* THE HIGH COURT OF DELHI AT NEW DELHI

Judgment reserved on: 16.05.2011
Judgment delivered on: 27.05.2011

\+ ITR No. 367/1992

COMMISSIONER OF INCOME TAX & ANR. ..... PETITIONERS

Vs

M/S. J.K. SYNTHETICS LTD. & ANR. ..... RESPONDENTS

Advocates who appeared in this case:
For the Petitioners : Mr. N.P. Sahni & Mr. Rakesh Sinha
For the Respondents: Mr. P.N. Monga & Mr. Manu Monga

CORAM :-
HON'BLE MR JUSTICE SANJAY KISHAN KAUL
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. The captioned reference pertains to assessment year 1982-1983. By virtue of the said reference, we have been called upon to adjudicate upon the following questions of law which have been raised on behalf of the revenue :-

> "(i). Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that in respect of sums totaling Rs.1,15,030/-, the assessee's liability had not

ceased and these amounts were not taxable under Sectio 41(1) of the Income Tax Act, 1961?

(ii). Whether on the facts and in the circumstances of the case, the ITAT was correct in law in holding that the assessee was entitled for deduction of Rs.1,86,49,403/- in respect of capital expenditure on scientific research under Section 35(i)(iv) even though the capital assets were acquired in the previous year relevant to A.Y. 1981-82?

(iii). Whether the ITAT was right in holding that expenditure incurred by the assessee on providing food and beverages to employees in a guest house was not expenditure in the nature covered by Section 37(4) of the Income Tax Act, 1961.

(iv). Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that out of payments made by the assessee to M/s. Zimmer in pursuance of the agreement dated 21.01.1980, 50% was capital expenditure and 50% was revenue expenditure?"

Question no.(i)

2. In so far as the first question is concerned, the brief facts are as follows :-

(i). The assessee had in his books of accounts credit balances favouring several parties. During the accounting year in issue, these credit balances which amounted to a sum of Rs.1,94,965/- were written off. The Assessing Officer brought these amounts to tax under section 41(1) of the Income Tax Act, 1961 (in short, IT Act). The Assessing Officer's order was sustained by the

Commissioner of Income Tax (A) [in short, CIT (A)]. The matter carried in appeal to the Income Tax Appellate Tribunal (in short, the Tribunal). The Tribunal sustained the taxability of these items (out of a total sum of Rs.1,94,965/-) in respect of which credit vouchers had been issued by the assessee on account of quantity and quality issues. This was a sum equivalent to Rs.79,935/-. As regards the rest, i.e., the sum equivalent to Rs.1,15,030/-, the Tribunal returned a finding of fact that there were merely liabilities which had been written back to the profit and loss account only to cut down paper work in the books of account. The Tribunal thus concluded that there was no cessation of liability and hence, revenue was not justified in bringing the said amounts to tax. We find that neither has the revenue has not challenged the finding as perverse nor are details provided with respect to these items. In that view of the matter, we are of the opinion that this question will have to be answered in the affirmative and against the revenue.

2.1 At this stage, it may be noted that in respect of the amount which had been brought to tax, the assessee had sought a reference which is a subject matter of question no.2 in ITR No.27/1997 for the same assessment year. Mr. Monga, who appears for the assessee both in the captioned reference as well as in ITR No.27/1997 says that he does not wish to press the said

question of law; a submission that we have noticed while dispo
of ITR No.27/1997.

Question no.(ii)

3. It is important to note that the said question was disposed of by the Tribunal by relying upon its own judgment rendered in the assessee's own case in assessment year 1981-82. The relevant facts are thus deducible from the Tribunal's order passed in the assessment year 1981-1982. It appears, the assessee had acquired capital assets used for scientific research vis-à-vis a project carried on by the assessee, in its research division, in Kota. These assets were purchased from time to time and the assessee sought to claim deduction under section 35(4) of the IT Act in respect of the said assets only in the year in which the asset was put to '*use*' for research. It appears this method was acceptable to the revenue till assessment year in issue i.e., A.Y. 1982-1983. The Assessing Officer for the first time held that a claim of Rs.1,86,49,403/- was not admissible as expenditure as it had not being '*incurred*' during the relevant accounting year. The Tribunal after a detailed discussion, in the operative part of its judgment rendered in respect of assessment year 1981-1982 observed as follows :-

> "It is, therefore, clear that there is a difference between the acquiring of an asset and bringing it into use for scientific research. Under section 35, it is only at the stage when the

> asset is brought into use for scientific research that t deduction could be claimed. This is what the assessee has done. We do not, therefore, see any difficulty in accepting the assessee's submissions. It is also eminently reasonable and safeguards the interest of Revenue. As pointed out by Shri Sharma, there may be cases, where the assessee acquires an asset ostensibly for scientific research, but never puts it to use for that purpose. As per the view of the ITO, deduction under section 35 would be admissible in such cases and the Department would be a loser. The method suggested and followed by the assessee safeguards the Revenue. We, therefore, have no hesitation in accepting the assessee's contention. However, as far as this additional ground is concerned, on the assessee's own reasoning and submissions, this will have to be rejected. This amount is admissible as a deduction for the assessment year 1982-1983."

4. The net result was that the Tribunal in its order for the assessment year 1982-83 simply followed its own order passed in assessment year 1981-1982 and allowed the deduction.

5. Mr. Sahni appearing for the revenue has contested this position. Mr. Sahni has submitted before us that the only issue which arose for consideration in Assessment Year 1981-1982 was whether the assessee was right in claiming the deductibility of the expenditure in A.Y. 1982-1983 as against that found by the Assessing Officer whereby he had veered to the position that the

expenditure was claimable in the A.Y. 1981-1982. Mr. Sahni fu contended that the Tribunal should have decided on merits the admissibility of the expenditure in terms of the then prevailing provisions of the Act. In this regard, Mr. Sahni referred to the provisions of section 35(2)(ia) of the Act. (to CHECK). The said provisions reads as follows :-

> "in a case where such capital expenditure is incurred after the 31st day of March, 1967, the whole of such capital expenditure incurred in any previous year shall be deducted for that previous year."

5.1 Based on the aforesaid provision, Mr. Sahni contended that the statute used the word 'incurred' as against 'used' and hence the expenditure on scientific research could only be allowed in the year in which it was incurred and not when the asset was used. It was Mr. Sahni's contention that the Tribunal should have decided the issue dehors its decision in the A.Y. 1981-82.

5.2 As against this, Mr. Monga said that the Tribunal while rendering its decision in A.Y. 1981-1982 had examined this very issue which could not be reopened at the behest of the revenue in the assessment year in issue i.e., A.Y. 1982-83.

6. Both counsels however did agree that in the orders of the authorities below there was a reference and discussion with regard to the provisions of section 35(2)(ia) of the Act. Based on the

provisions of section 35(2)(ia), the Assessing Officer had disallc expenses incurred prior to 01.01.1981. Consequently, apart from a sum of Rs.34,80,978/-, the balance sum equivalent to Rs.1,86,49,403/- was disallowed. It could not, therefore, be contested by Mr. Monga that since there was a discussion with regard to the provisions of section 35(2)(ia) of the IT Act, the Tribunal was required to direct its attention to the impact of the said provision which were not noticed in the order of the Tribunal rendered in respect of A.Y. 1981-82.

6.1 In these circumstances both counsels agreed that the matter be remanded to the Tribunal. It is ordered accordingly. The Tribunal shall re-examine the issue. While re-examining the issue, it will examine its decision rendered in respect of A.Y. 1981-82 in the light of the provisions of section 35(2)(ia) of the IT Act.

Question no.(iii)

7. In so far as question no.(iii) is concerned, the Tribunal has merely followed its decision in A.Y. 1981-82. The revenue has not been able to inform us as to whether the decision rendered by the Tribunal on the same issue in the A.Y. 1981-82 was challenged before the High Court. In these circumstances, we do not propose to disturb the findings of the Tribunal on this aspect.

Question no.(iv)

8. As regards question no.(iv), the Tribunal by the impugned judgment has come to a conclusion that the payments made by the assessee for acquiring technical know-how from a foreign collaborator to set up a new plant had to be disallowed as revenue expenditure only to the extent of 50%. In other words, the Tribunal came to the conclusion that 50% of the expenditure incurred by the assessee was on in the nature of capital expenditure while the balance was on revenue account. In coming to this conclusion, the Tribunal in paragraphs 67 and 68 has made the following observations :-

> "67. That, however is not the position in the assessee's case. We have already extracted clause 1 of the agreement which states that Zimmer would provide the assessee the documents for erection of a plant. Item 1 is the list of equipments to be manufactured in India and the descriptions of materials for construction. Item 2 is the equipment drawings item 3 is the list of measures and control equipment, item 4 is utility requirements, item 5 is mechanical safeguard thereon, item 6 is general play lay out, elevations and sections indicating the position of all equipments. In fact, all items 1 to 8 inclusive, relate to know-how of putting up of the plant. Items 9 to 16, however, are in connection with the product of the assessee. Clause 9 makes it very clear that all these

documents and informations would be utilized for t erection and operation of the plant.

68. On the above analysis, having found as a fact that a part of the payment related to the design for the erection of the plant we cannot accept the assessee's contention that the entire amount is revenue in nature. Neither can we accept the Department contention that the entire amount is capital in nature. A part of the know-how is definitely relatable to the process of manufacture and, therefore, it would be governed by the principle in Alembic Chemical Works' case. So, a suitable allocation must be made between the capital and revenue. On this point, unfortunately, neither the Department, or the assessee has addressed us. Therefore, we have to give some estimated allocation. We are of the opinion that 50% of the expenditure may be considered relatable to the capital. ON that basis, 50% of the claim would be admissible. This ground is partly allowed."

8.1 According to us, the Tribunal's observation that since there was no assistance rendered by the counsels for the revenue and the assessee as regards what part of the expenditure was incurred towards operations, it decided to apportion the expenses on an ad-hoc basis, is a methodology which according to us ought not to have been adopted specially in the circumstances that it was possible to allocate expenses to capital and revenue account more realistically with the assistance of parties in that regard. The Tribunal ought to

have given an opportunity to the parties to place on record rele material.

9. Both counsels are agreed that the issue be remanded to the Tribunal for making a more realistic apportionment of expenses towards capital and revenue. We agree with the suggestion of the counsel. The matter is remanded to the Tribunal to do the needful in this regard. The Tribunal shall accord necessary opportunity to both parties to lead evidence in this regard.

10. With the aforesaid observations, the reference is disposed of.

RAJIV SHAKDHER, J

SANJAY KISHAN KAUL, J

MAY 27, 2011
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