

*** THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment delivered on : 27.02.2009

ITA 873/2008 & 1156/2008

**COMMISSIONER OF INCOME TAX-IV,
NEW DELHI**

..... Appellant

versus

INSILCO LIMITED

..... Respondent

Advocates who appeared in this case:

For the Appellant : Ms Prem Lata Bansal, Mr Sanjeev Rajpal & Mr Mohan Prasad Gupta
For the Respondent : Mr V.P. Gupta & Mr Basant Kumar

CORAM :-

**HON'BLE MR JUSTICE VIKRAMAJIT SEN
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. These are appeals preferred by the Revenue against the judgment dated 25.01.2008 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') in ITA No. 626/Del/2004 and ITA No. 16/Del/2004 filed by the Appellant/Revenue and Respondent/assessee respectively pertaining to assessment year 2000-01.

2. The Revenue had filed an appeal before the Tribunal against the order of the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)'] allowing deduction on account of provision made by

the assessee in the sum of Rs 47,15,782/- in respect of amounts payable to its employees on account of “Long Service Award”.

2.1 The assessee, on the other hand, had preferred an appeal to the Tribunal against the order of the CIT(A) in rejecting its claim of depreciation amounting to Rs 35,41,123/- on emergency/insurance spares valued at Rs 1,41,64,495/- in its books of accounts.

2.2 The Tribunal by the impugned judgment, rejected the appeal of the Revenue on the issue of allowance of provision for “Long Service Award” payable by the assessee to its employees and consequently confirmed the order of the CIT(A), and also, allowed the appeal of the assessee on the issue of capitalization of emergency/insurance spares and resultantly, reversed the order of CIT(A).

3. As stated above, the Revenue being aggrieved by the impugned judgment, has preferred these appeals on the aforementioned issues.

4. In so far as issue with respect to allowance of provision made by the assessee in the sum of Rs 47,15,782/- with regard to “Long Service Award” payable to its employees is concerned, the following brief facts require to be noted:-

4.1 The assessee, which is in the business of manufacturing of spray dried silica in technical collaboration with a German company, during the relevant period, had evolved a scheme whereby, employees who render long period of service to the assessee are, as per the scheme, entitled to

monetary awards at various stages of their employment equivalent to a defined period of time. As per the facts recorded by the authorities below, employees of the assessee who had completed 10 years, 15 years and 20 years of service; on completion of the above number of years in service, were eligible by way of an award, salary equivalent to 2 months, 3 months and 4 months respectively under the aforementioned scheme.

4.2 Based on the provisions of the scheme, the assessee engaged an Actuary to make an actuarial calculation as regards the provision which it would be required to make in respect of the liability on account of “long service award” as envisaged in the scheme evolved by it. The Actuary made his calculations by taking into account 201 employees as also factors, such as probable future withdrawals under the scheme as well as increase in salary of the employees. Based on the actuarial report, a provision in the sum of Rs 47,15,782/- was made by the assessee.

4.3 The Assessing Officer, however, rejected the deduction claimed by the assessee in respect of the said provision primarily on the ground that the grant of award was at the discretion of the management of the assessee and, therefore, could not be said to be a provision towards ascertained liability.

4.4 The assessee, being aggrieved, preferred an appeal to the CIT(A). The CIT(A) reversed the order of the Assessing Officer. He accepted the view of the assessee that as per the mercantile system of accounting

provision of liability has to be made even though it was required to be discharged at some future date. The CIT(A), after taking into account the judgments of the Supreme Court in the case of *Shree Sajjan Mills Ltd vs CIT; (1985) 156 ITR 585*, *Bharat Earth Movers Ltd vs CIT; (2000) 245 ITR 428* and *Metal Box Company of India Ltd vs Their Workmen; (1969) 73 ITR 53*, and, upon perusing the provisions of the CBDT Circular No. 47 dated 21.09.1970, came to the conclusion, that a provision for 'long service award' is akin to a provision for gratuity, and if such a provision is made on a scientific basis, it would be in the nature of an ascertained liability and not a contingent liability as contended by the Revenue. The CIT(A) was also of the view that as per the Accounting Standards notified by the Central Government u/s 145(2) of the Act, it was incumbent upon the assessee to make provision for all known liabilities on the basis of best estimate in the light of available information. The CIT(A) specifically rejected the contention of the Revenue that since there was some discretion vested with the management with regard to the payment under the "long service award" scheme that would by itself make it contingent and that the deduction should be disallowed on this ground. The Revenue carried the matter in appeal to the Tribunal. The Tribunal after recording the facts noted in the order of the CIT(A) concurred with his view and held; that as per the mercantile system of accounting, provision for liability ascertained during the course of the relevant accounting period, which is payable at a future

date, was admissible in view of the decisions of the Supreme Court relied upon by the assessee before the CIT(A) as well as in the light of Circular No. 47 dated 21.09.1970 of the CBDT.

5. Having heard the learned counsel for the Revenue as well as the assessee, we are of the view that no fault can be found with the reasoning of both the CIT(A) as well as the Tribunal. In our view, the issue raised by the Revenue before us that the liability under the “long service award” scheme of the assessee is contingent as the payment under the same scheme is dependent on the discretion of the management is a submission which deserves to be rejected at the threshold. It is well settled that if a liability arises within the accounting period, the deduction should be allowed though it may be quantified and discharged at a future date. Therefore, the provision for a liability is amenable to a deduction if there is an element of certainty that it shall be incurred and it is possible to estimate the liability with reasonable certainty even though the actual quantification may not be possible as such a liability is not of a contingent nature. See ***Bharat Earth Movers (supra)***. The principles enunciated above have been applied by the Supreme Court also in the case of ***Metal Box Company (supra)*** wherein the Supreme Court was considering the question whether estimated liability under gratuity schemes were amenable for deduction from gross receipts shown in the profit and loss account. The observation of the Supreme Court being pertinent are extracted herein below:-

“But the contention was that though Schedule VI to the Companies Act may permit a provision for contingent liabilities, the Income Tax Act, 1961, does not, for under Section 36(v), the only deduction from profits and gains permissible is of a sum paid by an assessee as an employer by way of his contribution towards and approved gratuity fund created by him for the exclusive benefits of his employees under an irrevocable trust. This argument is plainly incorrect because Section 36 deals with expenditure deductible from out of the taxable income already assessed and not with deductions which are to be made while making the P. & L. Account. In our view, an estimated liability under gratuity schemes such as the ones before us, even if it amounts to a contingent liability and is not a debt under the Wealth-tax Act, if properly ascertainable and its present value is fairly discounted is deductible from the gross receipts while preparing the P. & L. Account. It is recognised in trading circles and we find no rule or direction in the Bonus Act which prohibits such a practice.”

6. In the case of ***Shree Sajjan Mills Ltd*** (*supra*), the Supreme Court was examining the provision made by the assessee towards gratuity under the Income Tax Act, 1961. The Supreme Court, after noticing the judgment in ***Metal Box Company*** (*supra*), crystallized its analysis at page 599 and made the following observations:-

“It would thus be apparent from the analysis aforesaid that the position till the provisions of section 40A(7) were inserted in the Act in 1973 was as follows:-

1 xxxx

2 xxxx

3 xxxx

4 xxxx

5 Provision made in the profit and loss account for the estimated present value of the contingent liability properly ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either under Section 28 or section 37 of the Act.”

7. The Division Bench of this Court, while considering deductibility of a provision for warranties made by an assessee, which dealt in computers in the case of **CIT vs Hewlett Packard India (P) Ltd**, by its judgment passed in ***Appeal No. ITA 486/2006 dated 31.03.2008***, upheld the deductibility of the provision for warranty on the ground that it was made on the basis of actuarial valuation being covered by the principle set out in ***Metal Box Company (supra)***. In view of the aforesaid decisions and given the fact that the provision was estimated based on actuarial calculations, we are of the opinion that the deduction claimed by the assessee had to be allowed. We find no fault with the reasoning of the Tribunal. No substantial question of law arises for our consideration.

8. As regards the second issue, we had at the time of hearing indicated to the counsel for both parties that a question of law arises for consideration of this Court and that we would frame a question as indicated hereinbelow and dispose of the appeal finally. Accordingly, with the consent of the counsel, submissions were heard and the appeal was taken up for final hearing. On hearing the counsel, we are of the view that the following question of law arises for our consideration:-

“Whether ITAT was correct in law in allowing depreciation of Rs 35,41,123/- to the assessee on spare parts u/s 32 of the Act as against Rs 5,49,806/- allowed by the Assessing Officer.”

9. In regard to the aforesaid issue, the following facts need to be noticed.

9.1 The assessee prior to the assessment year in issue, i.e., assessment year 2000-01 had been following the practice of charging the cost of spares as a revenue expense based on actual consumption during the relevant period. The Council of the Institute of Chartered Accountant of India (hereinafter referred to as the 'ICAI') in 1999 revised the Accounting Standard (AS) 2 with respect to valuation of inventories which came into effect in respect of accounting period commencing on or after 01.04.1999. The said Accounting Standard was made mandatory and superseded the existing Accounting Standard on '*valuation of inventories*' which was originally issued in June, 1981. The assessee pursuant to the change in accounting standard capitalized the cost of spares valued at Rs 1,41,64,495/- and claimed depreciation on the said capitalized spares to the extent of Rs 35,41,123/-. Before the Assessing Officer, the assessee in the first instance, claimed deduction by way of depreciation on capitalized spares as indicated above to the extent of Rs 35,41,123/- and in the alternative, claimed by way of deduction cost spares consumed amounting to Rs 31,76,187/-.

9.2 The Assessing Officer rejected the claim of the assessee for depreciation on the ground that the assessee had not "put to use" the emergency spares during the relevant period. Curiously, the Assessing Officer also rejected the alternative plea of the assessee that it should be allowed deduction of Rs 31,76,187/- being the cost of emergency spares actually consumed during the relevant period. The Assessing Officer on

the contrary allowed depreciation to the assessee in the sum of Rs 5,49,806/- with reference to the cost of spares consumed during the relevant period, that is, on Rs 31,76,187/-

10. The assessee being aggrieved, preferred an appeal to the CIT(A). The CIT(A) while sustaining the order of the Assessing Officer that no depreciation could be allowed on the cost of emergency spares capitalized by the assessee, however, allowed the alternative claim of the assessee, by directing the Assessing Officer to allow the assessee a deduction of Rs 31,76,187/-, being the cost of spares actually consumed by the assessee during the relevant period.

11. The assessee being aggrieved, preferred an appeal to the Tribunal. The Tribunal by the impugned judgment allowed the appeal of the assessee. In the impugned judgment, the Tribunal noted that the Assessing Officer had accepted the claim of the assessee that emergency spares were entitled to depreciation, but while doing so, had limited the depreciation with reference to the cost of spares actually consumed during the relevant period as against the claim of the assessee for depreciation on total cost of spares, i.e., Rs 1,41,64,495/-. The Tribunal also noted that the CIT(A) had given a clear finding of fact that the spare parts were readily available for use as and when required. Applying the judgment of the Madras High Court in the case of **CIT vs Southern Petrochemicals Industries Corporation Ltd;** (2007) 292 ITR 362 the

Tribunal allowed the claim of the assessee for depreciation on “*critical spare parts of plant and machinery kept as stand by*”.

12. The Revenue being aggrieved, preferred an appeal as indicated above to this Court.

13. We have heard the learned counsel for the Revenue, Ms Prem Lata Bansal and for the assessee, Mr V.P. Gupta. It is contended by the learned counsel for the Revenue that depreciation is available to an assessee on fulfillment of the twin conditions prescribed under Section 32 of the Act, these being: the ownership of the asset and its use during the relevant period. The learned counsel submitted that the assessee had not used the emergency spares during the relevant period. The provisions of Section 32 does not contemplate ‘passive user’ and hence depreciation could not have been permitted on the cost of the spares capitalized i.e., on a sum of Rs 1,41,64,495/-. The learned counsel thus relied upon the order of the Assessing Officer and submitted that the approach adopted by the Assessing officer by allowing depreciation with reference to only such emergency spares actually used during the relevant period was the correct approach in law being in accordance with the provisions of Section 32 of the Act.

14. On the other hand, the learned counsel for the assessee, Mr V.P. Gupta relied upon the judgments of various High Courts to support his submission that Section 32 of the Act brings within its ambit even

‘passive user’ for claim of depreciation. The judgments relied upon by the learned counsel for the assessee were *CIT vs Pepsu Road Transport Corporation*; (2002) 253 ITR 303 (P&H), *CIT vs Southern Petro Chemical Industries Corporation Ltd*; (2007) 292 ITR 362 (Mad), *Capital Bus Service (P.) Ltd vs CIT*; (1980) 123 ITR 404 (Del), *CIT vs Refrigeration & Allied Industries Ltd*; (2001) 247 ITR 12 (Del) and lastly *CIT vs Swarup Vegetable Products India Ltd*; (2005) 277 ITR 60(All).

15. The learned counsel for the assessee also relied upon the revised Accounting Standard (AS) 2 on ‘Valuation Of Inventories’ along with Accounting Standard (AS) 10 on ‘Accounting For Fixed Assets’ to buttress his argument that the emergency spares in issue requires to be capitalized.

OUR ANALYSIS

16. The accounting treatment, which is prescribed by the Council of the ICAI, clearly stipulates that after the revised Accounting Standard (AS) 2 comes into effect, it shall apply with respect to accounting period commencing on or after 01.04.1999. The revised Accounting Standard has been made mandatory by the Council of the ICAI.

16.1 At this point, it may be helpful to extract the relevant clauses of the Accounting Standards (AS) 2 and (AS) 10. In this regard, clause 4 of the Accounting Standard is of relevance which reads as follows:-

*“Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. **Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets.**”*

16.2. Similarly, Accounting Standard (AS) 10 issued by the Council of ICAI for fixed assets in paragraph 8.2 clearly provides as follows:-

“Stand-by equipment and servicing equipment are normally capitalized. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed assets and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.”

16.3 Apart from the above, the Council of the ICAI has also issued what are known as Accounting Standards Interpretation (ASI) 2 for the purpose of elucidating as to the machinery spares which are covered under the Accounting Standards (AS) 2 and (AS) 10 and what should be the accounting for machinery spares under the respective standards. In this context, it may be pertinent to note the following:-

“1 Which machinery spares are covered under AS 2 and AS 10 and what should be the accounting for machinery spares under the respective standards.

2 Machinery spares which are not specific to a particular item of fixed asset but can be used generally for various items

of fixed assets should be treated as inventories for the purpose of AS 2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.

3 Whether to capitalise a machinery spare under AS 10 or not will depend on the facts and circumstances of each case. However, the machinery spares of the following types should be capitalised being of the nature of capital spares/insurance spares—

(i) Machinery spares which are specific to a particular item of fixed asset, i.e., they can be used only in connection with a particular item of the fixed asset, and

(ii) their use is expected to be irregular.

4 Machinery spares of the nature of capital spares/insurance spares should be capitalised separately at the time of their purchase whether procured at the time of purchase of the fixed asset concerned or subsequently. The total cost of such capital spares/insurance spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal item, i.e., the fixed asset to which they relate.

5 x x x x

6 x x x x

7 x x x x

8 x x x x

9 Machinery spares of the nature of capital spares/insurance spares are capitalised. Capital spares/insurance spares are meant for occasional use. Since they can be used only in relation to a specific item of fixed asset, they are to be discarded in case that specific fixed asset is disposed of. In other words, such spares are integral parts of the fixed asset.”

16.4 It is clear upon reading the provisions of Accounting Standards (AS) 2 and (AS) 10 that, the opinion of the Council of the ICAI in respect

of treatment of machinery spares is briefly that; machinery spares which are not specific to any fixed asset and can be used generally should be treated as part of inventory and charged to profit and loss account as and when they are consumed during the ordinary course of business. On the other hand, if the machinery spares are of the nature of capital spares/insurance spares which are specific to a particular item of fixed asset and their use is irregular, then, they should be capitalized separately and depreciated on a systematic basis over a time frame not exceeding the useful life of the fixed asset to which they relate. As a matter of fact, in case the fixed asset to which they relate, is discarded, the machinery spares will also have to be disposed of as these spares are integral parts of the fixed asset.

16.5 It is to be noted that these Accounting Standards are mandatory in nature and applied to accounts prepared after 01.04.1999. In that sense the submission of the assessee has to be accepted that the change in the accounting policy had been brought about by virtue of the issuance of the revised accounting standards issued by the Council of the ICAI, which was, applicable for the assessment year under consideration. Furthermore, the provisions of sub-section (3A), (3B) and (3C) of Section 211 of the Companies Act, 1956, clearly provide that every profit and loss account and balance sheet of a company shall comply with the Accounting Standards prescribed. Where the accounts of the company do not comply with the Accounting Standards it is required to disclose in the

profit and loss account and the balance sheet: (a) the deviation from the Accounting Standards; (b) the reasons for such deviation; and (c) the financial effect, if any, arising, due to such deviation. What is important is that; sub-section (3) of Section 211 provides that until the Central Government prescribes an accounting standard in consultation with the National Advisory Committee as set up under Section 210A of the Companies Act, 1956 pursuant to a recommendation of the ICAI; the Accounting Standard issued by the ICAI shall prevail. Therefore, we have no difficulty in accepting the submissions of the learned counsel for the assessee that it was obliged to capitalize the entire cost of spares in consonance with the mandatory provisions of Accounting Standards (AS) 2 and (AS) 10.

16.6 It is not disputed that the assessee is maintaining the accounts based on a mercantile system. Under sub-section (1) of Section 145 of the Act the assessee's income which is chargeable under the head "profits and gains of business or profession" is required to be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

16.7 As indicated above the assessee has been maintaining a mercantile system of accounting, therefore, the treatment of emergency spares in accordance with the revised Accounting Standard (AS) 2 and (AS) 10 would be in consonance with the mercantile system of accounting which under the Act the Revenue is required to look at for computing income of

the assessee chargeable under the head “profits and gains” from business. The submission of the learned counsel for the Revenue that the accounting treatment to be meted out to a transaction in accordance with the Accounting Standard has no relevance for the purposes of the Income Tax Act, 1961 is a submission which does not commend to us.

16.8 In the past, Courts have applied rules and principles of accountancy where words and expressions used in the Act have not been given a definitive meaning. The Supreme Court in the case of **Challapalli Sugars Ltd vs CIT; (1975) 98 ITR 167** was called upon to interpret the meaning of the expression ‘actual cost’ for the purposes of determining the justiciability of the assessee’s claim for depreciation and development rebate under the Indian Income Tax Act, 1961. The assessee sought to include in the cost of asset the interest paid by it for the period prior to commencement of business on borrowings taken up by it. The Supreme Court in coming to the conclusion that the assessee’s stand was correct resorted to the rules of accountancy prevailing in the industry. In this context the following observations of the Supreme Court being apposite are extracted below:-

“In finding the answer to the question mentioned above, we have to bear in mind that it arises in the context of profits or gains of business and the permissible deductions on account of depreciation and development rebate relating to the machinery and plant of the assessee. As the expression ‘actual cost’ has not been defined, it should, in our opinion, be construed in the sense which no commercial man would misunderstand. For this purpose, it would be necessary to ascertain the temptation of the above expression in

accordance with the normal rules of accountancy prevailing in commerce and industry.”

“.....It would appear from the above that the accepted accountancy rule for determining the cost of fixed assets is to include all expenditure necessary to bring such asset into existence and to put them in working condition. In case money is borrowed by newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalized added to the cost of the fixed asset which have been created as a result of such expenditure. The above rule of accountancy should, in our view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.”

16.9 The learned counsel for the Revenue relied upon the judgment of the Supreme Court in the case of ***Tuticorin Alkali Chemicals & Fertilizers Ltd. vs CIT; (1997) 227 ITR 172*** to buttress her submission that accountancy principles cannot override the provisions of the Act. This proposition is unassailable. One cannot take resort to a principle or rule of accountancy when the Act provides specifically for the situation at hand. But when the situation is one where there is no definitive provision, a Court can take resort to well accepted accountancy rules and principles. The Supreme Court in ***Tuticorin Alkali Chemicals*** (*supra*) has not derogated from this principle enunciated in ***Challapalli Sugar Mills Ltd*** (*supra*). See observation in ***Tuticorin Alkali Chemicals*** (*supra*) at pages 183-186, in particular, observations at page 185(H) to page 186(D).

16.10 The applicability of the principles of accountancy by the courts has also found favour in the judgments of the Supreme Court in the cases of *CIT vs Indo Nippon Chemicals Co ltd;* (2003) 261 ITR 275 at page 277 (D – E) & *CIT vs U.P. State Industrial Development Corporation;* (1997) 225 ITR 703 and also the judgment of a Division Bench of this Court in *CIT vs Woodward Governor India P Ltd;* (2007) 294 ITR 451 at page 463-464 (paras 15-16). The observations of UPSIDC being apposite are extracted hereinbelow:-

*“In our opinion, this contention is devoid of force. The accounting practice followed by the assessee in the instant case was in consonance with the general principles of accountancy governing underwriting accounts. It is a well accepted proposition that “for the purposes of ascertaining profits and gains the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statutes. [see *Whimster and Co. v. Commissioner of Inland Revenue* (1925) 12 TC 813 (C. Sess); *Commissioner of Inland Revenue v. Cock Rusell and Co. Ltd.* (1949) 29 TC 387 (KB)]. This proposition has been affirmed by this court in *P.M. Mohamed Meerakhan vs CIT* (1969) 73 ITR 735. In the said case it has been observed (at page 743):*

“For that purpose it was the duty of the Income-tax Officer to find out what profit the business has made according to the true accountancy practice.”

17. The other issue whether the assessee could be disallowed depreciation under the provisions of Section 32 of the Act on the ground that the emergency spares are not put to use, will have to be seen in the light of the said provision as well as the case laws on the issue. The relevant part of the Section 32 of the Act reads as follows:-

“in respect of depreciation-

(1) building, machinery, plant or furniture being tangible assets;

(2) xxxxxx

*Owned, wholly or partly by the assessee and **used for the purposes of the business or profession**, the following deductions shall be allowed.....”*

17.1 The Bombay High Court, in the case of **CIT vs Viswanath Bhaskar Sathe; (1937) 5 ITR 621**, in the context of Section 10(2)(vi) of the Indian Income Tax Act, 1922, which is *pari materia* of Section 32 of the Act, while considering whether an assessee was entitled to depreciation in respect of factory which had not been employed in the work of ginning, interpreted the word ‘used’ as found in Section 10(2)(vi) of the Income Tax Act, 1922 as follows:-

“ But I think that the word “used” in this section may be given a wider meaning and embraces passive as well as active user. Machinery which is kept idle may well depreciate, particularly during the monsoon season. It seems to me that the ultimate test is, whether, without the particular user of the machinery relied upon, the profits sought to be taxed could have been made; and as I read the agreement in the case, the profits of the assessee during the year under assessment could not have been earned except by his maintaining his factory in good working order, and that involves user of the factory and the machinery.”

17.2 This was also considered by the Madras High Court in **CIT vs Vayithri Plantations Ltd; (1981) 128 ITR 675**. In the said judgment of the Madras High Court, the word “used” was interpreted to mean and this includes even forced idleness, whereby a machinery even though ready

for use, could not be used in a given year due to labour unrest. The court held that machinery which is kept ready for use would come within the expression “used” for the purposes of business as contemplated under the provision at hand.

17.3 The aforesaid judgments were noticed by the a Division Bench of the Madras High Court in the case of ***Southern Petrochemical Industries Corporation*** (*supra*). The issue which the Madras High Court was called upon to consider as extracted in the judgment of this Court, is as follows:-

“Whether on the facts and circumstances of the case the Tribunal was right in holding that the depreciation should be allowed on stand by spares parts even though they were not taken for use during the year.”

17.4 The Division Bench of the Madras High Court after noting the judgment of the Bombay High Court in ***Viswanath Bhaskar Sathe*** (*supra*) and of its own court in ***Vayithri Plantations Ltd*** (*supra*) held that the assessee was entitled to depreciation on spare parts which are stand-by items even though they were not used during the accounting year. The important point to be noticed here is that the case pertained to assessment year 1986-87 much prior to the issuance of the revised Accounting Standard (AS) 2 by the Council of the ICAI. A Division bench of our Court in the case of ***Capital Bus Service*** (*supra*) has observed as follows:-

“The words “used for the purposes of the business” are capable of a larger and a narrower interpretation. If the expression “used” is construed strictly, it can be taken as

connoting or requiring the active employment or the actual working of a machinery, plant or building in the business. On the other hand, the wider meaning will include not only cases where the machinery, etc., is actively employed but also cases where there is, what may be described as, a passive user of the same in the business.

The above survey of the decisions on the subject clearly shows that the consensus of judicial opinion is in favour of adopting the liberal interpretation. We are also of opinion that in the context in which the expression occurs and also having regard to the various types of cases that could arise, the wider interpretation has to be placed on this expression. The decided cases, which have been earlier referred to, have arisen in different contexts which clearly indicate that the wider and more liberal interpretation of the provision would in the context of s. 10(2) (vi) and (vii) may be appropriate.

Though it is true that a machinery generally depreciates with actual user, the decisions indicate that it is not necessary to import this concept in interpreting the expression "used" in the statute. In the first place, a machinery may well depreciate even where it is not used in the business and even due to non-user or being kept idle. Secondly, a very strict correlation between the actual use of machinery and the concept of depreciation would lead to several anomalies and difficulties, for a machinery cannot be used throughout the day and night or even throughout the working hours or even during the days when the business is in full scale operation. Thirdly, there will be no strain on the statutory language by interpreting it widely and not limiting it to the actual working or actual employment of the machinery in the business. On the other hand, it would be more appropriate to envisage the expression as comprehending cases where the machinery is kept ready by the owner for its use in the business and the failure to use it actively in the business is not on account of its incapacity for being used for that purpose or its non-availability. In the present case, e.g., the four buses in question were admittedly in working order and the assessed was keeping them ready for being operated upon if and when some tourist contract materialised. They were not actually run on the road not because they were under repair or were unfit for use for one reason or the other, but only because there were not enough contracts during the year to ply the buses for more than 30 days each. This does not mean that so far as the assessed was concerned he did not employ the trucks for the

purposes of the business. They were kept ready for operation and they were there only in the business and for use in that business. In these circumstances, in our opinion, it can be said, without straining the language of the statute and the context in which it is employed, that the buses were used for the purposes of the business throughout the year though they were not actually plied on the roads for more than 30 days.”

17.5 The same view has been expressed by another Division Bench of our Court in ***Refrigeration & Allied Industries Ltd*** (*supra*). The Division Bench in that case reiterated the position that the expression “used” for the purposes of business should be given a wider meaning and should include an asset which is kept ready for use. The Division Bench went on to hold that the efficacy of any asset declines with use and time. In determining the income of an assessee from business or profession for levy of tax it would be appropriate to make a provision for proper recompense of such diminution in the value of an asset to give a correct picture of income earned from business or profession. The Court observed that depreciation is the inherent decline in the value of asset for any cause whatsoever. It went on to say that the depreciation is the measure of an effective life of an asset owing to use or obsolescence during a given period. The object of providing for depreciation is to spread the expenditure incurred on the asset over its effective lifetime, and the amount written off during an accounting period is intended to represent the proportion of such expenditure which has expired during the period. The Court noted that the principle factors responsible for reduction in the value of capital asset and, therefore, responsible for

depreciation are (i) ordinary wear and tear (ii) unusual damage (iii) inadequacy and (iv) obsolescence. These factors include not only those relating to physical deterioration but also those referring to the suitability of the asset as an economically productive unit after a period of time. The depreciation allowance under Section 32 is, however, a statutory allowance not confined expressly to diminution in value of the asset by reason of wear and tear. The allowance can be claimed, if the asset in question is shown to be capable of diminishing in value on account of any factor known to the prevailing accounting or commercial practice.

17.6 In view of the ratio of the judgments referred to hereinabove we are of the considered opinion that the expression '*used for the purposes of business*' appearing in Section 32 of the Act also takes into account emergency spares which even though ready for use are not as a matter of fact consumed or used during the relevant period, as these are spares specific to a fixed asset and will in all probability be useless once the asset is discarded. In that sense, the concept of passive user which is applied by the aforementioned cases to standby machinery will be applicable to emergency/insurance spares.

17.7 In the instant case, the Assessing Officer has even while accepting the stand of the assessee that the spares in issue were emergency spares and that they were capital assets limited the depreciation to a sum of Rs 5,49,806/- by referring it to the cost of spares actually consumed

during the relevant year, i.e., Rs 31,76,187/- as against the total cost of spares capitalized by the assessee amounting to Rs 1,41,64,495/-.

18. In our opinion, the Assessing Officer misdirected himself in law by limiting the depreciation to the aforementioned amount. Similarly, the CIT(A) also erred in rejecting the claim of the assessee for capitalization of the cost of spares amounting to Rs 1,41,64,495/- by ignoring the crucial issue that it was not disputed by the Revenue that the spares in issue were 'emergency spares'. The only point in issue before the CIT(A) was whether depreciation could be allowed in respect of spares which had not been put to use. It is on account of this finding that the learned counsel has confined her submissions only to a limited issue as to whether depreciation under Section 32 could be allowed in respect of emergency spares on the basis of passive use.

18.1 In our opinion, once spares are considered as emergency spares required for plant and machinery as found by the Tribunal, the assessee was entitled to seek capitalization of the entire cost of spares amounting to Rs 1,41,64,495/- and claim depreciation thereon.

18.2 Though as a matter of fact, in the instant case, there was not much of a difference between depreciation claimed by the assessee which amounted to Rs 35,41,123/- as against actual consumption of spares during the relevant period which amounted to Rs 31,76,187/-; nevertheless on principle, in our view, the assessee was right as found by

the Tribunal in claiming depreciation on the entire capitalized cost of spares.

19. In the result, the question of law framed by us is answered in favour of the assessee and against the Revenue. The appeals are dismissed. No orders as to cost.

RAJIV SHAKDHER, J

February 27, 2009
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VIKRAMAJIT SEN, J