

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 24.07.2013

Coram

The Honourable Mrs.Justice CHITRA VENKATARAMAN  
and  
The Honourable Ms.Justice K.B.K.VASUKI

Tax Case (Appeal) Nos.140 to 143 of 2013  
489 to 491 of 2012 and 319 of 2013  
and connected MPs

---

Tax Case (Appeal).No.140/2013:-  
-----

M/s.Super Spinning Mills Ltd  
Elgi Towers, Green Fields,  
737-D, Puliakulam Road  
Coimbatore-641 045

.. Appellant

-vs-

The Assistant Commissioner of Income-tax  
Company Circle 1(2)  
Coimbatore

.. Respondent

Prayer in Tax Case (Appeal).No.140/2013:- Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai 'C' Bench dated 07th February 2013 in ITA.No.04/Mds/2013 for the assessment year 2005-06.

For appellant : Mr.C.Natarajan, Senior counsel  
for Mr.K.Ravi

For respondent : Mr.N.V.Balaji  
Standing Counsel for  
Income Tax Dept.

COMMON JUDGMENT

(The Judgment of the Court was made by CHITRA VENKATARAMAN, J.)

The assessee is one and the same in all the present Tax Case (Appeals). The assessee raised the following common substantial question of law seeking admission of the present Tax Case Appeals:

" Whether in the facts and circumstances of the case, the Income Tax Appellate Tribunal is right in law, in disallowing the claim of expenditure on replacement of machinery as revenue expenditure ?"

After issuing notice to the respondent in the Tax Case (Appeals), we decided to take the Tax Cases for final hearing.

2. It is seen from the documents placed before this Court that in respect of the assessment year 1994-95, the Revenue preferred an appeal before this Court in T.C(A).No.1074 of 2010, wherein, the same issue was raised, which reads as follows:-

"1. Whether the replacement of machinery parts will amount to revenue expenditure or not ?

2. Whether brining into existence of a new asset or obtaining a new advantage would amount to revenue expenditure or not ?"

3. Under order dated 10.01.2011, this Court remanded the matter back to the Commissioner of Income Tax (Appeals) to reconsider the issue as to whether the replacement of machinery parts brings into existence a new asset or a new advantage, so as to hold the expenditure as revenue or not by following the decision of this Court in Tax Case (Appeal) No.261 of 2010 dated 22.06.2010, wherein, this Court followed the decision in T.C.Nos.1290 and 1291 of 2009 and 1216 to 1221 of 2009 and the decision of the Apex Court in S.L.P.Nos.413 and 414 of 2009 and Civil Appeal No.7297 of 2009. Thus, a reading of the order of this Court shows that based on the decisions on similar issues rendered by the Apex Court and that of this Court, this Court remanded the matters therein back to the Commissioner of Income Tax (Appeals) for fresh investigation of the facts and thus the Revenue's case in TC(A).No.1074 of 2010 was also remitted back to the Commissioner of Income Tax (Appeals). Thereupon, the Commissioner of Income Tax (Appeals) passed the order dismissing the appeal, holding that the assessee had not submitted the efficiency of the machinery replaced nor had given details about the new machinery. The aggrieved assessee preferred appeals before the Tribunal, which dismissed the appeals.

4. The assessment years under consideration are 2003-04 and 2005-06 to 2008-09. Before going into the questions raised, few facts need to be seen. The assessee herein is engaged in the business of manufacture and trading in cotton yarn and allied products. In the course of the previous year relevant to the respective assessment years, the assessee incurred expenditure in respect of replacement of certain textile machinery. The machinery which had gone for replacement are different in respect of each of the assessment years involved in the respective Tax Cases. For the purpose of considering the question raised, for the reasons given below, it is not necessary for us to go into the details of the machinery replaced. It is suffice to say that the assessee claimed expenditure therein as revenue expenditure/ current repairs. However, the Assessing Officer held that the replacement could not be considered to be current repairs.

5. It is a matter of record that the question as to whether such replacement could be current repairs/capital in nature came up for consideration in series of decisions before this Court, which, however, went on appeal before the Apex Court. The question as to the nature of the claim on expenditure incurred on the replacement of machinery, came up for consideration before this Court in the decision reported in [2005] 275 ITR 403 (CIT Vs. Janakiram Mills Ltd.). There the assessee claimed the expenditure on the replacement on ring frames as current repair, while the Revenue treated it as a capital expenditure. On appeal, the Commissioner of Income Tax (Appeals) held the expenditure as revenue expenditure, that replacement of ring frames constituted an integral part of the production system in a textile machinery. The view of the Commissioner of Income Tax (Appeals) was affirmed by the Tribunal. On appeal, in the decision cited above, this Court held that the expenditure was deductible under Section 31(i) of the Income Tax Act. On appeal against the judgment of this Court, the Supreme Court considered the question in the decisions reported in (2007) 293 ITR 201 (SC) (CIT Vs. Saravana Spinning Mills P.Limited) and (2007) 294 ITR 328 (SC) (CIT Vs. Ramaraju Surgical Cotton Mills) as to (a) Whether the expenditure incurred on modernisation and replacement came with the constitution of the words "current repairs" in Section 31(i) and (b) Whether replacement of an old machinery by a new machinery constituted an advantage of an enduring nature and hence, capital in nature.

6. In the decision reported in (2007) 293 ITR 201 (SC) (CIT Vs. Saravana Spinning Mills P.Limited), the Apex Court considered the meaning of the phrase "current repairs". Reversing the decision of this Court, the Apex Court held that one of the basic tests to find out whether the expenditure was current repairs or not, was to see as to whether the expenditure was incurred to "preserve and maintain" an already existing asset. The expenditure must not be one to bring a new asset into existence or to obtain new advantage; the replacement of ring frames constituted substitution of an old asset by a new asset and therefore, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" under Section 31(i) of the Income Tax Act, 1961 (hereinafter called as the "Act"). The Supreme Court observed "... we may state that replacement generally may not fall under the expression "current repairs" but, in certain cases, where the old parts were not available in the market or where the old parts had worked for 50 to 60 years, replacement can, in such cases of exception, fall within the expression "current repairs". ... old type of replacement parts were not available in the market and, therefore, the expenditure came within the expression "current repairs." ... Holding that Section 37 is a residuary Section, the Supreme Court observed: "Therefore, whether an expenditure is revenue or capital in nature would depend on the facts of each case. " Thus, the Supreme Court held that even if the expenditure is revenue in nature, it may not fall within the connotation of "current repairs". Thus, the Supreme Court reversed the decision of this Court and held that the expenditure in question was not "current repairs" and hence, could not be allowed under Section 31(i) of the Act. The Apex Court accepted the case of the Revenue that the assessee was not entitled to deduction under Section 31(i) of the Act. It however pointed out to the decision reported in (1967) 3 SCR 957 (CIT Vs. Mahalakshmi Textile Mills Ltd.) that when old parts were not available in the market or where the old parts had worked 50 or 60 years, replacement in such cases of exception fall within the expression "current repairs". The Apex Court, however, expressed no opinion on the applicability of Section 37(1) of the Act. This came to be considered separately in other batch of cases reported in (2007) 294 ITR 328 (SC) (CIT Vs. Ramaraju Surgical Cotton Mills).

7. In the case of CIT Vs. Ramaraju Surgical Cotton Mills reported in (2007) 294 ITR 328 (SC), in the appeal taken by the Commissioner of Income-Tax, the Supreme Court considered the case where the assessee claimed the expenditure under Section 37 of the Act. The assessee contended that the expenditure incurred on replacement of assets without increase in the production capacity was revenue in nature. Pointing out that such question was not raised before the Commissioner, the Supreme Court pointed out that to decide the question as to whether the expenditure is revenue or capital, number of aspects are required to be considered therein; in the absence of any details regarding the production capacity even after replacement, the matter needed to be remitted back to the Commissioner of Income Tax (Appeals). The Apex Court pointed out that since there was confusion regarding the applicability between the tests to be applied in respect of Section 31 of the Act and the test to be applied in the case of Section 37 of the Act, the matter deserved to be remanded back to the Commissioner of Income Tax (Appeals) to decide the matter uninfluenced by any observations made in the orders of the Court. Thus, in the case of CIT Vs. Ramaraju Surgical Cotton Mills (SC) reported in (2007) 294 ITR 328 (SC), the Apex Court, after referring to the decision reported in (2007) 293 ITR 201(SC) in the case of CIT Vs. Saravana Spinning Mills (P) Ltd., held that Section 31 of the Act and Section 37 of the Act, operated on different spheres and the tests applicable to Section 31 of the Act could not be read into Section 37 of the Act. Thus, the matters were restored to the files of the Assessing Officer for fresh hearing.

8. Apart from these two decisions, there is yet another decision of the Apex Court in the case of CIT Vs. Sri Mangayarkarasi Mills P. Limited reported in 2009-TIOL-86-SC-II. There the assessee incurred expenditure on replacement of machines. The assessee claimed the expenditure as allowable under Section 37 of the Act. While the Assessing Officer disallowed the expenditure on the ground that each machine in a spinning mill was independent of each other and they were not integrally connected; hence, he treated the expenditure as capital in nature, the Appellate Authority allowed the appeal filed by the assessee. On further appeal by the Revenue before the Income Tax Appellate Tribunal, it followed the decision of this Court and upheld the order of the Commissioner of Income Tax (Appeals) and dismissed the appeal. On further appeal before this Court, this Court agreed with the assessee and rejected the Revenue's Appeal. This Court held that the expenditure on replacement of machinery was revenue in nature. In so holding, it followed the decision reported in [2005] 275 ITR 403 (CIT Vs. Janakiram Mills Ltd.), which was subsequently reversed by the Apex

Court. It further referred to the decision reported in (2007) 293 ITR 201 (SC) (CIT Vs. Saravana Spinning Mills P.Limited) and pointed out: "expenditure is deductible under section 37 only if it (a) is not deductible under sections 30-36, (b) is of a revenue nature, (c) is incurred during the current accounting year and (d) is incurred wholly and exclusively for the purpose of the business. We are satisfied that the assessee's expenditure satisfies requirements (a), (c) and (d) as stated above. ... expenditure is of a capital nature when it amounts to an enduring advantage for the business and repair is different from bringing a new asset for the business. Further, in Lakshmiji Sugar Mills (P) Co. v. CIT (AIR 1972 SC 159) it has been held by this Court that bringing into existence a new asset or an enduring benefit for the assessee amounts to capital expenditure." The Supreme Court considered the question as to whether the expenditure amounted to revenue expenditure or current repairs. The Supreme Court pointed out that each machine in a spinning mill should be treated independently as such and not as a mere part of an entire composite machinery of the spinning mill. It can, at best, be considered part of an integrated manufacturing process employed in a textile mill. Referring to its decision reported in (2007) 293 ITR 201 (SC) (CIT Vs. Saravana Spinning Mills P.Limited), it held that the expenditure could not be treated as current repairs under Section 31(i). The expenditure incurred for reaping long-term and enduring benefits by replacing the independent machine could only be a capital expenditure. Thus, the Apex Court restored the Assessing Officer's order and held that the expenditure was capital in nature. The decision in the case of CIT Vs. Sri Mangayarkarasi Mills P. Limited reported in 2009-TIOL-86-SC-II, thus rested on the facts of its case.

9. The question as to whether the expenditure incurred on replacement of machinery is revenue or capital expenditure, particularly in the nature of replacements of parts, thus rests on the nature of expenditure incurred, vis-a-vis the benefit that the assessee derives. The ratio deductible from the decisions referred to above are:

(i) To decide the applicability of Section 31(i), the test is not whether the expenditure is revenue or capital in nature, but whether the expenditure is "current repairs". The basic test is to find out whether expenditure is incurred to "preserve and maintain" an already existing asset and the expenditure must not be to bring a new asset into existence or to obtain a new advantage vide [2007] 293 ITR 201 (SC) (Commissioner of Income Tax Vs. Saravana Spinning Mills P. Ltd.)

(ii) Under Section 31(i), the deduction admissible is only for current repairs. Therefore, the question as to whether the expenditure incurred by the assessee conceptually is revenue or capital in nature is not relevant for deciding the question whether such expenditure comes within the etymological meaning of the expression "current repairs". In other words, even if the expenditure is revenue in nature, it may not fall in the connotation of "current repairs" ▴ [2007] 293 ITR 201 (SC) (Commissioner of Income Tax Vs. Saravana Spinning Mills P. Ltd.)

(iii) A new asset or new/different advantage cannot amount to 'current repairs'. - 2009-TIOL-86-SC-II (CIT Vs. Sri Mangayarkarasi Mills P. Limited)

(iv) Repair implies existence of a part of the machine which has malfunctioned, thereby requiring repair to that machinery, plant etc. Replacement cannot be a current repair, for, "replacement" and "current repair" do not go hand in hand. If one is to hold otherwise, it would only make Section 31(i) wholly redundant and absurd. Thus, replacement expenditure cannot be said to be 'current repairs' vide [2007] 293 ITR 201 (SC) (Commissioner of Income Tax Vs. Saravana Spinning Mills P. Ltd.) and 2009-TIOL-86-SC-II (CIT Vs. Sri Mangayarkarasi Mills P. Limited)

(v) Expenditure is deductible under section 37 only if it (a) is not deductible under sections 30-36, (b) is of a revenue nature, (c) is incurred during the current accounting year and (d) is incurred wholly and exclusively for the purpose of the business. - 2009-TIOL-86-SC-II (CIT Vs. Sri Mangayarkarasi Mills P. Limited);

(vi) Expenditure is of a capital nature when it amounts to an enduring advantage for the business and repair is different from bringing a new asset for the business. Further, bringing into existence a new asset or an enduring benefit for the assessee amounts to capital expenditure vide Lakshmiji

Sugar Mills (P) Co. v. CIT (AIR 1972 SC 159) referred in 2009-TIOL-86-SC-II (CIT Vs. Sri Mangayarkarasi Mills P. Limited).

(vii) Therefore, whether an expenditure is revenue or capital in nature would depend on the facts of each case. - [2007] 293 ITR 201 (SC) (Commissioner of Income Tax Vs. Saravana Spinning Mills P. Ltd.)

10. In the case of Empire Jute Co. Ltd Vs. Commissioner of Income Tax reported in (1980) 124 ITR 1 (SC), the Apex Court referred to the decision in the case of John Smith and Son Vs. Moore reported in (1921) 12 TC 266, 296 (HL) that for an expenditure to become a business expenditure, there must be an outlay of a business "in order to carry it on and to earn a profit out of this expense as an expense of carrying it on". The Apex Court further cautioned that when considering the question on the claim of the expenditure being revenue or capital, it must be viewed in the larger context of business necessity or expediency. The Apex Court further pointed out to the concept of an advantage of enduring benefit and further explained the question on capital or revenue expenditure in the following words:-

" There may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital 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."

11. Having thus held so, the Apex Court further pointed out that where an expenditure is incurred primarily and essentially for the purpose of business of an assessee without any addition or augmentation in the profit-making structure to the better utilisation of the assessee, the claim would be in the nature of revenue expenditure. The Apex Court pointed out that even if the expenditure is producing a larger quantity of goods and earning more income, nevertheless, the nature of expenditure would be revenue in character. This judgment of the Apex Court in the case of Empire Jute Co. Limited Vs. CIT reported in (1980) 124 ITR 1 (SC) has to be seen in the background of the decision of the Apex Court in the case of CIT, Madras Vs. Mahalakshmi Textile Mills Limited reported in (1967) 66 ITR 710 (SC).

12. The decision in the case of CIT, Madras Vs. Mahalakshmi Textile Mills Limited reported in (1967) 66 ITR 710 (SC) is related to the assessee introducing "Casablanca conversion system" in its spinning plant. This involves 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. Confirming the judgment of this Court, the Supreme Court pointed out that with the introduction of the Casablanca conversion system, there was no installation of new machinery or plant, but it amounted, in substance, to "current repairs" to the existing machinery.

13. The judgment of the Supreme Court in the case of CIT, Madras Vs. Mahalakshmi Textile Mills Limited reported in (1967) 66 ITR 710 (SC) read along with the decision the Madras High Court pointed out that there was no change in the method of spinning and that the parts that were replaced, performed precisely the same function as old parts and when it was found that the original old type of replacement parts were not available in the market, necessarily the company had to replace it with the new system; in that context, the Supreme Court affirmed the judgment of this Court that it was "current repairs" to the machinery and plant.

14. Keeping the decisions referred to above, one can detect that in considering the claim of the assessee, the decision must be guided by business prudence of the necessity or expediency which compel the assessee to carry on such repairs/replacement and if this repair ultimately has gone in for bettering its business profits in the nature of increasing its profits, as held by the Supreme Court in the case of CIT Vs Ramaraju Surgical Cotton Mills reported in (2007) 294 ITR 328 (SC) through increase in the production capacity, then the outlay, not being just to carry on the business to earn profit out of its existence, but to enlarge its profit-earning capacity, the expenditure may fall for consideration under the head of "capital expenditure". But, whether the expenditure in question has no such ingredient of increasing its production capacity, expenditure would necessarily fall under the head of "revenue expenditure".

15. With the law declared by the Apex Court in the background, when we look at the order of Commissioner of Income Tax (Appeals) as well as that of the Income Tax Appellate Tribunal, one may note herein summary of case law alone and admittedly, there is no discussion on the facts as to the impact of such expenditure on the profit-earning capacity or mechanism of the assessee. Learned Senior counsel appearing for the assessee placed before us the expenditure incurred on the various items which had gone in for replacement and also the date of installation of such machinery and its impact on the production capacity.

16. Even though the assessee has furnished list of items chart, the data which are available before us were not available before any of the Appellate Authorities for coming to the right conclusion herein. Thus, with no details available as stated in the case of CIT Vs. Ramaraju Surgical Cotton Mills reported in (2007) 294 ITR 328 (SC), the decision of the Tribunal cannot be held as based on any material data necessary for considering the claim one way or the other. Hence, the proper course herein is to set aside the order of the Income Tax Appellate Tribunal and remit the matter back to the Commissioner of Income Tax (Appeals) for de novo consideration.

17. Keeping in view the law declared by the Apex Court in the case of CIT Vs. Ramaraju Surgical Cotton Mills' case reported in (2007) 294 ITR 328 (SC) and in the case of CIT Vs. Sri Mangayarkarasi Mills P. Limited reported in 2009-TIOL-86-SC-II, the Commissioner of Income Tax (Appeals) shall grant an opportunity to the assessee to state its case in a proper perspective and decide on the issue as to whether the expenditure, in effect, could be treated as "revenue expenditure".

18. We direct the Commissioner of Income Tax (Appeals) to pass a detailed order on the impact of the replaced material as well as the functioning of the machinery after hearing the assessee in detail, whom, we hope, would extend all cooperation before the Commissioner of Income Tax (Appeals) and furnish the materials for arriving at a proper conclusion.

19. The Tax Case (Appeals) stand disposed of on the above terms. No costs. Consequently, connected MP is closed.

To

1. The Assistant Commissioner of Income-tax  
Company Circle 1(2)  
Coimbatore.
2. The Commissioner of Income Tax (Appeals) I,  
Coimbatore.
3. The Income Tax Appellate Tribunal,  
Chennai Bench 'C'

nvsri