

The Commissioner Of Income Tax, Madurai ... vs M/S Saravana Spinning Mills Pvt.Ltd on 10 August, 2007

Equivalent citations: 2007 AIR SCW 5196, 2007 (7) SCC 298, AIR 2007 SC (SUPP) 741, 2007 TAX. L. R. 741, (2008) 202 TAXATION 196, (2007) 7 SUPREME 156, (2007) 9 SCALE 697, (2007) 293 ITR 201

Bench: S. H. Kapadia, B. Sudershan Reddy

CASE NO.:

Appeal (civil) 7604-7605 of 2005

PETITIONER:

The Commissioner of Income Tax, Madurai etc. etc

RESPONDENT:

M/s Saravana Spinning Mills Pvt.Ltd

DATE OF JUDGMENT: 10/08/2007

BENCH:

S. H. Kapadia & B. Sudershan Reddy

JUDGMENT:

J U D G M E N T With Civil Appeal Nos. 7606, 7597-98, 7596, 7599 and 7603 of 2005 KAPADIA, J.

Aggrieved by the common judgment dated 29.4.2005 passed by the High Court of Judicature at Madras in Tax Case (Appeal) Nos. 53/2004 etc., the Department has come to this Court by way of a batch of civil appeals. For the sake of convenience, we have set out hereinbelow the facts in the lead case of M/s Saravana Spinning Mills Pvt. Ltd. (Civil Appeal Nos. 7604- 7605/2005).

2. In this group of civil appeals we are required to decide the extent and scope of Section 31(i) of the Income Tax Act, 1961 as it stood during the accounting years ending 31.3.1993 and 31.3.1994.

3. For this purpose, we quote hereinbelow Section 31, as it stood during the relevant period:

"31. Repairs and insurance of machinery, plant and furniture.- In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed-

(i) the amount paid on account of current repairs thereto;

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof."

4. The facts in Civil Appeal Nos. 7604-7605/2005 are as follows:

M/s Sarvana Spinning Mills Pvt. Ltd. (the assessee) is a textile mill engaged in the manufacture of yarn. For the accounting year ending 31.3.1993, it claimed deduction on account of "modernisation and replacement expenses" amounting to Rs. 97,95,755.00 whereas in the case of year ending 31.3.1994 it has claimed Rs. 77,84,047.00 as deduction under the same head. The question which arises for determination in this case is whether the assessee was entitled to claim the aforestated amounts as "current repairs" under Section 31(i). This is the basic controversy in the above civil appeals. To complete the chronology of events, it may be stated that the assessee claimed the aforestated amounts as deduction in its annual returns. The aforestated figures are mentioned in the Profit and Loss account for the year ending 31.3.1994. The return for the assessment year 1993-94 was filed on 31.12.1993. It was processed under Section 143(1)(a).

Subsequently, a Notice under Section 143(2) was issued to the assessee. Pursuant to the said Notice, the representative of the assessee appeared. He contended that during the previous year, the assessee had installed three Ring Frames at the cost of Rs. 23,99,855.00. According to the assessment order, the assessee claimed the cost of the new machinery as revenue expenditure on the ground that the expenditure involved should be treated as current repairs, since the new machinery was installed only as a replacement of the old machinery, which had become derelict (see page 93 of the Paper Book). According to the assessee, the whole Textile Mill was a "Plant" and the Ring Frames was one of the 25 machines which constituted one single process and, therefore, replacement of the frames be treated as replacement of part of the Plant/ Total Machinery and not replacement of a machine. The claim of the assessee was disallowed on the ground that the expenditure was on capital account; that it was not a revenue expenditure as the assessee had obtained enduring benefit by replacing the old machine with new machine. The claim of the assessee was also rejected on the ground that the machine replaced was an independent machine by itself and that it was not a part or portion of the other textile machinery (plant) as claimed by the assessee. The above arguments of the assessee were rejected by the A.O. stating, that the entire mill cannot be construed as Plant/ Total Machinery; that the said Ring Frames constituted independent and separate machines; that each Frame was capable of independent and specific function and, therefore, it was not possible to hold that the entire process as one single item of machinery of which all the others are parts. In this connection, the A.O. held that the assessee had replaced the existing old machines by new machines and thereby it had obtained enduring benefit and, therefore, the expenditure incurred thereon constituted capital expenditure and not "current repairs". Accordingly, the assessee's claim for deduction was dismissed.

5. Aggrieved by the said order, the matter was carried in appeal to the CIT(A). By Order dated 24.10.1996 the CIT(A) came to the conclusion that the expenditure related to replacement of three Ring Frames, which constituted an integral part of the production system in a textile mill and, therefore, replacement of an item cannot be regarded as installation of separate machine. Accordingly, the CIT(A) allowed the appeal and allowed the expenditure as revenue expenditure.

6. Aggrieved by the said decision of the Appellate Authority, the Department carried the matter in appeal to the Tribunal, which took the view that different segments of a textile mill are integrated parts of a continuous process and the expenditure incurred on replacement of the machines in any segment of the plant should be treated as revenue expenditure. Accordingly, the appeals filed by the Department stood dismissed.

7. Aggrieved by the decision of the Tribunal, the matter was carried in reference to the Division Bench of the Madras High Court. The High Court has given a common judgment in this batch of civil appeals. There are different assessees including M/s Saravana Spinning Mills Pvt. Ltd.. Apart from Ring Frames, different assessees have claimed deduction for other Items like simplex machines, doubling machines, cone winders, card conversion equipments. Each of these items have been treated by the Department as independent machines in the mill. At this stage, suffice it to state that the High Court had affirmed the decision of the Tribunal by holding that textile mills in Tamil Nadu have been claiming deduction on account of purchase of new machinery as revenue expenditure where the purchase was as a part of modernisation programme and where the purchase was concerning replacement of old machinery. This answer was given by the High Court in para 6 of its judgment with reference to the question framed in para 5. We quote hereinbelow para 5 of the said judgment.

"The point for consideration is, whether the modernization/current/repair expenditure is allowable as "revenue expenditure", as claimed by the assessees or the replacement of cards/blow room machinery/combing machinery etc., are to be considered as "capital expenditure", as claimed by the Revenue?"

(emphasis supplied) While disposing of the appeals, the High Court had relied upon the report of South India Textile Research Association ("SITRA"), Coimbatore. Placing reliance on the said report, the High Court held, that the process of converting fibre to yarn was one continuous interlinked process; that the output from various intermediate stages of production (Carding, Combing, Draw Frame Silvers and Roving) cannot be sold or marketed or used for any other purpose and, therefore, according to the High Court, the entire textile mill should be considered to be as one continuous process plant commencing from the blow room to the winding section. In the context of the Ring Frame the High Court held by placing reliance on the report of SITRA that Ring Frame cannot work independently, but it can work only as a part of spinning unit. According to the High Court, all the above items of machines put together would amount to one complete textile mill which is capable of manufacturing yarn. According to the High Court, all the above items of machines, though independent, are part of an integrated textile mill and, therefore, the expenditure incurred on replacement of any one of the above items of machine was an expenditure incurred to maintain production without breakdown and, therefore, the assessee was entitled to claim deduction for the said expenditure as revenue expenditure under Section 31(i). Accordingly, the High Court has affirmed the view expressed by the Tribunal. Hence, these civil appeals.

8. The issue before us is whether the expenditure incurred by the assessee for modernisation and replacement came within the connotation of the words "current repairs" in Section 31(i).

9. Before analysing Section 31(i) of the Income-tax Act, we must look at the process of manufacture and the composition of a textile mill in the broad sense. Broadly, a textile mill manufactures different varieties of yarns, namely, Cotton Yarn, Melange Yarn, Colour Melange, Polyester Viscose Yarn and the process of manufacture goes through various Segments/Divisions. The first Segment is the Blow Room. The function of the Blow Room is to clean the raw cotton thoroughly before it is fed to the Carding Department. The function of the Carding Department is to remove the waste in the cotton received from the Blow Room. In the Carding Department there are individual carding machines. They are equipped with Autolevelers to produce silver. The carding machine removes neps formed in the blow room line during the process. The carding machine produces Silver for better quality of yarn. This Silver produced in the Carding Department is carried to the Combing Department, for manufacturing Combed Yarn. After the carding operation, the impurities present in the Silver will be removed in the Combing Department. That silver which is produced in the Combing Department will pass through the Draw Frames used in the Drawing Department in order to obtain parallel fibers. These parallel fibers go through Speed Frames in the Roving Department in order to convert the Silver into thinner forms called as Roves which Roves are thereafter sent to the Spinning Department. In the Spinning Department we have what is called as the Ring Frames (machines) which are used to spin the Roves received from the Roving Department. The Ring Frames are machines, which are equipped with cleaners, removes the accumulated dirt. The Ring Frames play an important role in producing quality yarn. Thereafter, the yarn obtained from the Spinning Department goes to the Winding Department. In the Winding Department we have Autoconers in order to produce fault-free yarn.

10. From the above facts, it is clear that Blow Room, Carding, Combing, Drawing, Roving, Spinning and Winding are different Departments/Divisions in a textile mill. In each Department/Division there are several machines. Each of the above Departments/Divisions perform different functions and the functioning of each Department/Division produces a different Output which is carried forward to the next Department/Division having different machines therein. For example, in the Blow Room there are different beaters (machines) which open the raw- cotton and remove the dirt therefrom. That cotton is forwarded to the Carding Department in which there are Carding Machines equipped with Autolevelers which produces Silver which is then carried forward to the Combing Department. It is important to note that each Department has different items of machines, for example, in the Blow Room we have machines called as Beaters. Similarly, in the Carding Department we have Carding Machines with Autolevelers. If the Autoleveler fails, the Carding Machine becomes non-functional. If an Autoleveler is to be repaired then that repair would come within the connotation of the word "current repairs"

because it is a part of the Carding Machine. Even if in a given case, replacement of an Autoleveler could come within the connotation of the word "current repairs" if the old part is not available in the market. It is a "current repair" because the Carding Machine remains as an asset without any change even after repair or replacement of the autoleveler. To give an example, a Compressor is an important part of an Air-condition Machine. Repair of the Compressor will come in the connotation of the word "current repairs" in Section 31(i) of the said Act because the assessee does not replace the Air-condition Machine. At the highest, he replaces a part of the

Air-condition Machine. So is in the case of the picture tube in a Television Set, when the picture tube is replaced the Television Set is not replaced, therefore, such repairs alone can come within the connotation of the word "current repairs" in Section 31(i) of the said Act as it stood at the material time. They are effected to preserve and maintain the asset, viz, air- conditioner or carding machine. Lastly, it cannot be said that the textile mill constitutes a plant as it is one continuous process of manufacture beginning from Blow Room to the Winding Section. As stated above, different Outputs flow from different Segments of production like Blow Room, Carding, Combing, Roving, Winding etc. In the case of a textile mill there is no process whereby raw-material is fed on one end and the finished product comes out at the other end without intervention in-between. For example, in the case of continuous Casting Machine in the Steel Industry we have one continuous integrated process under which scrap (raw material) is put in and what comes out is steel or iron or aluminium. Another example, in the case of "Pasteurization Plant" we have three chambers and Ducts. In the first milk is collected, in the second it is heated and in the third it is cooled. Duct carries hot and cold water. The raw material is Raw Milk, the end product is the pasteurized milk. In the Heat chamber there is the heater. In the Cooling Chamber we have cooling plant which has a concept similar to air-condition plant. Such a process is one integrated process. Therefore, the Tribunal and the High Court erred in holding that the manufacturing process in the textile mill is one continuous integrated process.

11. An allowance is granted by clause (i) of Section 31 in respect of amount expended on current repairs to machinery, plant or furniture used for the purposes of business, irrespective of whether the assessee is the owner of the assets or has only used them. The expression "current repairs" denotes repairs which are attended to when the need for them arises from the viewpoint of a businessman. The word "repair" involves renewal. However, the words used in Section 31(i) are "current repairs". The object behind Section 31(i) is to preserve and maintain the asset and not to bring in a new asset. In our view, Section 31(i) limits the scope of allowability of expenditure as deduction in respect of repairs made to machinery, plant or furniture by restricting it to the concept of "current repairs". All repairs are not current repairs. Section 37(1) allows claims for expenditure which are not of capital nature. However, even Section 37(1) excludes those items of expenditure which expressly falls in Sections 30 to 36. The effect is to delimit the scope of allowability of deductions for repairs to the extent provided for in Sections 30 to 36. To decide the applicability of Section 31(i) the test is not whether the expenditure is revenue or capital in nature, which test has been wrongly applied by the High Court, but whether the expenditure is "current repairs". The basic test to find out as to what would constitute current repairs is that the expenditure must have been incurred to "preserve and maintain" an already existing asset, and the object of the expenditure must not be to bring a new asset into existence or to obtain a new advantage. In fact, in the present case, in the balance sheet the assessee, viz, M/s Saravana Spinning Mills has indicated the above expense as an item incurred for purchase of a New Asset. In our view, the High Court had erred in placing reliance on the report of SITRA in coming to the conclusion that the textile mill is a plant under Section 31(i). As stated above, each machine in a segment has an independent role to play in the mill and the output of each division is different from the other "Repair" implies the existence of

a part of the machine which has malfunction. If the argument of the assessee herein before us is to be accepted it would result in absurdity and it would make the provisions of Section 31(i) completely redundant. According to Shri R. Venkataraman, learned senior counsel for the assessee, the textile plant consists of about 25 machines. One of such machines is the Ring Frame. If the argument of the assessee is to be accepted, it would mean that periodically one machine out of 25 would be replaced, and on that basis, from time to time, each of these 25 machines in the textile plant would be entitled to claim allowance under Section 31(i). In our view, the A.O. was right in holding that each machine including the Ring Frame was an independent and separate machine capable of independent and specific function and, therefore, the expenditure incurred for replacement of the new machine would not come within the meaning of the words "current repairs". In the present case, it is not the case of the assessee that a part of the machine (out of 25 machines) needed repairs. The entire machine had been replaced. Therefore, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" in Section 31(i).

12. This Court in the case of *Ballimal Naval Kishore v. CIT* (1997) 2 SCC 449 approved the test formulated by Chagla C.J. in the case of *New Shorrock Spinning and Manufacturing Co. Ltd. v. CIT* (1956) 30 ITR 338 as to when the expenditure can be said to have been incurred on current repairs. In that case it was observed as follows:

"The simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as an expenditure for repairs what is really being done is to preserve and maintain an already existing asset. The object of the expenditure is not to bring a new asset into existence, nor is its object the obtaining of a new or fresh advantage. This can be the only definition of "repairs" because it is only by reason of this definition of repairs that the expenditure is a revenue expenditure.

If the amount spent was for the purpose of bringing into existence a new asset or obtaining a new advantage, then obviously such an expenditure would not be an expenditure of a revenue nature but it would be a capital expenditure, and it is clear that the deduction which the Legislature has permitted under section 10(2)(v) is a deduction where the expenditure is a revenue expenditure and not a capital expenditure."

In the said judgment, it has been further observed by Chagla C.J. that the definition of the word "repair" does not create much difficulty, but the difficulty is created by the word "current" which qualifies the expression "repair". This adjective, namely, "current" is put in by the Legislature. It indicates that the Legislature did not intend that the assessee should be permitted to claim allowance for all kinds of repairs, even though conceptually the expenditure may be revenue expenditure. The Legislature intended to stress that under Section 31(i) the permissible 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 as to whether such an expenditure comes within the etymological meaning of the expression "current repairs". In other words, even if the expenditure is revenue, it may not fall in the connotation of "current repairs" in Section 31(i). The test formulated above applies to cases where

the assessee claims allowance under Section 31(i). In the present case, the High Court has lost sight of the test to be applied for an expenditure to fall under Section 31(i) as "current repairs". It has embarked on the test which was not applicable, viz, whether the expenditure is revenue or capital in nature. The above test was not relevant during the assessment years in question as the explanation to Section 31(i) was inserted later on. In our view, applying the test laid down by Chagla C.J. in the case of New Shorrock Spinning and Manufacturing Co. Ltd. (supra) the assessee was not entitled to claim allowance under Section 31(i) for current repairs. In our view, the Ring Frame by itself constituted an independent machine with an independent function, which was replaced by a new Ring Frame giving enduring advantage to the assessee and, therefore, the expenditure incurred in that regard cannot come within the expression "current repairs". In our view, replacement of three Ring Frames constituted substitution of an old asset by a new asset and, therefore, the expenditure incurred did not constitute current repairs.

13. On behalf of the assessee, reliance was placed on the judgment of this Court in the case of CIT v. Mahalakshmi Textile Mills Ltd. reported in (1967) 3 SCR 957. In that case, the assessee carried on the business of manufacture and sale of cotton yarn. In the previous year relevant to assessment year 1956-57, the assessee spent Rs. 93,000 approx. for introduction of "Casablanca Conversion System" in its plant. The I.T.O. disallowed the claim of the assessee. The Appellate Authority agreed with the I.T.O.. Before the Tribunal, the assessee contended that the amount expended for introducing Casablanca Conversion System was current expenditure under Section 10(2)(v) of the Indian Income Tax Act, 1922 (Section 31(i) of the 1961 Act). The Tribunal inspected the spinning factory of the assessee. It studied the working of the machinery with the Casablanca Conversion System. It also studied the literature published by the manufacturer of Casablanca Conversion System. After a detailed study, the Tribunal held that on account of the stress and strain of production over a long period there was a need for change and that the assessee had replaced old parts by introducing the said System. Accordingly, the Tribunal treated the expenditure incurred for introducing the Casablanca Conversion System as allowance under Section 10(2)(v) of the Indian Income Tax Act, 1922. The High Court accepted the findings recorded by the Tribunal saying that by the introduction of the Casablanca Conversion System no new machinery or plant was installed, but the introduction of the system amounted to fitting of improved version and the expenditure in that behalf was of revenue nature. The High Court observed that certain parts of the machinery had worn-out, they needed replacement, and when it was found that the old type of replacement parts were not available in the market, the assessee had to introduce the Casablanca Conversion System. This finding was accepted by this Court in the above judgment. In our view, the said judgment has no application with the facts of the present case. At the outset, 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". In Mahalakshmi Textile Mills case (supra) the finding recorded by the Tribunal and the High Court was that old type of replacement parts were not available in the market and, therefore, the expenditure came within the expression "current repairs". That is not the case before us, hence, the said judgment has no application to the facts of the present case.

Moreover, the judgment of this Court in Mahalakshmi Textile Mills (supra) has not defined the word "asset" to mean the entire production system in the textile mill. In the said judgment, it is nowhere stated that the entire textile mill is one single asset and that it represents one single integrated process.

14. Some of the decisions cited on behalf of the assesseees are not being discussed by us as they deal with cases falling under Section 37. That section is a residuary section. Under Section 37, a particular item of expenditure may be deductible if the expenditure does not fall within Sections 30 to 36; that it should have been incurred in the accounting year; that it should be in respect of a business carried on by the assessee; that it should not be on personal account of the assessee; that it should not be in the nature of capital expenditure and that it should be spent wholly and exclusively for business. Whether expenditure is 'revenue' or 'capital in nature' would depend upon several factors, namely, nature of the expenditure, nature of the business activity etc. For example, construction of the building for self-use may be capital in nature whereas in the hands of the builder a building constitutes his stock-in-trade and, therefore, on the sale of the building the expenditure has to be revenue. Therefore, the builder would be entitled to deduct such expenditure from the sale proceeds/gross income. Therefore, whether an expenditure is revenue or capital in nature would depend on the facts of each case. We do not wish to express any opinion on the applicability of Section 37(1) in the present case. There were certain civil appeals wrongly tagged with the present batch which will be decided separately by us as they concern with Section 37(1). Hence we do not wish to express any opinion on applicability of Section 37(1).

15. Before concluding, one aspect needs to be discussed. It was submitted on behalf of the assesseees, in the present case, that although the assesseees had claimed deduction under Section 31(i), they should be permitted to claim deduction under Section 37(1) as on facts it has been held by CIT(A), Tribunal and the High Court that the expenditure was revenue in nature. We find no merit in this contention. As stated above, even if the expenditure incurred is revenue in nature, still it may not fall in the connotation of the words "current repairs" under Section 31(i) which test has not kept in mind. As held by Chagla C.J. in the case of New Shorrock Spinning and Manufacturing Co. (supra) all repairs do not attract Section 31(i) even though the expenditure is revenue in nature. Therefore, the basic test, which had not been applied, in the present case, by CIT(A), Tribunal and the High Court, is whether the expenditure came within the expression "current repairs". Instead all the three authorities proceeded on the footing that since the expenditure was revenue it constituted "current repairs". It is for this reason that we have interfered with the concurrent findings given by CIT(A), Tribunal and the High Court.

16. For the aforesaid reasons, we find merit in the above batch of civil appeals filed by the Department. Accordingly, we hold in this batch of civil appeals that the assesseees were not entitled to claim allowance under Section 31(i) of the Income Tax Act as it stood at the relevant time. Accordingly, the civil appeals stand allowed with no order as to costs.