

Situ Electro Instruments (P.) Vs. Ito

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Sep-18-2007

Judge : J S Reddy, P M Devi

Appellant : Situ Electro Instruments (P.)

Respondent : ito

Judgement :

1. This is an appeal filed by the assessee and is directed against the order of the Commissioner (Appeals)-X, Mumbai 15-6-2004 for the assessment year 2001-02 on the following grounds: 1. In the facts and circumstances of the case and in law, the learned Commissioner (Appeals) erred in not accepting plea and prayer that inasmuch as sum of Rs. 55,98,988 constituted expenditure of a revenue nature expended by the appellant during the impugned previous year in connection with the business of your appellant, the same was fully deductible in the computation of total income under Sections 28, 35, 37 and/or any other applicable provisions of the Act.

The Commissioner (Appeals) erred in adverting to irrelevant considerations and/or in not referring to the submissions made before him.

2. In the facts and circumstances of the case and in law, the learned Commissioner (Appeals) erred in confirming levy of interest under Section 234B of the Act.

3. In the facts and circumstances of the case and in law, the learned Commissioner (Appeals) erred in confirming levy of interest under Section 234D of the Act.

2. The facts as submitted by the assessee before the assessing officer are extracted, for convenience: The assessee-company is engaged in the business of manufacturing specialised engineering goods.

In the regular course of our business, we supply goods to customers such as Electricity Boards BEST Undertaking, Nuclear Power Projects for their highly specialised applications.

Each plant of our customer is ordinarily unique tailor-made plant in terms of infrastructure and desired applications. This poses challenges for us inasmuch that the goods which are supplied to them should match their plant and other intended requirements with precision to that extent none of the items that we supply is a standardised item.

Development of a non-standardised item to suit such requirement of a customer necessarily involves substantial study of client requirement conceptual thinking on our part experimentation, model testing, etc. before we are in a position to satisfy ourselves that we can make offer to the client or give any contractual commitment to our client. Any adventurous commitment to the client without ourselves being confident has the potential risk of embarrassment litigation and damages. Exposure of faulty thoughts to the client would mean loss of reputation and goodwill. It is hence that we need to be extremely careful in our homework even before we approach the client with any proposal or offer. After all we have to compete against multinationals like Siemens, ABB, Alstom, etc.

The process of development begins either after the tender is floated by a client or when we hear the news from company announcements or other sources that a particular customer is thinking of setting up a plant for which he is likely to source certain engineering products belonging to our field. We do, therefore, start upon conceiving the probably requirements intricacies that the application is likely to involve the level of standards which the product may need to meet in different

contingencies when it is interfaced with other components of the plant etc.

One alternative for us may be to make matter little easy may be to approach some overseas consultants - but that would be firstly expensive secondly uncertain of result thirdly some of them themselves may be our competitors at the bid.

In this background we ourselves on in-house basis do study the details; apply our mind and carry on with the experimentations. Our research team comprises of 25 people (like qualified electronic engineers, software developers) who are constantly working on such jobs. They do travel for seeking advice for collecting information for requesting companies to share some details about what they want to achieve in terms of application, etc.

The major components of development expense comprise of expenditure on personnel, their travel expenses, expenditure on items purchased for developing the models, prototypes or demo units for experimentation and testing. The expenses would be on a regular basis for one or the other engineering product.

Kindly note that at this stage of development we neither have any assurance nor any commitment from any one. It is not as if that we have secured any order and the client has agreed to fund the expenditure. Ironically, it is only if we are ready ourselves that we can expect to receive the order.

There is no guarantee that the product on which we have readied ourselves will result in our being able to procure the order. The order may eventually be awarded to some other competitor, the client may withdraw the tender, he may alter the design. In all such situations, the expense incurred by us would end up in a total loss.

The product developed by us will almost always be tailor-made and specific to a particular plant of a specific customer. There can, therefore, be only one single taker of a given product. Hence, each order that we target needs independent development in its own right.

There have been instances in the past that we failed to accomplish result at the end of development in time. Also there have been instances where despite our

hard labour. We could not compete with overseas suppliers or MNC's. But in order to be in this business where technology development is dominant there is no alternative but to incur such expenditure.

All the expenses (of which break up has been given) comprise of revenue items. It is not as if that we have created or installed any capital equipments for ourselves by incurring the expenditure. It is also not as if that the expenditure involves any payment to anyone who by virtue thereof agrees to endow some recurring contractual benefit to us. We do, therefore, submit that the entirety of expenditure should be allowed as deduction.

The assessee-company again submits its submission vide letter 24-3-2004 which is also reproduced as under: This refers to the discussion that we had with your Honours yesterday. Thereafter we have vide our written and oral submissions elaborated the nature of expenditure of Rs. 69,98,735 incurred by us during the year. We have also elaborated upon the business compulsions under which these expenses are being incurred by us.

We reiterate having submitted to your Honours that these expenses are pure revenue expenses in the nature of salary, tour, travel, consultation fees, purchases for experimentations on prototypes, etc.

The personnel who were engaged in this activity worked on multiple products. They also attended to the normal working operations of the unit.

Incurrence of such expenditure is our regular feature. The expenditure has not resulted in creation of any asset. It has not added to our installed capacity. It was a cost we had to incur for advertising and proving our credentials. Had we not incurred these costs ourselves we would have had to spend much more by retaining consultants to advise us for every enquiry that we came across. We have been able to effect our sales and have been able to withstand competition onslaught from MNC's only because of these regular costs which help us control our quotations to customers and enable us to prove our credentials to the customer.

These costs have no recurring value as each product that we manufacture is a non-standardised product.

It seems clear that if we had written off these expenses to profit and loss account there would have been no controversy on admissibility thereof as they are pure and simple revenue expenses like salary, tour, travelling books consumable, etc.

The major reservation expressed by your Honours was that since the treatment in the books is different it is impermissible for your Honours to consider the claim. In this behalf at Annexure A are some extracts which suggest that a rightful claim is not tied down to treatment in the books of account. These authorities also suggest that treatment in the books of account is not at all determinative of the issue. Yours Honours may kindly consider these authorities.

At Annexure B are certain extracts which suggest that the Courts have been pleased to admit allowance for expenses of a revenue nature in the year of incurrence in spite of the circumstance that the expense so incurred has been treated differently in the books of account as deferred revenue expenditure.

2.1 The assessing officer treated the expenses in question as deferred revenue expenditure and allowed the same only to the extent which the assessee has recorded in its books of account as revenue expenditure.

The first appellate authority after considering the submissions of the assessee in his order had rejected the assessee ground mainly on account of the following: (i) The project on which the expenses were made was not commissioned during the year under consideration; (ii) The assessee-company itself has not debited the entire amount to the profit and loss account and suo motu deferred it for write off in the subsequent years in the accounts; (iii) The assessee has not received any business on incurring the said expenses; (iv) The assessee has voluntarily treated part of the expenditure as capital expenditure in its books of account and it is under an obligation to explain the circumstances for treating it as deferred revenue expenditure in its books of account.

(v) What is substantially capitalised by the assessee in the balance-sheet, cannot be changed when it comes to the stage of computation of income.

He rejected the plea of the assessee. Aggrieved, the assessee is before us.

3. Shri D.B. Shah, the learned Counsel for the assessee repeated the contentions made before the revenue authorities. The sum and substance of his contention is that the assessee is continuously in the lookout for fresh business and that it is necessary on its part to develop tailor-made products of non-standardised items to suit the requirements of customers and offer them to certain clients. Such development involves conceptual thinking, experimentation, model testing, survey of clients' requirements, giving demonstrations, etc. and the expenditure incurred for these things are revenue in nature. That treatment of a particular item in the books of account, does not determine the allowability or otherwise of that item as expenditure in the income-tax computation. That the revenue has in fact agreed that the contention of the assessee that this expenditure is revenue expenditure and has to be allowed as such and that the only dispute is as to the quantum of deduction that has to be granted and the year in which such deduction has to be granted. That the entire expenditure incurred by the assessee are wholly and exclusively for the purpose of business and hence has to be allowed. He relied on several case laws which will be dealt with by us during the course of our decision below.

4. On ground No. 2, i.e., charging of interest under Section 234B where income is offered to tax under Section 115JB he relied on the following case laws: 5. The third ground is against the charge of interest under Section 234B/D. The case of the assessee is that this section is introduced with effect from 1-4-2003 and that interest under this section cannot be charged prior to the assessment year 2003-04. For this proposition he relied on the judgment of the Delhi Bench of the Tribunal in the case of Glaxo Smithkline Asia (P.) Ltd. v. Asstt. CIT .

6. Smt. Malati Sridharan, the learned departmental representative arguing on behalf of the revenue strongly relied on the order of the Commissioner (Appeals) and submitted that the assessee in its books of account maintained under the Companies Act has treated above expenditure as a deferred revenue expenditure.

She submitted that only an amount of Rs. 13,99,747 was debited to the profit & loss account and the balance amount of Rs. 55,98,988 has been treated in the balance-sheet as deferred revenue expenditure. The expenses of Rs. 69,98,735 pertained to different projects which have not taken up in the year under consideration. She pointed out that the assessee had in its own submissions, stated that it may or may not get the contract for execution of these projects. She relied on Sections 4, 2(45) and 145 and submitted that Section 145 lays down the manner of computation of income chargeable under the heads "Profits and gains of business or profession" and "Income from other sources" and mandates that the same be in accordance with the method of accounting regularly employed by the assessee and the only exception to this general principle is when the assessing officer is not satisfied about the correctness or the completeness of the accounts of the assessee or where the accounting standards notified in Sub-section (2) of Section 145 have not been regularly followed. She vehemently contended that the assessee after having made entries in its books of account consistent with the method of accounting followed by it, he cannot be permitted to seek assessment of his income for income-tax purposes on a different basis on the ground that another basis may also be permissible under the method of accounting followed by the assessee. She relied on the following case laws in support of her contentions: Madras Industrial Investment Corpn. Ltd. v. CIT .

7. With regard to ground No. 2 she submitted that charging of interest under Section 234B is consequential and mandatory, even while computing book profits under Section 115JB. Similarly on charging of interest under Section 234D she submitted that the amendment was effective from 1-6-2003 and that all proceedings taken thereafter, authorise the assessing officer to levy the interest.

8. Rival contentions heard. On a careful consideration of the facts and circumstances of the case and on a perusal of papers on record we hold as follows: 8.1 Before we decide on the issue the comparative sales statement of the assessee-company for the last 10 years is extracted below for ready reference: 8.2 The nature of the expenditure incurred and the years in which it was written off in the books of account are extracted for ready reference: A close look at the nature of these expenditures shows that no asset has been acquired by the

assessee. Similar expenditure is being incurred by the assessee year after year. The following gives the details: A close look at the above facts clearly shows that the assessee has been incurring expenditure on its account year after year. The facts presented by the assessee, i.e., that they are in the business of developing specialised engineering products such as embedded software for defence establishments, etc. is not disputed by revenue. It is also not disputed that the assessee is required to develop through its own R&D certain model products which can be offered to various defence and other establishments. Both the assessing officer and the Commissioner (Appeals) also recorded that such products developed by the assessee may never be purchased by any customer. On these facts we have to necessarily conclude, that under the peculiar facts and circumstances of the case and the line of business that the assessee is, it is required to mandatorily incur this expenditure to be in business. Thus the expenditure has been wholly and exclusively expended for the purpose of business.

8.3 Now we come to the issue as to whether it is a capital expenditure.

It is not the case of the revenue that the expenditure incurred is capital expenditure. The only ground of disallowance is that the assessee has not written off the entire revenue expenditure in the year under consideration in its books of account. There is no dispute of the fact that the expenditure in question has crystallised during the year and has been incurred for the purpose of business. It is also not in dispute that no asset of enduring nature has been acquired by the assessee on incurring of this expenditure. To put it in simple words, the expenditure is only towards research and development of new products or for modification of existing products, with an intention of offering the same for sale.

8.4 This leads us with the only question as to whether it is permissible for the assessee to claim the entire expenditure as revenue expenditure while filing its return of income, while on the other, under the Companies Act, adopted a method of accounting wherein only part of the expenditure in question was debited to the profit & loss account. The issue, in our considered opinion, is covered in favour of the assessee and against the revenue by a number of decisions which were cited

before us by the learned Counsel for the assessee. In the Hyderabad Bench in the case of Amar Raja Batteries v. Asstt. CIT (2004) 91 ITD 280, which is squarely applicable to the facts of this case, it was held that - The undisputed fact is that the expenditure is in the revenue field. The only issue to be considered is whether the assessee can claim the entire expenditure in this year itself, even though it had written off this expenditure in the books over a period of five years. Though the assessee has written off the expenditure in its books of account over a period of five years, it must be allowed in its entirety in the year in which it was incurred, if it is revenue expenditure and if it is wholly and exclusively incurred for the purposes of business. The assessee had launched a new product and incurred heavy advertisement expenditure. The period for which the assessee can be said to have secured benefit by incurring this expenditure cannot be reasonably estimated. The undisputed fact is that the new product launched may fail to take off in the year of launch itself or may have a long life as a product. There is no way in which it can definitely be estimated that the benefit of the expenditure would last for a particular period of time. The entries in the books of account do not clinch the issue either way and they do not determine the allowability or otherwise of the expenditure.

The entire advertisement expenditure for product launching is to be allowed in this year. The disallowance of Rs. 1,03,63,401 made by the assessing officer on account of advertisement expenditure is deleted.

It is well settled that the entries in the books of account cannot be the basis whether a receipt is taxable or not or whether expenses are allowable as a deduction or not. Courts are compelled to go by the true nature of receipts and not to go by the entries made in the books of account. If any authorities are required to be cited on this case on this issue we derive strength strongly from the following decisions: 8.5 Coming to the decisions relied upon by the learned Counsel for the revenue we find that the same has been considered by the Hyderabad Bench of the Tribunal in the case of Amar Raja Batteries (supra). The expenditure, as already stated, is of revenue in nature and no enduring benefit accrues to the assessee. Such expenditure has been claimed as revenue expenditure in the earlier years by the assessee, though in the accounts they had given a different treatment. Thus for all these reasons we allow this ground of the assessee.

9. Coming to the ground of charge of interest expenditure under Section 234B on book profits determined under Section 115JB, we find that the issue is covered in favour of the revenue and against the assessee by the judgment of the Special Bench of the Tribunal in the case of *Sutlej Cotton Mills Ltd. v. Asstt. CIT* (1993) 45 ITD 22 (Cal.). The Hon'ble Karnataka High Court in the case of *Jindal Thermal Power Co. Ltd. v. Dy. CIT* (2006) 154 Taxman 547 has held that interest is leviable on the profits determined under Section 115JB. Respectfully applying the same we dismiss this ground of the assessee.

10. Coming to the last ground, i.e., charge of interest under Section 234D we find that the issue is covered in favour of the assessee and against the revenue by the decision of the Delhi Bench of the Tribunal in the case of *Glaxo Smithkline Asia (P.) Ltd.* (supra). The Bench held that this is a substantive provision fastening liability on the assessee and cannot be retrospective. Respectfully following the same we uphold the contention of the assessee that interest under this section cannot be charged prior to the assessment year 2003-04.

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