
(1993) 10 KL CK 0018

In the High Court Of Kerala

Case No : Income-tax Reference No's. 60 of 1983, 379, 383, 384 and 426 of 1985, 52, 66 and 67, 84 and 87 of 1986, 105 and 106 of 1989

Vanaja Textiles Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 29-10-1993

Acts Referred:

Income Tax Act, 1961 — Section 36(1), 40A(7)

Citation : (1994) 118 CTR 372 : (1994) 208 ITR 161

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

Bench : Division Bench

Advocate : P. Balachandran, for the Appellant; P.K.R. Menon, for the Respondent

Judgement

Varghese Kalliat, J.—These Income Tax references are in respect of one assessee for the period 1973-74 to 1980-81. Since all these references relate to one assessee and in the majority of cases, one general question arises for consideration, we propose to dispose of all these references by a common judgment. Of course in regard to certain cases, apart from the general question, some other questions are also referred for decision. Except Income Tax References Nos. 60 of 1983 and 52 of 1986, all the references are at the instance of the Revenue. Some of these references are u/s 256(2) of the Income Tax Act, 1961.

2. The common question referred for our opinion, we propose to consider with reference to Income Tax References Nos. 105 of 1989 and 106 of 1989. We do so, since these Income Tax references arise from the assessment years 1973-74 and 1974-75 and the common question has been decided by the Tribunal in other Income Tax references, following the decision by the Tribunal for the assessment years 1973-74 and 1974-75.

3. Income Tax References Nos. 105 and 106 of 1989 :

These two references are at the instance of the Revenue. They relate to the

assessment years 1973-74 and 1974-75. The references are u/s 256(2) of the Income Tax Act. The questions referred for the opinion of this court are these :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that an amount of Rs. 95,911 was an allowable item of expenditure for the assessment year 1973-74 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that an amount of Rs. 3,18,903 was an allowable item of expenditure for the assessment year 1974-75 ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the various machines installed during the relevant period did not constitute "new assets" ?

4. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the facts are identical with the facts in Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., ?

5. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion, that the expenditure incurred for substitution of new parts which substantially change the identity of machinery and effect improvement, will not be a capital expenditure ?

6. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the expenditure incurred was not for an attempt to bring into existence "new assets" but only for repair on account of un service ability ?"

4. The assessee is a company doing business in manufacture of yarn. The company undertook a comprehensive scheme of modernisation and rehabilitation of old machinery in the mills from October, 1972, onwards. This was done on the report to the shareholders by the directors stating that it is being done to bring the mill in line with modern mills. The company had as a first step converted 14 carving engines to metallic card clothing, costing over Rs. 1 lakh, thus considerably getting over the bottleneck of want of supply of enough carded silver to the preparatory section. The items of expenditure involved for the assessment year 1973-74 as stated in the statement of facts are these :

Rs.

Wax assembly 4,970

Second hand drafting system 2,983

Metallic card clothing 57,453

Life roller bearing 29,705

Total

95,111

5. For the assessment year 1974-75, the items of expenditure as shown in the statement of case are as follows :

Rs.

Carding machine metallic fitting 1,36,784

Cbiler sets 21,630

Pulley drive conversion 87,420

7" life spindles and bobbins 55,475

Plug type spindles and plastic bobbins 56,977

1,110 pullies used in spindling machines 13,215

Simplex machine conversion materials 66,690

Total

4,38,191

6. The expenses incurred for the years 1973-74 and 1974-75 were discussed by the Tribunal item by item. In regard to the first item of expenditure for the year 1973-74, the Tribunal found that wax assembly is to give a thin layer of wax coating to the outer surface of yarn. Although this represents an additional part fitted to the cone winder, no additional capacity is created. As regards the second item, viz., the second hand drafting system, the Tribunal found that this also does not bring in any new asset. It is found that the assessee had a similar drafting system. This system was found to be unserviceable. So replacement was necessary. This is only a part of the machinery and in the circumstances no new asset had been brought into existence. The clear finding of the Tribunal is that what has been done is a repair on account of unserviceability. In regard to item No. 3, metallic card clothing, the Tribunal found that the whole system had not been changed. What the company has done is to substitute certain parts with more modern parts to ensure less wastage. The Tribunal found that no new asset is brought into existence by the metallic card clothing. It found that the whole system had not been changed. The assessee is still carrying on with the same carding frame with the same numbers of spindles and the same capacity and what they have done is to substitute certain parts with more modern parts so that there is less wastage. Modernisation if it could be so-called, that is because, as the directors in their report had pointed out, the machinery was sufficiently old and repairs and rehabilitation was imperative. In regard to the last item, viz., life roller bearing, in the accounting year 1973-74, the Tribunal found that in respect of the 6" life roller bearing being replaced by the 7" roller bearing, no new asset is brought into use. It is only a question of replacing unserviceable parts.

7. For the assessment year 1974-75, the expenditure of Rs. 1,36,784 in respect of carding machine metallic fitting, the Tribunal held that it is similar to the third

item in the assessment year 1973-74, the expenditure of Rs. 57,453 considered by the Tribunal. It further held that in the earlier order eight carding machines had been modernised whereas in 1974-75, 21 carding machines had been modernised, and no new asset was brought into existence in that process. The same number of carding machinery continues and the only change is that they are a little more efficient by the changes made from what they were before. In regard to the second item for the year 1974-75, the Tribunal found that the expenditure on replacement of coiler sets in 12 out of 21 carding machines was required because the old coiler sets were unable to withstand the vibration and high speed. When the carding machines had been improved these coiler sets also had to be changed. Thus, the workload was better handled and no new asset had come into the possession of the assessee.

8. In regard to item No. 3, the expenditure of Rs. 87,420, the Tribunal found that the amount had been incurred in fitting the spindles with pulleys in replacement of the rollers earlier. Referring to Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., , whether modernisation of ball bearing jockey pulleys instead of original band drivers, the Tribunal observed that the Supreme Court has held that it is revenue expenditure, and so, the Tribunal cannot come to a different conclusion on identical facts. In regard to the expenditure of Rs. 55,475 on life spindles, the Tribunal found that it is similar to the expenditure already considered for the assessment year 1973-74 and for reasons given therein, this expenditure also has to be considered as revenue expenditure. In regard to the expenditure amounting to Rs. 56,977 for introducing plug typed spindles and plastic bobbins, the Tribunal found that it had been incurred in changing the blade type spindles to the plug type. The number of spindles has not been increased and that this was required in the process of modernisation as the plug type spindles were able to run at high speed and it required less energy. The use of plastic bobbins had reduced the accidents caused by wooden bobbins. The introduction of the simplex machine was found to be consequent to the other changes brought about in the spindles and consequent to modernisation of the machinery. Further, the Tribunal found that by the introduction of the simplex machine, no new asset had been brought into existence. Finally, the Tribunal found that all the expenditure incurred by the company for the years 1973-74 and 1974-75 to the tune of Rs. 95,111 and Rs. 4,38,191, respectively, are deductible revenue expenditure.

9. The company had incurred expenditure on similar items for the subsequent years covered by the other Income Tax references and for the assessment years 1974-75 to 1980-81, the company spent a total amount of a little more than Rs. 45 lakhs.

10. Counsel for the Department submitted that the Tribunal ought to have considered all the appeals together and ought to have found that huge expenditure has been incurred and by incurring such expenditure, the company has acquired new assets and so, the expenditure is in the nature of capital

expenditure for all the years in question.

11. Further, counsel for the Department submitted that the expense incurred for each year of account ought to have been considered on the basis of the facts revealed in the nature of that assessment year and ought not to have followed the decision in the accounting years 1973-74 and 1974-75. Counsel also submitted that the process of modernisation made by the assessee has brought in new assets and as such the expenditure is not a revenue expenditure, but it is in the nature of capital.

12. From the questions referred, it is clear that what has to be determined in these cases is as to whether on the facts and circumstances disclosed and the findings by the Tribunal, the expenditure incurred by the company for the purpose of modernisation and rehabilitation would be an outgoing of revenue expenditure or one in the nature of capital expenditure. The Tribunal has relied on Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., . Counsel submitted that the facts of Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., are different and distinguishable from the facts of these cases.

13. We shall first refer to Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., . In this case, the Supreme Court was considering the expenditure incurred by a textile mill for the introduction of the Casablanca conversion system in its spinning plant. The court observed that the introduction of the system 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 of ball-bearing jockey-pulleys for converting the original band-drivers to tape drivers and other additions and alterations in the drafting mechanism. The assessee claimed in the alternative that the amount laid out was in any event expenditure for current repairs allowable u/s 10(2)(v) of the Indian Income Tax Act, 1922. The court observed 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 and the sum of Rs. 93,215 was allowable as an expenditure incurred for current repairs u/s 10(2)(v) of the Act. It is pertinent to note the following observations (at page 712) :

"The High Court observed that certain moving parts of the machinery had because of "wear and tear¹ to be periodically replaced, 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. Counsel for the Commissioner has not challenged these findings and the answer to the second question recorded in the affirmative by the High Court, must be accepted."

14. The above-quoted observation was pressed into service by counsel for the

Department to distinguish the cases we are now considering from Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., . The facts of a case to be considered may have their own pattern, but that cannot dissuade the court from applying the principle or dictum, the parameter or test applied in a similar set of facts and circumstances in the precedent cited for guidance, and more so when the precedent cited is a decision of the Supreme Court- We cannot agree with the submission that Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., has no relevance here.

15. Counsel then referred us to Van Den Berghs Ltd. v. Clark [1935] 3 ITR and submitted that the magnitude of the expenditure is not an irrelevant matter in determining whether the expenditure is a capital expenditure or a revenue expenditure. He relied on the passage "but the magnitude of a transaction is not an entirely irrelevant consideration. The legal distinction between a repair and a renewal may be influenced by the expense involved".

16. We have read the entire decision carefully. It has to be noted that in the decision it is seen clearly stated that they should guard against being misled as to the legal character of the payment by its magnitude, for magnitude is a relative term. It was further observed : "we are dealing with companies which think in millions". It is also observed : "in the present case, however, it is not the largeness of the sum that is important but the nature of the asset that was surrendered". We do not think there is any force in the argument of counsel for the Department based on the magnitude of the expenditure incurred by the assessee spread over the several assessment years. Counsel submitted that if the magnitude of the expenditure is a relevant factor to be considered, the fact that the expenditure has been incurred for different assessment years in the process of modernisation may not be of any moment. Perhaps, counsel may be correct in submitting that if the magnitude of the expenditure is relevant, the spreading over of the amount for different assessment years will not render the norm not applicable, but we feel that the significant aspect as stated by the House of Lords, is that it is not the largeness of the sum that is important but the nature of the expenditure.

17. In M.K. Brothers (P) Ltd. Vs. Commissioner of Income Tax, Kanpur, , the Supreme Court has considered this aspect of the matter and said that the answer to the question as to whether the money paid is a revenue expenditure or capital expenditure depends not so much upon the fact as to whether the amount paid is large or small or whether it has been paid in lump sum or by instalments, as it does upon the purpose for which the payment has been made and expenditure incurred. It is the real nature and quality of the payment and not the quantum or the manner of the payment which would prove decisive, (emphasis* added). If the object of making the payment is to acquire a capital asset, the payment would partake of the character of a capital payment even though it is made not in a lump sum but by instalments over a period of time. On the contrary, payment made in the course of and for the purpose of carrying on business or

trading activity would be revenue expenditure even though the payment is of a large amount and has not to be made periodically.

18. In the Madras case, CIT v. Kasturi Mills Ltd. [1981] 129 ITR 12, the Madras High Court held that there is no merit in the argument that though individual items of expenditure are held to be revenue expenditure, if one considers the entirety of the expenditure as a whole, it will be a capital expenditure. The court observed that once individual items can be considered as revenue, the sum total of it cannot be treated as capital.

19. We do not think it will be proper for us to consider the largeness of the total expenditure for the different assessment years for the purpose of determining the nature of the expenditure as to whether it is capital or revenue expenditure. Of course we have to consider the question with reference to the nature of the expenditure incurred in the relevant assessment years.

20. Counsel submitted that though there is a finding by the Tribunal that all the different items of expenditure are revenue expenditure, that finding cannot be treated as a finding of fact, and that this court must consider it as a question of law. Counsel referred us to the decision in Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377. We are of the opinion that we cannot dispose of these cases by saying that the question referred is a question of fact and not law.

21. Counsel referring to the decision in Assam Bengal Cement Co. Ltd. v. CIT [1955] 27 ITR 34 submitted that where the expenditure is made for a substantial replacement of the equipment, it is capital expenditure. Both counsel for the Revenue and for the assessee relied very much on the following three decisions of the Supreme Court :

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) for the purpose of evolving a proper parameter for deciding the nature of expenses incurred in these cases, for the comprehensive scheme of modernisation and rehabilitation of old machinery in the mill of the assessee.

22. On a careful, examination of the English case law on the question how to decide whether an expenditure is a capital expenditure or revenue expenditure, three formulations stand out. The first formulation was that the outlay on the "acquisition of the concern" is in the field of capital while an outlay in "carrying on the concern" is revenue. Subsequently, English judges accepted the formulation that if the expenditure is "once for all" it is capital and if it is going to recur every year it is revenue. Finally, in 1926, Viscount Cave L. C. made a modified formulation of the theory of enduring benefit of a trade in the oftquoted decision in British Insulated and Helsby Cables Ltd. v. Atherton [1926] AC 205. We are dealing with this case a little elaborately.

23. If we scan through the decided cases, it can be seen that from time to time

courts evolved various tests for distinguishing between capital and revenue expenditure but no one test is paramount or conclusive. It is difficult to have an all embracing formula which can provide a ready solution to the problem. There is no litmus test to say that a particular expenditure is revenue expenditure or capital expenditure. Every case has to be decided on its own facts, keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. We think that we should also outline a few tests formulated by courts since we feel that it might help us to arrive at a correct decision of the controversy now raised in these cases between the assessee and the Revenue.

24. Lord Cave L. C. in *Atherton v. British Insulated and Helsby Cables Ltd.* [1925] 10 TC 155 said :

" . . . when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

25. The above decision has been referred to in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, . The court observed that the parenthetical clause is significant and that the test has to be applied giving importance to the parenthetical clause and that the test will fail where there are special circumstances leading to a contrary conclusion. This aspect has been noted by Lord Radcliffe in *Commr. of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1965] 58 ITR 241. In this case, his Lordship said that it would be misleading to suppose that in all cases, securing a benefit for the business would be, prima-facie, capital expenditure "so long as the benefit is not so transitory as to have no endurance; at all". Considering the dictum laid down by Lord Cave L. C. and how that dictum has been understood by Lord Radcliffe in *Commr. of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1965] 58 ITR 241, Bhagwati J. in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, said that : "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 field 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." In this case, *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , the Supreme Court has referred to the test given by Lord Haldane in *John Smith and Son v. Moore* [1921] 12 TC 266, which focussed on the distinction between fixed capital and circulating capital, the

words which have almost acquired the status of a definition. His Lordship said (at page 282) : . . .

". . . fixed capital is what the owner turns to profit by keeping it in his own possession, circulating capital is what he makes profit of by parting with it and letting it change masters."

26. Again in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , Bhagwati J. examined the test given by Lord Haldane and said : "But this test also sometimes breaks down because there are many forms of expenditure which do not fall easily within these two categories and not infrequently, as pointed out by Lord Radcliffe in *Commr. of Taxes v. Nehanga Consolidated Copper Mines Ltd.* [1965] 58 ITR 241, the line of demarcation is difficult to draw and leads to subtle distinctions between profit that is made "out of" assets and profit that is made "upon" assets or "with" assets. It is significant to note that Bhagwati J. made it plain and clear in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, that there may be cases where expenditure, though referable to or in connection with fixed capital, is nevertheless allowable as revenue expenditure. His Lordship has given an illustrative example of the expenditure incurred in preserving or maintaining capital assets. Finally his Lordship said that the test is therefore clearly not one of universal application.

27. Counsel for the Department submitted that if the expenditure is one pertaining not to the area of profit-earning process but referable to the profit-earning machinery or apparatus, then the expenditure is in the nature of capital expenditure. He has referred to *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) . We will be adverting to that decision later. At the moment we only say that Bhagwati J. has said that even when the expenditure is referable to or in connection with fixed capital, it is nevertheless allowable as revenue expenditure.

28. Now we shall refer to *Commissioner of Income Tax, Bombay City-I, Bombay Vs. Associated Cement Companies Ltd., Bombay*, . The facts of this case are of a little importance. So, we shall briefly summarise the facts. The assessee spent an amount of Rs. 2,09,459 during the year of account for laying of pipelines, installations and other accessories of which Shahabad Municipal Committee was the owner. The Appellate Assistant Commissioner allowed the deduction. The Revenue preferred an appeal to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal passed an order directing the Income Tax Officer to scrutinise the expenditure and allowed the deduction of the expenditure to the extent that it did not result in the company becoming the owner of any asset. The assessee contended before the High Court that the entire amount of Rs.2,09,459 pertained to expenditure on pipelines, installations and other accessories, which under the agreement, came to the ownership of the Shahabad Town Municipality and did not pertain to any increase of the assets of the company. The Bombay High Court, after discussing exhaustively several decisions of the Supreme Court and several English decisions, came to the

conclusion that the expenditure in question was revenue expenditure and was liable to be allowed as a deduction. The matter was considered by the Supreme Court.

29. Two points were raised for consideration by the Revenue. The first point is that as a result of the expenditure incurred certain water pipelines were laid which could be considered only as capital assets, and so the expenditure could only be regarded as capital expenditure. The second point was that the advantage of not being liable to pay municipal rates, taxes, etc., which the assessee-company secured by reason of making the expenditure in question was for a period of fifteen years and hence it could be said to be an advantage of an enduring nature, so that the expenditure incurred in acquiring the same would be regarded as capital expenditure. The second point is relevant for the case at hand.

30. The Supreme Court observed that it is difficult to accept such a case. Referring to *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, the Supreme Court observed that "there may be cases where expenditure, even if incurred for obtaining 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 field that the expenditure would be disallowable on an application of this test".

31. Counsel for the assessee submitted that the expenditure incurred brought about an advantage but that advantage consists merely in facilitating the assessee's manufacturing operations and process and the conduct of the business is to be carried on more effectively or more profitably. There is no new asset and that is the finding of the Tribunal. Counsel also submitted that even if the assessee has gained enduring benefit, considering the nature of the advantage, the expenditure incurred cannot be considered as in the nature of capital expenditure.

32. Now we shall refer to the decision in *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) . The case related to the acquisition of know-how to produce higher yield and sub-culture of high-yielding strain of penicillin. There was no evidence to indicate that this was not in the line of existing manufacture of penicillin. The assessee with a view to increasing the yield of penicillin, started negotiations in 1963 with Messrs. Meiji Seika Kaisha Ltd., a reputed Japanese enterprise, engaged in the manufacture of antibiotics which culminated in an agreement dated October 9, 1953, whereunder, Meiji, in consideration of once for all payment of 50,000 U. S. dollars (then equivalent to Rs. 2,39,625) agreed to supply to the assessee the "sub-cultures of Meiji's most suitable penicillin-producing strains, the technical information, know-how and written description of Meiji's process for fermentation of penicillin along with a flow-sheet of the

process on a pilot plant, the design and specifications of the main equipment in such pilot plant, arrange for the visits to and training at the assessee's expense of technical representatives of the assessee, Meiji's plant at Japan and to advise the assessee in the large scale manufacture of penicillin for a period limited to two years from the effective date of the agreement.

33. For the assessment year 1964-65, the assessee claimed deduction of a sum of Rs. 2,39,625 as revenue expenditure. The Appellate Assistant Commissioner and the Income Tax Appellate Tribunal rejected the claim holding that the expenditure must be capital in nature. This claim of the Tribunal was based on an interpretation of the agreement holding that: (i) the assessee had to instal a larger plant modelled on the pilot plant; (ii) the payment was not made in the course of carrying out of an existing business of the assessee but was for the purpose of setting up a new plant and a new process ; and (iii) that the outlay was incurred for a complete replacement of the equipment of the business inasmuch as a new process with a new type of plant was to be put up in place of the old process and old plant. On a reference, the High Court held that the sum of Rs. 2,39,625 was not a revenue expenditure, but the Supreme Court disagreed with the decision of the High Court and reversed the same.

34. It is significant to note that in considering the case, the Supreme Court has observed that "it would be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast-changing area of medical science. . . . The rapid strides in science and technology in the field should make us a little slow and circumspect in too rapidly pigeon-holding an outlay such as this as capital", (emphasis* added). The Supreme Court further observed that in the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue expenditure arises, it is well nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive to draw any clear line of demarcation. Further, the Supreme Court observed that some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. The Supreme Court cautioned that these tests are generally efficacious and serve as useful servants; but as masters they tend to be over-exacting. The tests of once for all payment and enduring benefit, the Supreme Court observed, are not to be treated as something akin to statutory conditions ; nor are "the notions of capital or revenue a judicial fetish". What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasise the element of a sufficient degree of durability appropriate to the context.

35. As we said earlier, in this decision also, the court observed that what is

relevant is the purpose of the outlay and its intended object and effect, considered in a commonsense way having regard to the business realities.

36. Referring to the using of the phrase "enduring benefit" in *British Insulated and Helsby Cables Ltd. v. Atherton* [1926] AC 205 and in *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) , Justice Venkatachaliah, as he then was, observed (at page 387) : "There is a difference between the lasting and the everlasting. The time over which the thing endures is a matter of degree and one element only to be considered. Horses in the ola! days and motor trucks in these days are plant and their acquisition for "the purpose of transport in business usually involves a capital expenditure. But the horses were not immortal any more than the trucks have proved to be".

37. The fact that the assessee had set up a plant for the production of penicillin even at the time it entered into an agreement with the Japanese enterprises was taken as an important factor to be considered for determining the nature of the outlay. The court observed that it is important to note that the agreement was only to increase the yield of penicillin and that no new venture envisaging the setting up of a new plant was ever intended by the assessee. It was emphasised that the production of penicillin which was the established line of business of the assessee, was sought to be improved upon with the use of an improved process of fermentation with new penicillin producing strains isolated and developed by Meiji so as to increase the unit yield of penicillin per millilitre of the culture medium. So, the process of a plant and the expenditure incurred for increasing the yield of the production of penicillin per millilitre was held to be a revenue expenditure. Of course, counsel for the Department submitted that a distinction has to be drawn with the cases we are now considering and *Alembic Chemical Works*" case : [1989]177ITR377(SC) in so far as in *Alembic Chemical Works*" case, the expenditure incurred pertained to the area of the profit-earning process while the expenditure incurred in the cases we are considering is on profit-earning machinery or apparatus. It is not very correct to make such a distinction in these cases. In these cases also, the process adopted as found by the Tribunal is not a new venture but only an improvement of the existing facilities by replacing worn out and unserviceable parts of the unit. No profit-earning machinery was sought to be supplanted. We are of the opinion that it is not an expenditure for the acquisition of profit-earning machinery or apparatus.

38. In *Alembic Chemical Works*" case : [1989]177ITR377(SC) , the Supreme Court was emphasising the fact that the expenditure incurred which was found to be a revenue expenditure was for the improvisation of the process and technology in some areas of the enterprise and was supplemental to the existing business and further that it never amounted to a new or fresh venture. It was also taken note of that the expense incurred for obtaining the agreement pertained to a product already in the line of the assessee's established business and not to a new product.

39. In these cases also as in the case of *Alembic Chemical Works* :

[1989]177ITR377(SC) , the comprehensive scheme of modernisation and rehabilitation is for improvement in the operation of an existing business and its efficiency and profitability not removed from the area of the day-today business of the assessee's established enterprise. There is no fresh or. new venture in the scheme of modernisation envisaged by the assessee.

40. Now, we may refer to some passages from IRC v. Carron Co. [1968] 45 TC 18. The question considered by the House of Lords which is relevant is whether certain sums expended were wholly or exclusively for the purpose of the company's trade. After referring to the decision of Lord Cave L. C. in British Insulated and Helsby Cables Ltd. v. Atherton [1925] 10 TC 155 and the decision of Lord Reid in Morgan v. Tate and Lyle Ltd, [1954] 35 TC 367, Lord President Clyde said (at page 48 of 45 TC) :

"In the present case the Special Commissioners have held that the expenditure in question was all incurred by the company to modernise its structure by securing additional borrowing powers and as a means of engaging managerial staff of the required calibre. These purposes are obviously purposes which are in their nature capable of being for the purposes of the trade, and as these are the purposes which the Commissioners held were in fact the company's purposes, their conclusion is one of fact for them."

41. Lord President Clyde in this case further said that the determination of the question whether the expenditure is in the nature of capital expenditure is a matter largely of commonsense and not the strict application of any single legal principle. For this proposition, his Lordship referred to the decision in Strick v. Regent Oil Co. Ltd. [1965] 43 TC 1 ; [1966] AC 295. We may quote a passage of Lord Reid from the same case (at page 68 of 45 TC) : "The main argument for the Crown was that by obtaining the new charter the company obtained an enduring advantage in the shape of a better administrative structure. Of course they obtained an advantage : companies do not spend money either on capital or income account unless they expect to obtain an advantage. And money spent on income account, for example, on durable repairs, may often yield an enduring advantage. In a case of this kind what matters is the nature of the advantage for which the money was spent. This money was spent to remove antiquated restrictions which were preventing profits from being earned. It created no new asset." In the same decision, Lord President (Clyde) further observed (at page 48) : "The benefit was essentially of a revenue character because the company became able more easily to finance its day-to-day transactions, and more efficiently to carry on its day-today manufacture".

42. We may now refer to what Dixon J. said in Hallstorm's Property Ltd. v. Federal Commissioner of Taxation, 72 CLR 634 : ""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. If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure". In *Federal Bank Ltd. Vs. Commissioner of Income Tax*, (Paripoornan). after considering several decisions of the Supreme Court and other English authorities, said (at page 245): "The dichotomy between the "profit-earning process" and "profit-earning machinery or apparatus", the distinction between the expenditure which is only supplemental to the existing business by way of improvement in the operations of the existing business, its efficiency or profitability or for the better conduct of the business in contradistinction to a "new business" or a "fresh one" were highlighted. It is evident from the approach of the Supreme Court in the recent decision that for a revenue expenditure, what is material to consider is the nature of the advantage in a commercial or practical sense, and not to view the matter in a wooden manner". His Lordship further observed that (at page 246) : "in some of the decisions taking the contrary view, too much emphasis was placed on the concept of enduring benefit or advantage of enduring nature without effectively reckoning the new trends, needs and developments of modern society and the requirements of trade or business in an overall and practical manner."

43. Though six questions have been referred, we are of opinion that questions Nos. 1 and 2 are the basic questions and the other questions Nos. 3 to 6 are explanatory and incidental to questions Nos. 1 and 2. We have adverted to the relevant facts, the findings of the Tribunal and discussed certain decisions which we felt relevant to the questions raised. The result is that we come to the opinion that the answer to the questions referred should be 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 for the conduct of the assessee's business to be carried on more efficiently and to update the facilities on the lines of the modern trends in the business and should therefore be held to be revenue expenditure. Accordingly, we answer questions Nos. 1 and 2 in the affirmative and in favour of the assessee. The other questions Nos. 3 to 6 are also answered in favour of the assessee and against the Revenue.

44. Now, we shall consider separately the other connected cases.

45. Income Tax Reference No. 426 of 1985: The reference is at the instance of the Revenue, u/s 256(2) of the Income Tax Act, 1961. This is in respect of the assessment year 1975-76 of the same assessee in Income Tax References Nos. 105 and 106 of 1989. The questions referred are these:

" 1. Whether, on the facts and in the circumstances of the case, the manner and method of computation of incremental liability for gratuity by the Tribunal are

right in law ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in allowing the claim for Rs. 34,152 representing incremental liability for gratuity ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that an amount of Rs. 7,56,802 was an allowable item of expenditure for the assessment year 1975-76 ?"

46. Question No. 3 is identical to the questions that have been answered in Income Tax References Nos. 105 and 106 of 1989. Of course, the question whether an expenditure is of a capital nature has to be decided on the peculiar facts of each case. It has to be remembered that a common significant factor runs through all these cases. The expenditure in question was incurred for implementing a scheme of modernisation. We have already said that it is not easy ordinarily to evolve a test for ascertaining whether in a given case expenditure is capital or revenue, for the determination of the question must depend upon the facts and circumstances of each case. The court has to consider the nature and ordinary course of business and the objects for which the expenditure is incurred. The Tribunal found that the amount of Rs. 7,56,802 spent for modernisation and renovation of the assessee's old spinning machinery is an allowable item of expenditure, since it is a revenue expenditure and not an expenditure of capital nature.

47. Counsel for the Department submits that the Appellate Tribunal has decided the case following the decision of the Tribunal for the assessment years 1973-74 and 1974-75--the subject matter of Income Tax References Nos. 105 and 106 of 1989. Counsel submits that the Tribunal has gone wrong in considering the facts relating to the expenditure for the assessment year in question. Of course, whether an expenditure is a revenue expenditure or a capital expenditure is a question of law. But a finding on evidence that the items of expenditure are similar to those considered for two preceding assessment years is a finding of fact in so far as the items considered in the year in question are similar to the items considered for the years 1973-74 and 1974-75. The Tribunal found that the facts being similar for the year in question, the Tribunal did not see any ground for holding a different view. In the result, the Tribunal held that the expenditure of Rs. 7,56,802 is a revenue expenditure. We have considered at length the question whether the expenditure incurred for similar items for modernisation by repair and renovation is revenue expenditure or capital expenditure in Income Tax References Nos. 105 and 106 of 1989. We have held that it is revenue expenditure.

48. In this view, we have to answer question No. 5 in the affirmative, in favour of the assessee and hold that the Tribunal was right in law in coming to the conclusion that an amount of Rs. 7,56,802 was an allowable item of expenditure for the assessment year 1975-76.

49. Questions Nos. 1 and 2 relate to computation of incremental liability for gratuity and as to whether the Tribunal was right in law in allowing the claim of Rs. 34,152 representing incremental liability for gratuity.

50. The question whether incremental liability is a concept germane to Section 40A(7)(b)(ii) of the Income Tax Act was considered by this court in the decision in Commissioner of Income Tax Vs. Chembra Peak Estates Ltd., . This court held that the incremental liability is not a concept germane to Section 40A(7)(b)(ii) of the Income Tax Act. In this view, we hold that the Tribunal was not justified in holding that the assessee was entitled to deduction of Rs. 34,152 for the assessment year 1975-76 though it did not exceed 8-1/3 per cent, of the salary of the employees. A similar view was expressed in CIT v. Periya Karamalai Tea and Produce Co. Ltd. [1987] 167 ITR 32. We answer questions Nos. 1 and 2 in the negative against the assessee and in favour of the Revenue.

51. Income Tax References Nos. 80 of 1983, 383 of 1985 and 384 of 1985:

These references are with respect to the assessment for the year 1976-77 of the same assessee. Income Tax Reference No. 60 of 1983 is at the instance of the assessee which is a reference u/s 256(2) of the Income Tax Act. Income Tax References Nos. 383 and 384 of 1985 are at the instance of the Revenue u/s 256(2) of the Income Tax Act. Since all these Income Tax references relate to the assessment year 1976-77, facts have to be referred from the statement in Income Tax Reference No. 60 of 1983. At the first instance, we shall deal with Income Tax Reference No. 60 of 1983.

52. Income Tax Reference No. 60 of 1983 :

For the assessment year 1976-77, three items of expenditure were in dispute as to whether they are revenue expenditure or capital expenditure. These items are : (1) expenditure on repairs to machinery Rs. 5,18,184. This forms the subject-matter of Income Tax Reference No. 384 of 1985 ; (2) expenditure on power house cable installation--Rs. 4,02,552. This forms the subject-matter of Income Tax Reference No. 383 of 1985 ; and (3) expenditure on new electricity line-Rs. 51,940. This is the subject-matter of Income Tax Reference No. 60 of 1993. The question referred in Income Tax Reference No. 60 of 1993 is : "Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the expenditure of Rs. 51,940 under the head "Expenditure on electricity new line" incurred is benefit of enduring nature and consequently the expenditure is capital expenditure"". The Tribunal in its order has stated that the assessee had incurred expenditure on new electricity line amounting to Rs. 51,940. It is stated that due to frequent power failure in the factory, the assessee's production was adversely affected and on representations made to the Kerala State Electricity Board the assessee was directed to construct an independent 11 KV feeder at their own cost as per the letter of the Chief Engineer dated April 17, 1974. The assessee remitted a sum of Rs. 50,000 towards the estimated cost of constructing an independent 11

KV feeder from Viyyur sub-station to their factory premises. It is contended that the expenditure was in respect of laying of H. T. overhead power line through public road for a total length of 6 miles. The line thus drawn does not belong to the assessee and it was contended that it is not a depreciable asset of the company and so it has to be allowed as a revenue expenditure. The Revenue contended that the expenditure had been incurred by the assessee for acquiring an enduring benefit by the construction of an independent 11 KV feeder and so it is an expenditure of capital nature and it is not allowable. The case of the Revenue before us also is that the expenditure incurred is of a benefit of enduring nature.

53. Counsel for the assessee submitted that the expenditure incurred for drawing a new electricity line was for carrying on the business efficiently and effectively and, as such, it is a revenue expenditure and an allowable deduction. Counsel also submitted that even if it is an asset of an enduring nature it is not an asset of the assessee and so the expenditure incurred is an allowable deduction. Counsel referred us to the decisions in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, *Alembic Chemical Works Co. Ltd. v. CIT* : [1989]177ITR377(SC) and *Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd.*, *AIR 1968 SC 101*, for persuading us that the expenditure incurred for installing a new electricity line is for carrying out the business of the assessee-company in a more profitable manner and so it is an expenditure incurred in the process of profit-earning.

54. In regard to the second point, counsel referred us to the following decisions : *Commissioner of Income Tax, Bombay City-I, Bombay Vs. Associated Cement Companies Ltd., Bombay*, *Commissioner of Income Tax Vs. Kanodia Cold Storage*, *Hindustan Times Ltd. Vs. Commissioner of Income Tax*, *Commissioner of Income Tax Vs. T.V. Sundaram Iyengar and Sons P. Ltd.*, and *COMMISSIONER OF Income Tax, GUJARAT-II Vs. GUJARAT MINERAL DEVELOPMENT CORPORATION.*, . In *Commissioner of Income Tax, Bombay City-I, Bombay Vs. Associated Cement Companies Ltd., Bombay*, , the Supreme Court was considering an almost identical position in respect of laying a pipeline. At page 263, the court observed thus :

"... As a result of the expenditure incurred, there was no addition to the capital assets of the assessee-company and no change in its capital structure. The pipelines, etc., which might have been regarded as capital assets and which came into existence as a result of the expenditure incurred did not belong to the assessee-company but to the municipality. In these circumstances, applying the principles laid down in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , the expenditure is clearly liable to be allowed as deductible from the profits u/s 10(2)(xv) of the Indian Income Tax Act."

55. In view of the above decision, counsel for the Revenue did not seriously contend that the expenditure incurred for drawing the new electricity line in the context can be considered as expenditure in the nature of capital expenditure.

On the particular facts and circumstances revealed, we are of the opinion that the question referred has to be answered in the negative and in favour of the assessee. We do so.

56. Income Tax Reference No. 383 of 1985 :

This reference is at the instance of the Revenue. The question referred in this case is : "Whether, on the facts and in the circumstances of the case, the expenditure incurred under the head "Power house cable replacement" of Rs. 4,02,552 was not of a capital nature, resulting in a durable benefit to the assessee ?" The case of the assessee is that the electrical inspector after inspection of the wiring installations in the factory, had intimated on July 6, 1972, various defects in the electrical installations and that the assessee was forced to carry out the suggestions mentioned in the inspection report. This involved the replacement of certain switch boards and electrical cables even though the same had not become that much old to be replaced. The assessee's claim is that the expenditure constituted current repairs and an allowable deduction under the Act. The Tribunal held that the substitution in a machine of new parts for old and worn out parts was in the nature of current repairs on revenue account, that the replacement of defective parts was carried out as required by the electrical authorities and that it was not a case of substitution of new machinery and that it was clearly in the nature of current repairs. The question referred is identical to the question we have already answered in Income Tax References Nos. 105 and 106 of 1989.

57. In the result, we answer the question in the affirmative, in favour of the assessee and against the Revenue.

58. Income Tax Reference No. 384 of 1985 :

This is a reference at the instance of the Revenue. The question referred is : "Whether, on the facts and in the circumstances of the case, there was any material to hold that the modernisation expenses of Rs. 5,18,184 were incurred by the assessee for replacing worn-out parts ?" The Tribunal has considered the matter thus : " For the assessment year 1975-76 also, a similar claim was allowed in appeal by the Commissioner of Income Tax (Appeals). As there is no change in the circumstances of the case in relation to this claim, we do not consider that the ground taken up by the Revenue can be sustained". The Commissioner of Income Tax (Appeals) has stated that the expenditure was claimed as revenue expenditure since it was spent for modernisation and renovation of the assessee's plant and machinery by replacement of worn-out parts. It has been clearly stated in the order of the Commissioner of Income Tax (Appeals) that the expenditure incurred is for renovation and replacement of worn-out parts.

59. The question referred in this case also has to be answered on the same lines as we have answered the questions referred in Income Tax References Nos. 105 and 106 of 1989. We answer the question in the affirmative and in favour of the

assessee.

60. Income Tax References Nos. 66 and 67 of 1986 :

These references relate to the same assessee for the assessment years 1977-78 and 1978-79. The common question referred is : "Whether, on the facts and in the circumstances of the case, the expenditure incurred by the assessee of Rs. 7,61,087 in the assessment year 1977-78 and Rs. 4,97,750 in the assessment year 1978-79 for converting the existing machines into modern machines was not of a capital nature resulting in a durable benefit to the assessee ?" As we said earlier, each case has to be decided on the facts of the case. We shall advert to certain facts found in this case.

61. The Tribunal has given the details of conversion materials for the assessment year 1977-78. They are :

"Conversion materials-Assessment year 1977-78 :

Rs. P.

Doubling machine conversion wooden holders 1,820.00

Reeling 21/2" dia pipe tin roll complete set 2,820.00

Simplex machine creel conversion for 3 machines 7,749.00

Doubling machine conversion for 2 machines 1,305.71

Doubling machine conversion for 2 machines 13,497.00

Doubling machine conversion for 2 machines 1,600.00

Head stock fibre wheel conversion for machines 14,375.00

Simplex machine UTM.620 conversion materials for 2 machines 1,16,063.76

Toyoda spinning machine SKF drafting PK 225 conversion materials 3,84,632.00

Cable terminals, switch board, T. P. N. switch with cable and box fuse, etc., replacements 2,17,223.50

7,61,086.75"

Similarly, the details of the conversion materials for the year 1978-79 are given. The details are these :

"Conversion materials-Assessment year 1978-79 :

Rs. P.

Blow room machine Krishna Beater Lags 7,100.70

Spinning machine tin roll new flanges 613.60

Spinning machine lift conversion for 8 frames 17,160.00

Spinning machine lift conversion for 8 frames 3,244.80

Reeling Tin roll conversion for 10 sets 5,685.40

L/R plug type spindle complete set-- 400 Nos. 26,732.16

Spinning machines SKF drafting conversion-6 sets 3,85,053.27

Spinning machine rings 45 mm. dia 2 flags-- 200 Nos. 27,368.65

Metallic card clothing cylinder, deffer and border wire (S. H.)-8 sets 20,938.67

Carding machine flats, rapp-o-tops seconds-2 sets 3,853.20

4,97,750.45"

For the assessment year 1977-78, the assessee has incurred an expenditure of Rs. 7,61,086.75 and for the assessment year 1978-79 an amount of Rs. 4,97,750.45. The Tribunal has recorded a finding that no new plant has been installed as urged by the Department in its grounds of appeal, but only the existing machines were converted into modern machines by suitable modifications. Of course, the Tribunal has referred to the fact that for the previous years also similar items have been treated as allowable deductions. It is pertinent to note that in the order it is stated that : "for the assessment year 1973-74 together with the appeal for 1974-75 in Income Tax Appeals Nos. 449/ (Coch.) of 1976-77 and 219/(Coch) of 1978-79 by their order dated October 16, 1980, the Tribunal allowed the assessee's claim for conversion materials in similar circumstances. The assessee's claim for the assessment year 1976-77 was also allowed by the Tribunal in similar circumstances by its order dated September 29, 1982, in Income Tax Appeal No. 328/(Coch) of 1980. As the facts and circumstances are similar for these two assessment years under appeal also, we do not see any reason to interfere with the orders of the Commissioner of Income Tax (Appeals)".

62. We have already considered the question referred for. the assessment years 1973-74 and 1974-75 and held that the question has to be answered in favour of the assessee. Whether the items considered in the previous years are similar to the items considered in the relevant year is a question of fact. In this view, we have to answer the question referred in these two tax references in the affirmative and in favour of the assessee.

63. Income Tax Reference No. 379 of 1985 :

This reference is also of the same assessee for the assessment year 1974-75. The reference is at the instance of the Revenue. The questions referred are :

"1. Whether, on the facts and in the circumstances of the case, the manner and method of computation of incremental liability for gratuity by the Tribunal are right in law ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is

right in law in allowing the claim of Rs. 84,142 representing incremental liability for gratuity ?"

64. In Income Tax Reference No. 426 of 1985, following the decisions in Commissioner of Income Tax Vs. Chembra Peak Estates Ltd., and CIT v. Periya Karamalai Tea and Produce Co. Ltd. [1987] 167 ITR 32, we have already held that the Tribunal was not justified in holding that the assessee was entitled to deduction of certain amount for the assessment year 1975-76 as incremental liability since the incremental liability is not a concept germane to Section 40A(7)(b)(ii) of the Income Tax Act. In the result, we answer the questions in the negative and in favour of the Revenue and against the assessee.

65. Income Tax Reference No. 87 of 1986 :

This is also a reference of the same assessee for the assessment year 1979-80. The reference is at the instance of the Revenue. The questions referred are :

" 1. Whether, on the facts and in the circumstances of the case, the expenditure of Rs. 4,90,021 incurred in connection with the modernisation of the factory is allowable as revenue expenditure ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the assessee is entitled to claim deduction towards bonus paid in excess of the statutory bonus ?"

66. The first question is the general question we have already considered in the other references. Since each case has to be decided on the particular facts of the case, we advert to certain facts of this case for answering the first question. The Tribunal has held in paragraph 5 of its order thus : "Grounds Nos. 1 and 2 in the appeal by the Department : These are to the effect that the Commissioner of Income Tax (Appeals) erred in holding that an expenditure of Rs. 4,90,021 incurred in connection with the modernisation of the factory is allowable as a revenue expenditure. The Commissioner of Income Tax (Appeals) decided the issue in favour of the assessee following the order of this Tribunal dated September 29, 1982, in Income Tax Appeal No. 328/(Coch) of 1980 relating to assessment year 1976-77. No distinguishing features have been pointed out for the assessment year under appeal. Following the earlier order, the issue is decided in favour of the assessee". We have already considered the same question with regard to the assessment year 1976-77 in Income Tax Reference No. 384 of 1985 and held that the expenditure incurred is revenue expenditure and an allowable deduction.

67. In this view, we have to answer the first question in the affirmative in favour of the assessee and against the Revenue.

68. Question No. 2 relates to bonus paid in excess of the statutory bonus to the employees. The Commissioner of Income Tax (Appeals) deleted the disallowance made by the Income Tax Officer of Rs. 1,52,073 being excess claim under the item, bonus, under which the assessee was bound to pay bonus at the rate of 15

per cent. of the salary. The Income Tax Officer held that the maximum bonus that can be allowed under the first proviso to Section 36(1)(ii) of the Income Tax Act was only 8.33 per cent. Holding so, he disallowed the excess payment of Rs. 1,52,073. The Commissioner of Income Tax (Appeals) accepted the contention of the assessee that the payment of bonus was contractual and customary and that it was not therefore hit by the first proviso to Section 36(1)(ii) of the Income Tax Act. The Tribunal held that the first proviso to Section 36(1)(ii) of the Income Tax Act will not attract the payment of contractual bonus and held that what has been done by the Commissioner of Income Tax (Appeals) is correct.

69. 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).

70. The order of the Tribunal reveals that this 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. Kerala Agro Industries Corporation, ; Commissioner of Income Tax Vs. P. Alikunju, M.A. Nazir, Cashew Industries, 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 questions referred are answered as above.

71. Income Tax Reference No. 84 of 1986 :

This is a reference at the instance of the Revenue for the assessment year 1980-81 of the same assessee. Two questions are referred and they are : "1. Whether, on the facts and in the circumstances of the case, the expenditure incurred by the assessee of Rs. 9,87,681 in the assessment year 1980-81 for converting the existing machines into modern machines was not of a capital nature resulting in a durable benefit to the assessee ? 2. Whether, on the facts of the case, Section 36(1)(ii) is inapplicable to the case ?" The Tribunal said thus : "One of the grounds in this appeal relates to the assessee's claim for modernising expenses of Rs. 9,87,681 disallowed by the Income Tax Officer and allowed by the Commissioner of Income Tax (Appeals). The Commissioner of

Income Tax (Appeals) in allowing the assessee's claim relied on the order of the Tribunal dated August 29, 1982, in Income Tax Appeal No. 328/(Coch) of 1980 for the assessment year 1976-77. As his decision is in accordance with the order of the Tribunal in the assessee's own case for an earlier year we find no reason to interfere with the action of the Commissioner of Income Tax (Appeals)". The Commissioner of Income Tax (Appeals) in his order has stated that the assessee had four Toyoda simplex machines which were used for converting draw frame silver to roves. They were 1949 models. On account of the wear and tear and the sheet age of the machines many parts had become unserviceable. Hence, extensive repairs were carried out for the machinery at a total cost of Rs. 8,77,572. It is understood that a new machine would cost not less than Rs. 5 lakhs and the extent of repairs carried out constituted 50 per cent. of the total machinery in terms of volume and 30 per cent. in terms of weight. These were all imported machines and they had been repaired by Messrs. Vijayalakshmi Engineering Works, Coimbatore. The relevant invoices indicate that the amounts billed were by way of charges for reconditioning and modernisation. Thus, the expenditure on repairing these 4 simplex machines is in no way different from the general expenditure incurred on modernisation by the assessee. These facts have been accepted by the Tribunal.

72. We have already considered similar questions in the income tax references relating to previous assessment years of the same assessee, We have already held that the expenditure incurred for replacement of unserviceable parts of the machines is revenue expenditure. In this view, we have to answer the question referred in the affirmative, in favour of the assessee and against the Revenue. We do so.

73. The second question relates to the applicability of Section 36(1)(ii) of the Income Tax Act. The Income Tax Officer disallowed the assessee's claim for deduction of a sum of Rs. 3,64,565 representing bonus by applying the first proviso to Section 36(1)(ii) of the Income Tax Act. The Commissioner of Income Tax (Appeals) held that the bonus paid by the assessee was a customary bonus and hence it was not regulated by the provisions of the Payment of Bonus Act, 1965. He, therefore, allowed the assessee's claim. The Department filed an appeal and the Tribunal noted that the bonus was paid in terms of an agreement dated August 26, 1979, between the management and the workers and paid around the Onam festival. The Tribunal held that it was customary in point of time and contractual because it was in pursuance of an agreement.

74. We have already considered the question of payment of excess bonus by the assessee in Income Tax Reference No. 87 of 1986. The circumstances here are identical to that case (income tax Reference No. 87 of 1986). We decline to answer the question for the reason that the Tribunal has not considered 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. The same is the position in this case. So, following the decision in Commissioner

of Income Tax Vs. Kerala Agro Industries Corporation, , we decline to answer the question. We direct the Tribunal to consider the matter afresh in the light of the decisions of this court in Commissioner of Income Tax Vs. P. Alikunju, M.A. Nazir, Cashew Industries, 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,).

75. Income Tax Reference No. 52 of 1986 :

This is a reference at the instance of the same assessee for the assessment year 1979-80. The question referred is : "Whether, on the facts and circumstances of the case, the Tribunal was right in holding that the surcharge of Rs. 2,97,034 payable under the Kerala State Electricity Supply (Kerala State Electricity Board-Licensee's Areas) Surcharge Order, 1968, cannot be deducted as an expenditure while computing the taxable income for the assessment year 1979-80, on the ground that the liability to pay the surcharge did not arise during the accounting year 1978 relevant to the assessment year 1979-80 ?" The assessee is following the mercantile system of accounting. The liability to pay surcharge arose on the issue of the Surcharge Order in 1968. The assessee did not even contest the claim initially and was satisfied with watching the outcome of writ petitions filed by other customers. The assessee filed the writ petition only in 1971 when the writ petitions filed by other consumers were allowed by the High Court. It has been held by the Kerala High Court in L.J. Patel and Company Vs. Commissioner of Income Tax, , with regard to the liability to pay excise duty that an assessee who was following the mercantile system of accounting has to provide for the liability during the relevant accounting periods in spite of the fact that he was contesting the liability. The Tribunal found that the ratio of the decision in L.J. Patel and Company Vs. Commissioner of Income Tax, is applicable to the facts of this case,

76. The assessee did not take any step for payment of surcharge even though the order for levying surcharge Was passed in 1968 and in the light of the order, the assessee was asked to pay electricity surcharge by the Kerala State Electricity Board. This court upheld the constitutional validity of the order passed by the Electricity Board by its judgment dated June 19, 1978. The assessee made a claim before the Income Tax Officer that the electricity surcharge to the tune of Rs. 2,97,034 had become payable during the relevant previous year ended on December 31, 1978. The question is whether the assessee is entitled to make such a claim.

77. In Commissioner of Income Tax Vs. K.A. Karim and Sons and Others, , a Full Bench of this court has held that where an assessee maintains his accounts on the mercantile system of accounting his liability to sales tax arises in the year in which he undertook the transactions liable to tax. The fact that steps were not taken for recovery of the tax and that a notification exempting certain transactions which took place between September 1, 1970, to September 30,

1973, was passed on October 12, 1973, and cancelled on November 9, 1973, by the Government, i.e., the exemption was in effect for a very short time, would not affect the date of accrual of liability. We are of the opinion that the above Full Bench decision covers the point and so we have to answer the question in the affirmative, in favour of the Revenue and against the assessee.

78. In the result, we answer the questions in these Income Tax references as follows :

Income Tax References Nos. 105 and 106 of 1989 :

Questions Nos. 1 to 6 are answered in the affirmative and in favour of the assessee.

Income Tax Reference No. 426 of 1985 :

Questions Nos. 1 and 2 are answered in the negative, against the assessee and in favour of the Revenue. Question No. 3 is answered in the affirmative and in favour of the assessee.

Income Tax Reference No. 60 of 1983 :

Question referred is answered in the negative and in favour of the assessee.

Income Tax Reference No. 383 of 1985 :

Question referred is answered in the affirmative in favour of the assessee and against the Revenue.

Income Tax Reference No. 384 of 1985 :

Question referred is answered in the affirmative and in favour of the assessee.

Income Tax References Nos. 66 and 67 of 1986 ;

We answer the common question in the affirmative and in favour of the assessee.

Income Tax Reference No. 379 of 1985 :

Question referred is answered in the negative, in favour of the Revenue and against the assessee.

Income Tax Reference No. 87 of 1986 :

Question No. 1 is answered in the affirmative, in favour of the assessee and against the Revenue. We have declined to answer question No. 2.

Income Tax Reference No. 84 of 1986 :

Question No. 1 is answered in the affirmative, in favour of the assessee and against the Revenue. We have declined to answer question No. 2.

Income Tax Reference No. 52 of 1986 :

Question referred is answered in the affirmative, in favour of the Revenue and

against the assessee.

References are disposed of as above.

79. 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.