* **HIGH COURT OF DELHI : NEW DELHI**

\+ **ITR No. 90 of 1985**

Judgment reserved on: September 19, 2007

% Judgment delivered on: October 05, 2007

Jay Engineering Works Ltd.
New Delhi. ...Appellant

Through Mr.Santosh K. Aggarwal, Advocate

Versus

Commissioner of Income Tax
Delhi-III, New Delhi. ...Respondent

Through Mrs. P.L. Bansal, Advocate

Coram:

HON'BLE MR. JUSTICE MADAN B. LOKUR
HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether the Reporters of local papers may be allowed to see the judgment? Yes

2. To be referred to Reporter or not? Yes

3. Whether the judgment should be reported in the Digest? Yes

MADAN B. LOKUR, J.

At the instance of the Assessee, the following questions have

been referred for our opinion under Section 256(1) of the Income Tax Act, 1961 (for short the Act) in respect of the assessment year 1979-80: -

> 1. Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in holding that the pre-operative expenditure of Fuel Injection Equipment Project amounting to Rs.20,14,158/- was a capital expenditure?
>
> 2. Whether on the facts and circumstances of the case, Tribunal was right in deleting the addition of Rs.41,666/- on the ground that the same was not disallowable u/s 37(3) read with rule 6B?

2. With regard to the second question, the tax effect of the amount in question is quite inconsequential and, therefore, we decline to answer this question and return the reference unanswered.

3. The first question is really the only substantive question that would require our consideration.

4. The Assessee is a company which manufactures fans and sewing machines at various units, including in Hyderabad. The Assessee decided to expand its activities and, therefore, undertook a

Fuel Injection Equipment Project (for short the Project) in Hyderabad. In respect of this Project, the Assessee incurred an expenditure of Rs.1.56 crores out of which it spent Rs.1.35 crores towards acquisition of plant and machinery. This amount is not in dispute. The balance amount consisting of Rs.20,41,158/- is in dispute and the break up of this amount is as follows: -

Particulars	Amounts/Rs.
1. Testing Charges	51,021
2. Interest/Commitment Charges	7,39,019
3. Bank Commission	2,82,944
4. L.C. Opening	88,461
5. Salary/Perquisites/Motor Car upkeep	1,16,254
6. Foreign Travelling	6,25,304
7. Consultants Fees	1,09,000
8. Miscellaneous Expenses	
– Travelling Charges of IFCI	457
– Stamp – ICICI	45
– Consultancy fees to Dev Sons for existing Machines	1,050
– Interview Charges	27,603
Total	20,41,158

5. According to the Inspecting Assistant Commissioner (the Assessing Officer) the above expenditure is in the nature of expenses incurred in connection with the setting up of a new line of business and, therefore, it should have been capitalized. In other words, the Assessing Officer rejected the contention of the Assessee that the expenditure incurred was revenue in nature. The view taken by the Assessing Officer was upheld by the Commissioner of Income Tax (Appeals) as well as by the Income Tax Appellate Tribunal (for short the Tribunal).

6. During the course of hearing, neither learned counsel required us to go into each item of expenditure which aggregate to the sum of Rs.20,41,158/-. Indeed, we do not think it necessary to do so because there is broad agreement that the said items of expenditure are pre-operative in relation to the Project and the only question that is required to be decided is whether the expenditure falls in the category of revenue expenditure or in the category of capital expenditure.

7. Among the decisions cited, the first was ***India Cements Ltd. v. Commissioner of Income Tax, Madras, [1966] 60 ITR 52***. In this

decision, a large number of cases have been referred to by the Supreme Court and two important conclusions flow out from a reading of this decision. The first is that the law as contained in the English Income Tax Act has no relevance to cases arising under the Indian Income Tax Act. This is of some importance because the Tribunal, while deciding against the Assessee, has relied upon ***Atherton v. British Insulated and Helsby Cables Ltd., (1925) 10 Tax Cases 155***. The second important conclusion is the approval of the law laid down by the Supreme Court in its earlier decision in ***Bombay Steam Navigation Co. Ltd. v. Commissioner of Income Tax, [1965] 56 ITR 52*** wherein it was observed as follows: -

> "Whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. The question must be viewed in the larger context of business necessity or expediency. If the outgoing or expenditure is so related to the carrying on or 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."

8. Keeping the above conclusions in mind, learned counsel took

us through several other decisions rendered by various Courts including this Court.

9. In ***Prem Spinning and Weaving Mills Company Ltd. v. Commissioner of Income Tax, U.P., [1975] 98 ITR 20***, the assessee was a limited company running a spinning and weaving mill as well as a new project of straw-board manufacturing factory. The question before the Court was whether the expenditure incurred for the new venture was a revenue expenditure or not. The Allahabad High Court noted that control over the existing spinning mill as well as the new project of straw-board manufacturing factory was in the hands of the assessee and it was effectively one establishment controlling both the units. The business of the two units were interconnected; the profit and loss account of the company embraced the business of the straw-board manufacturing factory and the balance sheet represented the financial picture of the company after taking into consideration the affairs of both the units. Relying upon ***Produce Exchange Corporation Ltd. v. Commissioner of Income Tax, [1970] 77 ITR 739***, it was held that unity of control is a decisive test and not the nature of the two lines of

business. It was further held that if the management, the trading organization, the administration, the funds and the place of business were common, then it cannot be said that the two ventures are two different businesses carried on by the same company.

10. In ***Commissioner of Income Tax, Gujarat II v. Alembic Glass Industries Ltd., [1976] 103 ITR 715***, the assessee was a company manufacturing glass at Baroda. The assessee desired to set up a new glass manufacturing unit in Bangalore and the question that arose was whether the amount spent for the undertaking in Bangalore should be taken on the revenue account or on the capital account. The Gujarat High Court took into consideration the fact that the business organization, administration and fund of both the units of the assessee are common; there was, therefore, complete interconnection, interlacing and interdependence between the two units. The fact that the Bangalore unit is many miles away from Baroda was of no consequence since the head office at Baroda controlled the affairs of both the units.

11. ***Commissioner of Income Tax v. Expanded Metal***

Manufacturers, [1991] 189 ITR 317 was a case in which the assessee was engaged in the business of expanding of iron metal by a mechanical process and its supply. It started a new business of manufacturing of rubber products. Relying upon ***Prem Spinning and Weaving Mills Company Ltd.***, it was held that the expenditure incurred for setting up a unit for the manufacture of rubber products was a revenue expenditure.

12. In ***Commissioner of Income Tax v. Modi Industries Ltd. (No.3), [1993] 200 ITR 341*** the supplementary factors earlier laid down were reiterated viz. whether the management of the new business and the earlier business is the same and whether there is also unity of control and a common fund. The assessee in this case was engaged in the manufacture of various commodities like sugar, vanaspati, soaps, paints and varnish, torch and lantern and it was intending to diversify its activities by manufacturing a new commodity, that is, special alloy wire and billets. Based on the finding that the new business and the earlier business is the same, in a broad sense namely that the activity is of manufacture and that there is unity of control and a common fund, it was held that the business of manufacture of special alloy wire and billets

was an extension of the existing business and not a new business. Consequently, the expenditure incurred was held to be a revenue expenditure.

13. Finally, in ***Veecumsees v. Commissioner of Income Tax, [1996] 220 ITR 185 (SC)***, the assessee ran a jewellery business and then commenced business in the exhibition of cinematographic films. The assessee obtained loans for building a cinema theater and the question was whether the interest payable on the loans borrowed for the new business was a revenue expenditure or not. While answering the question in favour of the assessee, the Supreme Court found that the two businesses were composite in the sense that there was interconnection, interlacing or interdependence between the jewellery business and the cinema business.

14. On an appreciation of the law laid down by the various decisions referred to above, it is clear that the nature of the new business is not a decisive test for determining whether or not there is an expansion of an existing business. The nature of the business could be

as distinct as a jewellery business and a business of cinematographic films; it could be as different as manufacture of metal alloys and manufacture of rubber products. What is of importance is that the control of both the ventures, the existing venture as well as the new venture, must be in the hands of one establishment or management or administration. The place of business of the existing business and the new business may not be in close proximity – it could be as far apart as Baroda and Bangalore. However, the funds utilised for the management of both the concerns must be common as reflected in the balance sheet of the company.

15. In other words, there may be several permutations and combinations that may arise for determining whether the expenditure is revenue or capital and each case must, of course, be dealt with on the broad principles that have been accepted by the Courts as are mentioned above.

16. Applying these principles to the present case, it is quite clear to us that the control over the two units is in the hands of the same

management and administration. There is no doubt on this score and in fact, the annual report of the Assessee, which has been shown to us by learned counsel, makes a reference to the Project at Hyderabad. There can be no dispute from the facts that have been placed before us on record that the new venture was managed from common funds and there is the necessary unity of control leading to an interconnection, interdependence and interlacing of the two ventures such that it can be said that the fuel injection equipment project is only an extension of the existing business of the Assessee and, therefore, the expenditure incurred by the Assessee on this Project is a revenue expenditure.

17. Learned counsel for the Revenue relied upon ***Challapalli Sugars Ltd. v. Commissioner of Income Tax, A.P., [1975] 98 ITR 167*** to contend that the expenditure incurred by the Assessee, as mentioned above, is a part of the actual cost of its assets and, therefore, this amount needs to be capitalized and added to the cost of the fixed assets of the Assessee.

18. There can, of course, be no quarrel with the proposition laid

down by the Supreme Court in ***Challapalli Sugars Ltd.*** but the facts of that case are completely distinguishable in as much as that decision did not concern itself with an extension of an existing business but concerned itself with the setting up of a new business altogether. In fact, the Supreme Court distinguished the decision in ***India Cements Ltd.*** by observing that in ***India Cements Ltd.*** the assessee at the time when it raised the loan was a running concern. In ***Challapalli Sugars Ltd.***, the case of the assessee was that it had borrowed considerable sums of money for the installation of machinery and plant and that the interest should be added to the cost of plant and machinery. As such, while calculating depreciation admissible, the interest paid should be treated as a part of the cost of the machinery and plant to the assessee. The Income Tax Officer rejected the claim of the assessee and held that interest was an admissible item of revenue expenditure and no depreciation could be claimed thereon. The argument advanced on behalf of the assessee and which was accepted by the Supreme Court was that the interest for the period before the commencement of production (on money borrowed for the purposes of acquiring and installing the machinery and plant) should be included in the actual cost

of the plant and as such capitalized for the purpose.

19. We are of the view that the decision in ***Challapalli Sugars Ltd.*** is clearly inapplicable to the facts of the present case. On the other hand, the law laid down by the Supreme Court in ***India Cements Ltd.*** would be applicable.

20. Learned counsel for the Assessee also relied upon ***E.I.D. Parry (India) Ltd. v. Commissioner of Income Tax, [2002] 257 ITR 253*** to contend that the Assessee cannot convert capital expenditure into revenue expenditure. We are unable to appreciate the relevance of this decision. The Assessee has shown the cost of acquisition of plant and machinery amounting to Rs.1.35 crores as capital expenditure. It is only an amount of Rs.20,41,158/- that has been claimed as revenue expenditure and there is no question of converting capital expenditure into revenue expenditure.

21. Under the circumstances, we answer the question referred to us in the negative, in favour of the Assessee and against the Revenue.

The reference is disposed of accordingly.

Madan B. Lokur, J

October 05, 2007 **S. Muralidhar, J**
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Certified that the corrected copy of the judgment has been transmitted in the main Server.