenditure.

7. The Apex Court in the case of *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, has held as under:

(ii) There may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none-the-less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital held that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case.

(iii) What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. The question must be viewed in the larger context of business necessity or expediency.

8. In the case of *Scales v. George Thompson & Co. Ltd.* [1927] 13 T.C. 83, 89 (K.B.), dealing with the test for determining whether the two constitute the same business or different businesses, it is held what the Court has to look is, was there any inter-connection, any inter-lacing, any inter-dependence, any unity at all embracing those two businesses? That inter-connection, inter-lacing, inter-dependence and unity are furnished in a case by the existence of common management, common business organization, common administration, common fund and a common place of business, then the irretrievable inference that is to be drawn is it is the same business and then the amount spent would be in the nature of revenue expenditure and not capital expenditure. In the instant case,

the assessee is the same. Assessee is the person who borrowed money for setting up the V-SAT application and incurred the entire expenditure. After setting up the new facility or the new project, the assessee continues to manage the said project as a part and parcel of the existing project. The very letter on which the Assessing Authority relies on clearly demonstrates that the assessee was using telephone line for data transfer. Subsequently, the assessee was using cable network, but still it was slow in the operation. In order to increase the said capacity, V-SAT application through satellite was adopted. The result was that the data can be transferred at much higher speed. It is in the context of switch over to the new technology and adopting this new technology, the aforesaid expenditure was incurred and therefore, the said expenditure incurred is revenue expenditure and therefore, the assessee sought for allowance of the said expenditure. The Tribunal was justified in allowing the said expenditure, as it squarely falls u/s 37 of the Act. Insofar as the interest aspect is concerned, the Apex Court in the case of Deputy Commissioner of Income Tax, Ahmedabad Vs. Core Health Care Ltd., has held as under:

Section 36(1)(iii) of the Act, 1961, has to be read on its own terms: It is a code by itself. It makes no distinction between money borrowed to acquire a capital asset or a revenue asset. All that the section requires is that the assessee must borrow capital and the purpose of the borrowing must be for business which is carried on by the assessee in the year of account. Unlike section 37 which expressly excludes an expense of a capital nature. The Legislature has, therefore, made no distinction in section 36(1)(iii) between "capital borrowed for a revenue purpose" and "capital borrowed for a capital purpose". An assessee is entitled to claim interest paid on borrowed capital provided that capital is used for business purpose irrespective of what may be the result of using the capital which the assessee has borrowed. Actual cost of an asset has no relevancy in relation to section 36(1)(iii).

The proviso inserted in section 36(1)(iii) by the Finance Act, 2003, with effect April 1, 2004, will operate prospectively.

Held accordingly, that the assessee was entitled to deduction u/s 36(1)(iii) prior to its amendment by the finance Act, 2003, in relation to money borrowed for purchase of machinery even though the assessee had not used the machinery in the year of borrowing.

Accordingly, we answer the substantial questions of law in favour of the assessee and against the Revenue.

In that view of the matter, the order of the Tribunal cannot be found fault with.

For the aforesaid reasons, we do not see any merit in this appeal. Hence, the appeal is dismissed.