
(2006) 08 P&H CK 0381
In the Punjab And Haryana At Chandigarh
Case No : ITA No. 1 of 2003

Commissioner of Income Tax-I

APPELLANT

Vs

Vardhman Polytex Ltd.

RESPONDENT

Date of Decision : 17-08-2006

Acts Referred:

Income Tax Act, 1961 — Section 143(1), 28, 29, 30, 31

Citation : (2006) 205 CTR 457

Hon'ble Judges : Rajesh Bindal, J; Adarsh Kumar Goel, J

Bench : Division Bench

Advocate : S.K. Garg Narwana, for the Appellant; Akshay Bhan, for the Respondent

Judgement

Rajesh Bindal, J.—This is an appeal filed by the Revenue raising following substantial question of law, arising out of order dated 8.7.2002 passed by the Income Tax Appellate Tribunal, Chandigarh Bench "A", (for short "the Tribunal"), for the assessment year 1992-93:

i) Whether on the facts and the circumstances of the case, the Hon'ble Income tax Appellate Tribunal was justified in deleting the addition of Rs. 1,97,290/- on account of interest and Rs. 9,80,000/- on account of upfront fees by ignoring Explanation 8 to Section 43(1)?

2. The assessee, who is engaged in the business of yarn, filed its return of income for the year in question on 30.12.1992, declaring its taxable income at Rs. 3,59,86,351/-. The return was processed u/s 143(1)(a) of the Income Tax Act, 1961 (for short "the Act") on 6.1.1992 at a total income of Rs. 3,60,04,130/-. The assessee thereafter filed revised return on 6.8.1993 declaring a taxable income of Rs. 3,48,09,071/-. In the computation of income filed alongwith revised return, the assessee claimed additional deduction on account of Rs. 1,97,290/- and Rs. 9,80,000/- on account of interest u/s 36(1)(iii) of the Act and upfront fees, respectively. This claim was made on account of loans raised for set up of a new unit at Baddi (HP). In the revised return a detail note

was given at Serial No. 9 that the assessee has set up a new unit, for the purpose of which, the assessee incurred expenses on interest of loans and upfront fees of loan raised from financial institutions for establishing a new unit. It was admitted in the return that the new unit had not yet come into commercial production. However, the claim of the assessee was that the same is nothing but expansion of its earlier business under the same management and administration. The assessing officer, keeping in view, the admitted facts that the loan was raised for setting up a new unit for creating a capital asset which was yet come into production, the interest for the period prior to that could not be allowed as revenue expenditure for the purpose, Explanation 8 to Section 43(1) of the Act which added retrospectively from 1.4.1974 was relied upon. Besides this, number of judgments of different High Courts were also referred to. In appeal, learned CIT(A) accepted the plea of the assessee.

3. While holding in favour of the assessee that the new unit at Baddi(HP) was part and parcel of the existing business of the assessee and it was only expansion of the already existing activity, the CIT(A) relied upon a judgment of Gujrat High Court in Commissioner of Income Tax, Gujarat II Vs. Alembic Glass Industries Ltd., , while distinguishing a judgment of this Court in Commissioner of Income Tax Vs. Oswal Spinning and Weaving Mills Ltd., . The Tribunal, in appeal by the Revenue against the order of the CIT (A), approved the order passed by the CIT (A). While rejecting the appeal, the Tribunal recorded following findings:

24. On careful consideration of the rival submissions, we find force in the submission advanced on behalf of the assessee and are inclined to uphold the order of learned Commissioner of Income Tax (Appeals). As is evident from record, the assessee is carrying up a new unit for carrying on similar business at Baddi(HP). The Director's report and balance sheet clearly reflect that it is expansion of business earlier carried on by the assessee. The new unit at Baddi and old on business of manufacturing and spinning of yarn at Ludhiana and setting unit have common management and control, common funds interlacing and inter connection. The unit at Baddi cannot be held to be a new business. It is only expansion of old business. Interconnection of funds is established not only from the balance sheet but also from the fact that machinery and plant of old unit has been mortgaged to finance the new unit. The factual finding recorded by the learned Commissioner of Income Tax (Appeals) could not be challenged before us with reference to any material on record. The contention advanced on behalf of the Revenue that the learned Commissioner of Income Tax (Appeals) did not examine relevant question of common funds and common management and control, is not correct. As noted earlier, the plea on the above line was raised before the Assessing Officer and was not refuted in the assessment order. The Commissioner of Income Tax (Appeals) also examined the question in depth and decided the issue in favour of the assessee after elaborate discussion. We do not find any error in the approach of learned Commissioner of Income Tax (Appeals). The view taken in the impugned order is not only supported by the decision

referred to by the learned Commissioner of Income Tax (Appeals) but is also supported by fourteen decision given in the paper Books of the assessee, the latest in line, being the decision of Hon'ble Supreme Court in the case of Commissioner of Income Tax, Kerala Vs. Associated Fibre and Rubber Industries (P) Ltd., . As it is a case of expansion of business, interest paid on borrowed funds for installation of machinery and upfront fees were rightly treated as of revenue nature and allowed. We confirm the action of learned Commissioner of Income Tax (Appeals).

4. The provisions relevant for consideration on the issue are extracted below:

Other deductions.

Section 36(1) the deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing referred to in Section 28-

(i) xx xx

(ii) xx xx

(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:

[Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.]

Explanation.- Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;

Definitions of certain terms relevant to income from profits and gains of business or profession.

43. In Sections 28 to 41 and in this section, unless the context otherwise requires-

(1) "actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority:

xx xx

xx xx

Explanation 8.- For the removal of doubts, it is hereby declared that where any amount is paid or is payable as interest in connection with the acquisition of an

asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost, of such asset.]

5. The undisputed facts in the present case are that the assessee, who was already continuing with its business at Ludhiana, started setting up of a new unit at Baddi (HP) for which the loans were raised from financial institutions on which the assessee was liable to pay interest besides payment of upfront fee. The new unit being set up at Baddi (HP) had not yet come into commercial production. The question for consideration in the present case is as to whether interest paid on borrowed capital for setting up of a new unit till such time it comes into commercial production, is deductible as the revenue expenditure u/s 36(1)(iii) of the Act while computing the income of the assessee or to be treated as capital expenditure to be added to the cost of asset.

6. Section 43 of the Act defines certain terms relevant to determine the income from business or profession. Sub-section (1) thereof provides the definition of actual cost of an asset. Explanation 8 to Section 43(1) of the Act was added by the Finance Act, 1986 w.e.f. 1.4.1974. The object of the said amendment as contained in the Finance Bill, 1986 as it appeared in [1986] 158 ITR 88 is as under:

Under the existing provisions of Clause (1) of that section, "actual cost" means the actual cost of the asset to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. The proposed amendment seeks to clarify that any amount paid or payable as interest in connection with acquisition of an asset and relatable to a period after the asset is first put to use shall not form part and shall be deemed never to have been formed part of the actual cost of the asset.

7. A perusal of Explanation 8 of Section 43(1) of the Act and the object for which the same was inserted with retrospective effect shows that no interest paid or payable by the assessee in connection with the acquisition of the asset for any period after the asset is first put to use shall not form part of the actual cost of the asset. The proposition in the present case is just reverse. The natural consequences of Explanation 8 would be that in case of any expansion, interest paid or payable on loans raised in connection with the acquisition of an asset before the same is first put to use shall form part of the actual cost of the asset. Meaning thereby that it will be capitalised to be added in the cost of the asset. Addition of Explanation 8 to Section 43(1) of the Act with retrospective effect from 1.4.1974 is a clear and ambiguous. The same is in terms of the judgment of Hon'ble the Supreme Court in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, . In the said case, the expression actual cost under the Income Tax Act, 1922 was under consideration, which had not been defined therein. An identical issue therein was as to whether interest paid before commencement of production on the amount borrowed for the acquisition and installation of plant and machinery has to be considered as part of the actual cost

of the assets. Hon''ble the Supreme Court held that actual cost has not been defined in the 1922 Act, it was to be construed in the sense which no commercial man would misunderstand. While referring to and relying upon various principles and Rules on accountancy prevailing in the commerce and industries it was held that correct method for determination of the cost of capital asset is to include all expenditure necessary to bring such asset into existence and to put them in working condition. In case money is borrowed by a newly started company in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalized and added to the actual cost of fixed assets which have been created as a result of such expenditure and such rule of accountancy should be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.

8. A perusal of Explanation 8 to Section 43(1) of the Act, referred to above, clearly shows that the same is nothing but reiteration of the principles laid down in M/s Challapalli Sugars" case (supra). The expression does not make any distinction whether the asset is acquired by the assessee for setting up of an entirely new business or in the process of expansion of its existing business or industry. It merely provides for determination of actual cost of asset on a date when the asset first is put to use. Unless an asset, which is being acquired, starts generating income, it cannot be said that the same is being used for the purpose of business. Once it is established that interest paid after asset is put to use is not to be included in the actual cost on asset. There would be no alternate but to hold that the interest paid before the asset was first put to use would be included in the actual cost thereof and has to be treated as capital expenditure and not revenue in nature.

9. In Oswal Spinning"s case (supra), this Court answered the question as to whether the interest paid by the assessee on purchase of machinery should be considered as part of the cost of machinery. This Court held that the interest paid on acquisition of machinery should be treated as part of the cost of machinery while relying upon Challapalli Sugar Ltd. v. CIT (supra); Commissioner of Income Tax, Gujarat Vs. Tensile Steel Ltd., ; Ballarpur Paper and Straw Board Mills Ltd. Vs. Commissioner of Income Tax, Vidarbha and Marathwada, Nagpur, and Commissioner of Income Tax Vs. New Central Jute Mills, . While dealing with an identical issue, Calcutta High Court in JCT Ltd. Vs. Deputy Commissioner of Income Tax and Another, , decided the issue in favour of the Revenue and against the assessee by holding that even in cases of expansion of existing business, the interest paid or payable on the loans raised for acquisition of new asset would not be termed as revenue expenditure deductible u/s 36(1)(iii) of the Act. The conclusion drawn in the judgment is extracted below:

Having regard to the discussion and the question of law as discussed above, we are of the view that the interest paid on the borrowed capital under the deferred payment scheme for the period relevant till the asset was first put to use would

not be eligible for deduction u/s 36(1)(iii) or Section 37 since it is includible in the actual cost of acquisition of the asset till the asset was first put to use, in view of Explanation 8 to Section 43(1). Once the same comes within the purview of Section 43(1), Explanation 8, deduction u/s 36(1)(iii) or 37 cannot be claimed which stands clarified by the insertion of the proviso therein under the Finance Act, 2003. As such the assessee cannot claim any benefit of Section 36(1)(iii) or Section 37 in this case. The learned Tribunal was right in holding against the assessee.

10. Recently this Court had dismissed the appeal of the revenue in the case of Commissioner of Income Tax-1, Chandigarh v. Punjab Alkalies and Chemicals Ltd. 2006 30 ITR 247 on a similar ground raised by the revenue.

11. In M/s. Veecumsees, Madras Vs. Commissioner of Income Tax, Madras, , Hon"ble the Supreme Court held that deduction for payment of interest on the loans raised for building a cinema theatre, which was ultimately closed, was allowable deduction as the assessee was engaged in a composite business of jewellery and cinema. The facts of the case are quite different with the facts of the present case.

12. Keeping in view the earlier judgment of this Court in Commissioner of Income Tax v. Oswal Spinning and Weaving Mills Ltd. (supra) and also the recent judgment of Calcutta High Court in JCT Ltd. v. Deputy Commissioner of Income Tax and Anr. (supra), addition of proviso in Section 36(1)(iii) of the Act, in our view, the question raised in the present appeal is required to be heard by a larger Bench. Accordingly, we direct that the papers be placed before Hon"ble the Acting Chief Justice for constituting a larger Bench.