Commissioner of Income Tax-II Vs Modi Rubber Ltd.

Court: Delhi High Court

Date of Decision: Aug. 4, 2015

Acts Referred: Income Tax Act, 1961 - Section 143 (3), 260A, 37 (1), 43 (B), 43B

Citation: (2015) 8 AD 9 : (2015) 378 ITR 128

Hon'ble Judges: S. Muralidhar, J; Vibhu Bakhru, J

Bench: Division Bench

Advocate: Kamal Sawhney, Senior Standing Counsel, Raghvendra Singh, Junior Standing Counsel and Shekhar Garg, for the Appellant; Ajay Vohra, Senior Advocate, Kavita Jha and Vaibhav Kulkarni, Advocates for the Respondent

Judgement

Dr. S. Muralidhar, J
This appeal by the Revenue under Section 260A of the Income Tax Act, 1961 (''Act'') is directed against the

impugned order dated 23rd August 2013 passed by the Income Tax Appellate Authority (''ITAT'') in ITA No. 1846/Del/2010 (appeal of the

Revenue) and ITA No. 1816/Del/2010 for the Assessment Year (''AY'') 2001-02.

2. There are three broad issues projected by the Revenue for consideration. The first pertains to deletion by the Commissioner of Income Tax

(Appeals) [''CIT (A) ''] and affirmed by the ITAT of addition made by the Assessing Officer (''AO'') of Rs. 30,450 and Rs. 46,40,822 under

Section 43 (B) of the Act on account of delayed contribution of ESI, provident fund (''PF'') and superannuation fund.

3. As regards the deletion of the addition of Rs. 30,450 relatable to the delayed contribution of ESI and PF, the Court declines to frame a question

since the sum is insubstantial. The question is left open for the consideration in the appropriate place.

4. As regards the deletion of the addition pertaining to the delayed contribution of Rs. 46,40,822 on account of the superannuation fund, the Court

has been shown a copy of the Employees'' Superannuation Scheme of the Respondent-Assessee. Clause 6 of Section-II is titled ''Contributions

and Annuities''. Clause (a) envisages the payment of contribution by the employer and not by the employee. Clause (d) clearly states that ''''the

employer shall be liable to pay the total contributions under the Scheme and shall pay the entire contributions to the Trustees in one or more

instalments as the case may be.'''' The remaining clauses of Section-II also envisage payment of expenses of scheme by only the employer. In other

words, there is no question of employee''s contribution under the Scheme in question. Consequently, the Court finds that there was no occasion to

apply Section 43B of the Act to disallow the delayed contribution by the Assessee to the superannuation fund for the months of February and

March 2001. The order of the CIT (A), as affirmed by the ITAT, does not call for any interference. The Court declines to frame a question in that

regard.

5. The second issue projected by the Revenue concerns the expenditure incurred by the Assessee on purchase of machinery from foreign countries

as revenue in nature by treating them as expenses on ''repair and maintenance''.

6. The relevant facts are that the Respondent-Assessee filed its return of income on 31st October 2001 declaring a loss of Rs. 40,11,55,746. The

assessment was completed by the Assessing Officer (''AO'') under Section 143 (3) of the Act on 26th March 2004 at an income of Rs.

28,49,40,760 after adjusting all brought forward losses and depreciation. In response to the rectification application filed by the Assessee, the

income assessed was revised at Rs. 27,77,93,470.

7. The appeal of the Assessee was partly allowed by the CIT (A). Certain disallowances and additions made by the AO were upheld. The order

giving the appeal effect was passed on 12th January 2005 at a loss of Rs. 22,93,75,375. Both the Revenue and the Assessee preferred appeals

before the ITAT against the order of the CIT (A).

8. By an order dated 1st June 2007 in the Assessee''s the ITAT noted that the Assessee had not furnished its books of accounts before the AO.

Meanwhile the Assessee had got its accounts audited and was declared a sick company. Accordingly, the order of the CIT (A) was set aside by

the ITAT with a direction to the AO to frame the assessment de novo in respect of the additions/disallowance made by the AO. The ITAT

disposed of the Revenue''s appeal by a separate order dated 1st June 2007.

9. Pursuant to the remand, the Assessee was given an opportunity to furnish all the necessary evidence to support its claim. As regards the claim of

Rs. 3,97,53,676 incurred on installation of plant and machinery, the AO noted that the Assessee had claimed 1/5th of the expenditure in the profit

and loss account whereas in the computation of the income attached to the return, the Assessee had claimed the entire amount as revenue

expenditure. The AO disallowed 80% of the said amount as capital expenditure under Section 37 (1) of the Act.

10. In the remand proceedings the Assessee furnished invoices dated 15th September 1999 and 12th October 2000 for purchase of ''one heavy

duty internal (Banbury) mixer G.K. 255N'' and purchase of ''reduction gear box for 3 roll calendar'' respectively. The Assessee also furnished a

Bill of Entry (B/E) dated 3rd November 2000 corresponding to the aforementioned invoice dated 15th September 1999 in respect of the Banbury

internal mixer G.K. 255N.

11. The AO in his order dated 19th December 2008 noted that no other documentary evidence was produced by the Assessee. The AO after

examining the documents and the written submissions noted that the Assessee had described the machines as "part of the tyre manufacturing plant",

''vital part of the process of manufacture of tyres'' and ''equipment for mixing the rubber and chemical''. The AO concluded that the Assessee was

unable to establish that the said machines were part of some other machines. The AO also rejected the claim of the Assessee that the expenditure

was incurred on ''current repairs''. It was concluded that the expenditure was ''capital expenditure'' and depreciation as per the rules would be

allowed to the Assessee.

12. The above order dated 19th December 2008 of the AO was challenged before the CIT (A). By an order dated 12th February 2010 the CIT

(A) disagreed with the AO and held that the AO had not recorded any finding as to how the Banbury mixture and gear boxes could function

independently and how the other plant and machinery were expected to run without the support of the aforesaid components. The CIT (A) held

that the AO appeared to have been influenced by the heavy amount of expenditure. Moreover, the expenditure on identical items incurred in the

earlier years were allowed as revenue expenditure. No distinguishing feature was pointed out by the AO as regards the AY under consideration.

The CIT (A) accordingly deleted the disallowance by holding that the expenditure incurred on the Banbury internal mixer G.K. 225N and

reduction gear box would fall within the meaning of repairs and maintenance only.

13. In the impugned order dated 23rd August 2013 the ITAT agreed with the CIT (A) and held that the cost of importing the Banbury internal

mixer GK 225N and reduction gear box respectively would fall within the meaning of expenditure on ''current repairs and maintenance'' and

entitled to deduction as such.

14. With reference to the above issue this Court by its order dated 6th July 2015 required the Assessee to file copies of the entire submissions/

documents placed by it before the AO on remand. Along with affidavit dated 29th July 2015 the Respondent filed those details. It is seen that by a

letter dated 3rd December 2008 addressed to the Deputy Commissioner of Income Tax, the Assessee gave details of the expenditure in the sum

of Rs. 3,97,53,676 as under:

15. In the same letter, the Assessee further stated as under:

It will kindly be appreciated that all the aforesaid expenditure were incurred by the Assessee for the maintenance and upkeep of the machinery

and replace the old and worn out parts of plant and machinery, which was necessary for keeping the machines in working order. It is further

respectfully submitted, that no new asset came into existence by incurring of the said expenditure and there was no enhancement in the

capacity/efficiency of the machines.

16. Enclosed with the affidavit is also inter alia the details submitted justifying the expenditure on the three equipments aforementioned. As regards

the Banbury GK 255N mixer, the justification provided reads as under:

Justification for expenditure

The Banbury mixer is the most important machine for tyre manufacturing. Its body is put to the rigorous use while mixing rubber compound. The

mixer body thus wear out after regular use of 4-5 years. The body needs to be normally changed on completion of the period. Since the advantage

of overhauling is accrued over a period of 4-5 years hence the expenditure has been amortised over for a period of 5 years by charging 20% of

the total expenditure every year in profit and loss account.

17. A similar justification provided for the Banbury F-370 mixer as under:

F-370 is the major equipment of the company and is used for mixing the rubber and chemical on regular basis and needs to be kept in perfect

condition to ensure uninterrupted production and quality parameters. The aforesaid expenditure was incurred keeping in mind the aforesaid.

18. The justification shown for the 3 Roll calendar was as under:

The 3 Roll calendar is one of the vital machinery in the process of manufacturing of tyres. It is used for the treatment of fabric and it play vital role

in ensuring the smooth production and quality parameters and is single unit in the entire plant. Any breakdown in the plant would lead to total

stoppage of production line. Therefore, the regular up keep and maintenance of this machinery is of paramount importance.

19. Mr. Ajay Vohra, learned Senior counsel appearing for the Respondent- Assessee, submitted that what was in fact imported was only the body

of the Banbury mixer and not the mixer itself. Since the body of the Banbury mixer had got worn out it required to be replaced. According to him,

the expenditure was incurred only on replacing the body of the mixer.

20. The Court is unable to accept the above submission. Both the invoice dated 15th September 1999 and the corresponding bill of entry, copies

of which have been placed on record, describe the equipment imported as "one heavy duty internal mixer G.K. 255N". There is no indication

whatsoever that what has been imported is only the body and not the entire mixer. There was sufficient opportunity to the Assessee to produce

before the AO in the remand proceedings, sufficient documentation to substantiate its plea that what was imported was only the body of the mixer.

The Assessee however, failed to do so.

21. Turning to the decisions on when the cost of import of an equipment could be treated as ''repairs and maintenance'', and therefore whether of a

capital or revenue nature, in The Commissioner of Income Tax, Madurai, Vs. Saravana Spinning Mills Pvt. Ltd., (2007) 211 CTR 281 : (2007)

293 ITR 201 : (2007) 10 JT 111 : (2007) 9 SCALE 697 : (2007) 7 SCC 298 : (2007) 8 SCR 944 the Supreme Court was dealing with the issue

whether a ring frame in a textile mill was an ''independent and separate machine''. It was held that each machine in a textile mill may be part of the

integrated process of manufacture of yarn and integrally connected to the other machines in the mill for production of the final product. However,

such interconnection did not take away the independent identity and distinct function of each machine. Accordingly, it was held that each machine

in a textile mill was required to be considered independently. As regards the question whether a particular item of expenditure amounted to

expenses towards ''current repairs'' the Supreme Court explained that the question to be asked was ""whether the expenditure is incurred to

''preserve and maintain'' an already existing asset and not to bring a new asset into existence or to obtain a new advantage. For ''current repairs''

determination, whether expenditure is revenue or capital is not the proper test."" It was held that the replacement of a ring by a new one did not

amount to ''current repairs''.

22. The issue was re-visited by the Supreme Court in Commissioner in Commissioner of Income Tax, Madurai Vs. Sri Mangayarkarasi Mills (P)

Ltd., (2009) 224 CTR 513 : (2009) 315 ITR 114 : (2009) 9 JT 658 : (2011) 11 SCC 656 : (2009) 10 SCR 1187 : (2009) 182 TAXMAN 141

: (2009) 6 UJ 2910 . There the question was whether the expenditure incurred by the Assessee, which was engaged in the manufacture and sale of

cotton yarn, on replacement of machinery was the revenue expenditure. On the facts of the case, and applying the tests enunciated in CIT v.

Saravana Spg. Mills (P) Limited (supra), the claim of the Assessee was negatived.

23. Turning to the case on hand, the Court notes that the two Banbury mixers have been described by the Assessee itself as equipment used for

mixing natural rubber, synthetic rubber, carbon black, chemicals and other raw materials and that it ""is the most important part for tyre

manufacturing plant"". It has described the Banbury F 370 equipment as a ""major equipment and is used for mixing the rubber and chemical on

regular basis and needs to be kept in perfect condition to ensure uninterrupted production and quality parameters."" The invoices produced by the

Assessee do not support its plea that the expenditure was incurred only on replacement the body of the mixers. The Assessee had sufficient

opportunities to demonstrate before the AO that the expenditure incurred by it was not of a capital nature. The Assessee was unable to succeed in

that effort. The only documents produced by it to show that the Banbury mixers imported were vital to the tyre manufacturing plant and were of

enduring benefit to it. The expenditure incurred in that behalf was rightly held by the AO, in terms of the tests laid down by the Supreme Court in

Saravana Spg. Mills (P) Ltd. (supra) and Sri Mangayarkarasi Mills (P) Ltd. (supra) to be of a capital nature.

24. However the expenditure on the reduction gear box for the 3 coil calendar stands on a different footing. From the invoice produced by the

Assessee, it is clear that the said imported item was part of the 3 roll calendar. Therefore, the Court concurs with the decisions of the CIT (A) and

ITAT holding it to be revenue expenditure and deleting the disallowance of the AO.

25. The conclusion as far as the second question projected by the Revenue is that ITAT erred in deleting the disallowance of the expenditure on

the purchase of Banbury mixers as ''repair and maintenance''. The said expenditure on the import of the two Banbury mixers is required to be

treated as capital expenditure. It is further held that the ITAT and the CIT (A) were right in deleting the disallowance of the expenditure on the

reduction gear forming part of the 3 Roll calendar to the extent of Rs. 41,23,890.

26. The third and final issue projected by the Revenue pertains to deletion of the notional interest of Rs. 24 lakhs which was sought to be added by

the AO on the ground that an interest free loan of Rs. 2 crores was given by the Assessee to its sister concern, Modi Stone Limited.

27. In this regard it is seen that the ITAT noted that the sum of Rs. 2 crores was advanced to Modi Stone Limited on account of commercial

expediency as the said company was declared sick by the BIFR by its order dated 15th April 1998. No interest was accrued on the above

amount. From a perusal of the financial statements for the year ended 30th September 1997 it was seen that the Assessee was having mixed pool

of funds comprising owned funds and loan funds. It was held that in such a situation where the one to one nexus between the borrowed funds and

the loan advanced to Modi Stone Limited was unable to be established, the loan to Modi Stone had to be held as having come out of its own

funds. Consequently, the order of AO and CIT (A) was set aside.

28. The Court finds that the decision of the ITAT on the above aspect is turned purely on facts. The view taken by the ITAT on facts was a

plausible one. Consequently, the Court finds that no substantial question of law arises for determination as far as the said issue is concerned.

29. The appeal is disposed of in the above terms but in the facts and circumstances of the case, with no orders as to costs.