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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Jan-11-1982

Reported in : (1982)1ITD996(Delhi)

Judge : O Garg, V Sharma

Appellant : inspecting Assistant

Respondent : Orient Abrasives Ltd.

Judgement :

1. This is an appeal by the revenue pertaining to the assessment year 1976-77 for which the previous year ended on 30-6-1975. The only controversy which has been raised is with regard to the allowance as revenue expenditure of an amount of Rs. 7,69,110 by the learned Commissioner (Appeals).

2. The relevant facts are briefly as follows : The assessee is a limited company manufacturing fused aluminium oxide abrasive grains with foreign collaboration of a Czechoslovakian concern. This undertaking of the assessee-company is absolutely a new undertaking.

Plant and machinery of the undertaking was under installation until 31-12-1974. There had been trial run of the machinery in June 1974 but actual production commenced a few months later. In fact production of white aluminium grains commenced with effect from 1-1-1975 and that of brown A grains with effect from 1-4-1975. Over and above the actual cost of plant and machinery an expenditure

of Rs. 16.49 lakhs had been incurred which was directly related to the installation of the plant and machinery and the same was capitalised and included in the initial cost of the plant. Further the assessee-company claimed capital expenditure of Rs. 5,25,781 as deferred revenue expenditure in terms of Section 35D out of which the ITO accepted the claim to the extent of Rs. 4,80,942 and allowed deduction for one-tenth thereof. There was further expenditure of Rs. 7,69,110 with which we are concerned in the present appeal. The circumstances under which this expenditure was incurred are as follows : The assessee-company's factory was located in the industrial area at Porbandar of the Gujarat Industrial Development Corporation ("GIDC" for short). There was no arrangement for supply of power in that area. Since the undertaking of the assessee was power intensive, at the assessee's request, it was arranged that Gujarat Electricity Board (GEB) would establish a sub-station at Porbandar laying down power line from Ramavav to Porbandar and the expenditure incurred thereon which was Rs. 19.80 lakhs was to be shared equally by GIDC and GEB, i.e., Rs. 9.90 lakhs each. Out of Rs. 9.90 lakhs to be borne by GIDC, the assessee accepted liability for payment of two-third, i.e., Rs. 6.60 lakhs. In addition the assessee-company paid directly to GEB Rs. 1.09 lakhs for laying power line to connect the assessee's factory with the sub-station at Porbandar. Thus expenditure of Rs. 7,69,110 was incurred. The power line and the sub-station remained the assets of the GEB.3. In the assessment for the year 1975-76 (year ending 30-6-1974) the assessee had claimed as business expenditure the said amount vide letters dated 9-8-1977 and 19-8-1977 but the ITO rejected the claim of the assessee for two reasons. Firstly, the ITO contended that the expenditure in question having been incurred prior to commencement of production, it could not be allowed as revenue expenditure. Secondly, the ITO came to the conclusion that the expenditure in question was capital expenditure, since by incurring the same the assessee had secured enduring benefit an for that conclusion he derived support from the Supreme Court decision in Travancore Cochin Chemicals Ltd. v. CIT [1977] 106 ITR 900. Reliance was also placed on the Calcutta High Court decision in the case of Ganesh Sugar Mills Ltd. v. CIT [1969] 73 ITR 4. In appeal the learned AAC upheld the action of the ITO. The learned AAC took notice of the directors' report dated 26-12-1974 for the year ending 30-6-1976 which stated that production was now being started.

The learned AAC found that trial run had taken place in June 1974 but production commenced a few months later. The expenditure in question was, thus, found to have been incurred prior to the commencement of production. The learned AAC further held that the ITO had rightly treated the said expenditure as capital expenditure. Disallowance made was sustained. This decision of the AAC was accepted by the assessee-company. ' 5. In the assessment for the year 1976-77, which is under our consideration in this appeal, before the ITO deduction of one-tenth of the total expenditure of Rs. 7,69,110 was claimed once again. The ITO, however, rejected the claim of the assessee following the decision taken in the assessment for the year 1975-76, 6. The assessee appealed to the learned Commissioner (Appeals) and before the learned Commissioner (Appeals) the same claim was made but in the course of the hearing, an additional ground was raised with the permission of the Commissioner (Appeals) by which deduction for the entire amount was claimed as revenue expenditure and learned Commissioner (Appeals), for the reasons recorded in paragraph 3 which is reproduced below, allowed the claim of the assessee for the deduction of the entire amount as revenue expenditure : 3. I note that the appellant's requirement of power for its manufacturing process at the Porbandar factory is very substantial.

To meet this requirement it was necessary to lay a power line from Ranavav to Porbandar and to establish a sub-station at Gujarat Industrial Development Corporation, Industrial Area, Porbandar. The Gujarat State Electricity Board agreed to erect these facilities if the cost thereof was shared between it and the GIDC equally. The appellant agreed to incur 2/3rd of the amount that might fall to the share of GIDC under this arrangement. This sum amounted to Rs. 6,60,000 which was paid on 10-3-1975 which date falls in the current accounting year ending 30-6-1975. In addition to this amount, the company also paid Rs. 1,90,110 to Gujarat Electricity Board for laying of power line from their sub-station to the company's sub-station inside the factory. Admittedly the ownership of the sub-station and the power line are with Gujarat State Electricity Board. On these facts it is claimed that the total payment of Rs. 7,69,110 is made purely on account of commercial expediency and the same should be allowed as revenue expenditure in computing the total income of the company. Reliance is placed on the decision of the Bombay High Court in CIT v. Excel Industries Ltd. [1980] 122 ITR 995. On

similar facts, in that case the High Court held that as the assessee was not the owner of the service line it did not acquire any capital asset or an enduring benefit or advantage. It was also held that the object of making such payment was purely one of commercial expediency. Therefore, it was held, relying on the Supreme Court decision in Lakshmiji Sugar Mills Co. (P.) Ltd. v. CIT [1971] 82 ITR 376 (the principles of which decision are reported in the recent Supreme Court decision in Oil Mills (P.) Ltd. v. CIT [1980] 125 ITR 293) that payment made to the Electricity Board towards the cost of laying the service line which remained the property of the Electricity Board constitutes revenue expenditure and was an allowable deduction. Respectfully following this decision, the appellant is clearly entitled to the deduction of Rs. 7,69,110 as revenue expenditure. This will mean a reduction of Rs. 7,69,220.

7. Against the decision of the learned Commissioner (Appeals), revenue has come up in appeal to the Tribunal. The learned departmental representative urged that the expenditure in question had been incurred in the period prior to the commencement of production and, therefore, the question of allowing it as business expenditure did not arise. He stated further that the ITO had rightly treated the expenditure in question as capital expenditure as enduring benefit had been secured by the assessee-company by incurring the same and the learned Commissioner (Appeals) was not justified on facts and in law in allowing the amount in question as revenue expenditure. Reference was made to Supreme Court decision m Assam Bengal Cement Co. Ltd. v. CIT [1955] 27 ITR 34 and Sitatpur Sugar Works Ltd. v. CIT [1963] 49 ITR 160 and to the decision of the Kerala High Court in CIT v. T.C.C. Ltd. [1973] 87 ITR 66.

8. The learned counsel for the assessee, on the other hand, vehemently supported the decision of the learned Commissioner (Appeals).

Emphasising the fact that the service line laid down by the Gujarat Electricity Board remained the asset of the said Electricity Board, it was urged that by incurring the said expenditure the assessee-company neither acquired any asset nor any benefit of enduring nature. The learned counsel stated further that the expenditure had been incurred in order to enable the assessee-company to carry

on its business and that the capital structure of the assessee-company was not at all affected by it and, therefore, the learned Commissioner (Appeals) had rightly treated it as expenditure of revenue character. Reference was made in support of this view to the decision of the Bombay High Court in the case of CIT v. Excel Industries Ltd. (supra) in which Their Lordships held that since the service line remained the property of the Electricity Board, the assessee did not acquire any capital asset or an enduring benefit or advantage and that object of making the payment was purely one of commercial expediency. The learned counsel also derives support from the Supreme Court decision in Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1, another Supreme Court decision in L.H. Sugar Factory and Oil Mills (P.) Ltd. v. CIT (supra) and the decision of the Gujarat High Court in CIT v. Gujarat Mineral Development Corporation [1981] 132 ITR 377. Specific reference was made by the learned counsel to the Gujarat High Court decision in CIT v. Gujarat Mineral Development Corporation (supra) in which following the Supreme Court decision in the case of Empire Jute Co. Ltd. (supra), Their Lordships held that the expenditure of Rs. 20.46 lakhs incurred by the assessee-company in respect of payments made to the Gujarat Electricity Board for laying down electric cables and electric supply transmission lines was a revenue expenditure. It was urged by the learned counsel on the authority of all these decisions that where the advantage derived from the expenditure was not in the capital field but related to the profit earning apparatus, the same had to be treated as expenditure incurred wholly and exclusively for the purpose of business. In the present case, it was submitted, that by incurring the expenditure in question the assessee had neither acquired any asset nor any enduring benefit and that it was only for enabling the company to carry on its business that the expenditure in question had been incurred and, hence, the learned Commissioner (Appeals) had rightly allowed the same as business expenditure.

9. We have considered the facts and the rival submissions. We have also gone through the various decisions which have been cited before us. As stated above, the assessee-company was, for the first time, starting a manufacturing concern. For the purpose of setting up the concern, apart from expenditure on the installation of plant and machinery, the assessee spent Rs. 7,69,110 for the purpose of procuring the electrical energy which was necessary for carrying on the

business of the assessee-company. The question for our consideration is whether the expenditure in question can be allowed as business expenditure.

10. At the very outset, it must be stated that in deciding an issue of this type, distinction has to be made between cases in which expenditure is incurred in the course of a running business and cases in which expenditure is incurred in connection with the setting up of the business itself. The considerations to be applied in the two type of cases would be entirely different. In the former type of cases the expenditure incurred may be for the efficient running of the existing business and may be treated as revenue expenditure even if by incurring the same any benefit of enduring character has been derived. In the latter type of cases the expenditure apparently would not be in the course of the business and would be for the purpose of setting up of the business and, therefore, any such expenditure incurred before the business is actually commenced, will not be admissible as business expenditure.

11. The revenue has referred to the Supreme Court decisions in Assam Bengal Cement Co. Ltd. v. CIT (supra) and Sitalpur Sugar Works Ltd. v.CIT (supra) and to the Kerala High Court decision in CIT v. T.C.C. Ltd. (supra) but all these decisions relate to existing businesses. These decisions, therefore, would not be helpful. In the same way the various cases which have been relied upon on the assessee's behalf are also cases of existing businesses and therein it has been held that even if benefit has been derived, the expenditure incurred has to be treated as business expenditure as the object of incurring the expenditure was to run the business more efficiently and profitably. The expenditure, it has been held, relate to the profit earning apparatus. These decisions also, therefore, cannot help. In Bombay High Court decision in CIT v.Excel Industries Ltd. (supra) and the Gujarat High Court in CIT v.Gujarat Mineral Development Corporation (supra) which have been strongly relied upon, the assessee-companies had been carrying on their businesses and in the course of those, new line of activity had been started for which purpose expenditure had been incurred on service lines for the purpose of procuring electricity and it was held that the expenditure was incurred purely out of commercial expediency and for the purpose of carrying on the existing business more efficiently and profitably and, therefore, the expenditure was admissible as

revenue expenditure. Similarly in the Supreme Court decisions in Empire Jute Co. Ltd. v. CIT (supra) and Oil Mills (P.) Ltd. v. CIT (supra), it was in the course of carrying on of the existing business that expenditure was incurred and it was held that the expenditure was for facilitating the carrying on the business or that it related to the profit earning apparatus and, therefore, it was admissible. As stated, these cases cannot be applied to the present case wherein the expenditure was incurred in connection with the setting up of the business itself.

12. We have -before us a number of cases in which expenditure incurred for to the setting up of the business was claimed as revenue expenditure it was held that no allowance could be made in respect thereof. The Gujarat High Court decision in CIT v. Sarabhai Sons (P.) Ltd. [1973] 90 ITR 318 is one of such cases. In that case the assessee, a private limited company, decided to start a new business for the manufacture of scientific instruments and communication equipments. It placed orders for machinery and equipment in January 1966 and some of the machinery was received in February 1966. It also placed orders for raw material and stores and took on lease premises from an industrial estate. These preparations went on and in July 1967 the machinery was installed and production was commenced. The assessee claimed to deduct a sum of Rs. 16,257 spent in connection with the new business during the period ending 31-3-1966 for the assessment year 1966-67. Their Lordships held that the new business could not be said to be ready to discharge the function for which fit was established, namely, the manufacture of scientific instruments and communication equipments until the machinery necessary for the purpose of manufacture was installed. Obtaining land on lease, placing orders for machinery and raw materials were merely operations for the setting up of the business. On the facts of the case, it was held, the business could not be said to be set up until July 1966 when the machinery had been installed and the factory was ready to commence business. The revenue expenditure incurred before that date would not be a permissible deduction, in the assessment for the assessment year 1966-67.

13. The Bombay High Court in Bhodilal Menghraj & Co. (P.) Ltd. v. CIT [1979] 119 ITR 968 has considered the same issue. In that case the ;assessee-company established a factory for manufacture of tools and the 'factory went into production

in August, 1961. The assessee had earlier .approached the Gujarat Electricity Board for getting power supply and on 14-7-1960 the Board agreed to provide necessary supply of electricity on the condition that the assessee paid a sum of Rs. 92,400 towards the estimated cost of laying new single circuit line and even though the cost was fully borne by the assessee, the service line would remain the property of the Board and would be maintained by the Board.

The assessee paid the amount and in due course the lines were laid and the assessee started getting supply of electricity to run the factory.

The assessee claimed deduction for the sum of Rs. 92,400 being payment made to the Electricity Board as revenue expenditure. Their Lordships held that the assessee could be said to have set up its business when it received the power connection and not earlier although the machinery had been installed earlier. Therefore, the assessee cannot be said to have set up its business when it incurred the expenditure of Rs. 92,400 and the amount was not deductible as revenue expenditure. Two other Bombay High Court decisions in Bhodilal Monghraj & Co. (P.) Ltd. v. CIT (supra) and CIT v. Forging & Stamping (P.) Ltd. [1979] 119 ITR 616 (Bom.) have also dealt with the same issue and therein also. Their Lordships held that the expenditure incurred prior to the setting up of the business could not be allowed as revenue expenditure. It would thus emerge from the various Bombay High Court decisions mentioned in the immediately proceeding paragraph and the Gujarat High Court decision in CIT v. Sarabhai Sons (P.) Ltd. (supra) that in the case of newly started concern, any expenditure incurred prior to the setting up of the business cannot be allowed as revenue expenditure. The facts of the present case have been stated above already. Installation of plant and machinery of the assessee-company was completed in December 1974.

Production actually commenced with effect from 1-1-1975. It is obvious that the expenditure in question which had been incurred for procuring electrical energy had been incurred before the business was actually set up. This was one of the grounds on which deduction claimed by the assessee for the said amount in the assessment year 1975-76 was rejected by the ITO. The learned AAC also upheld

the ITO's finding and conclusion noticing that in the directors' report dated 26-12-1974, pertaining to the assessment year 1975-76, it was stated that regular production was now being started. This decision and the findings of the ITO and the AAC were accepted by the assessee. It has to be held on the facts that the expenditure in question was incurred for the purpose of setting up of the assessee's factory and, therefore, it was incurred prior to the setting up of the business and, hence, it would not be allowed as revenue expenditure.

14. Another aspect of the issue is that in the case of an assessee following mercantile system of accounting, expenditure has to be claimed in the previous year in which it is incurred or liability arises in view of the Supreme Court decision in the case of Kedarnath Jute Manufacturing Co. Ltd. v. CIT [1971] 82 ITR 363. The date of actual payment of the amount representing the expenditure has no relevance at all. In the present case the assessee itself claimed, on mercantile basis, deduction for the expenditure in the previous year ending 30-6-1974, relevant for the assessment year 1975-76. The deduction of claiming the expenditure again in the assessment year 1976-77, did not arise. In this context the learned counsel for the assessee has invited our reference to certain observations occurring at pages 388-389 of the Gujarat High Court in the case of CIT v. Gujarat Mineral Development Corporation (supra). These, in our view, are not relevant being on entirely different facts. On this score also the claim of the assessee deserved to be rejected.

15. Yet another aspect of the issue is that in the case of a newly set up concern, the expenditure incurred prior to the commencement of business, can be either capitalised and added to the initial cost of the plant or if covered by Section 35D(2), then it can be treated as deferred revenue expenditure and allowed over a period of 10 years. The remaining expenditure, whether revenue or capital, is the assessee's dead loss.

16. The learned Commissioner (Appeals) allowed the claim of the assessee following the Bombay High Court decision in CIT v. Excel Industries Ltd. (supra) and the Supreme Court decision in the case of Oil Mills (P.) Ltd. v. CIT (supra). The learned Commissioner (Appeals), however, overlooked the fact that these

cases related to expenditure incurred in the course of an existing business and, therefore, these were not applicable to the present case. Moreover, the learned Commissioner (Appeals), having held that the expenditure was revenue expenditure, did not proceed further and consider whether it would be allowed as a deduction even though it had been incurred prior to the commencement of the business. As stated above, such expenditure irrespective of whether it is revenue or capital, can either be capitalised and added to the initial cost of the plant or it can be allowed under Section 35D. The expenditure claimed by the assessee does not fall under either of these categories and, therefore, it was not admissible as deduction even if it was revenue expenditure.

17. It has also been held that the expenditure in question was capital expenditure. This view was taken by the ITO in the assessment year 1975-76 and was upheld in appeal by the AAC and was accepted by the assessee. In fact in the assessment for the assessment year 1976-76 initially the assessee itself proceeded on that basis and claimed deduction for one-tenth of the expenditure only. Later on, in the course of the appeal proceedings, additional ground was raised before the learned Commissioner (Appeals) claiming that the expenditure in question was admissible in full as revenue expenditure. As held already, in our view, the expenditure in question cannot be allowed as revenue expenditure, having been incurred prior to the setting up of the business. Even as capital expenditure, as already stated, it could either be considered under Section 35D or it could be added to the initial cost of the plant for grant of depreciation but neither of the two cover the said expenditure. The expenditure is thus dead loss to the assessee and the ITO had rightly disallowed the same. We cancel the order of the learned Commissioner (Appeals) and restore that of the ITO, though for different reasons.