IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 16.09.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE KRISHNAN RAMASAMY

Tax Case (Appeal) No.11 of 2017

Principal Commissioner of Income Tax 2
No.121, Mahatma Gandhi Road,
Nungambakkam, Chennai ... Appellant

vs.

M/s.HSI Automative Ltd.,
Survey No.73, A Block,
100, Thandalam Post,
Mevalurkuppam,
Sriperumbudur Taluk,
Kanchipuram District ... Respondent

Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai "D" Bench, dated 29.07.2016 in ITA No.2088/Mds/2015.

This Appeal filed against the order of the Income Tax Appeal Tribunal Madras "D" Bench, dated 29/07/2016 in ITA No.208/MDS/2015 against the Commissioner of Income Tax (Appeals) 6, No.121, Mahatma Gandhi Road, Nungambakkam, Chennai 600 034 in ITA No.50, 52, 59 & 93/CIT(A)-6/2010-2011 and ITA No.68/(CIT(A)/6/2013-14 dated 18/05/2015 in PAN No.AAACA2804E for the Assessment Year 2005-2006, 2006-2007 and 2007-2008 against the Deputy Commissioner of Income Tax, Company Circle II(2) Room No.512, Vth Floor Wanaparthy Block, "AAYAKAR BHAVAN" No.121, Uttamar Gandhi Salai, Chennai 600 034 for the Assessment Year 2007-2008.

For Appellant : Mr.Karthik Ranganathan,
Senior Standing Counsel

For respondent : Mr.K.Senguttuvan

JUDGMENT

(Delivered by DR.VINEET KOTHARI, J.)

The Revenue has preferred this appeal, under Section 260A of the Income Tax Act, arising from the order of the learned Income Tax Appellate Tribunal, Madras D Bench

2. The following purported substantial questions of law are raised in this appeal for our consideration :-

> "1.Whether on the facts and in the circumstances of the case in law the Appellate Tribunal was right in confirming the order of the CIT Appeals without adjudicating specific Grounds of Appeal 3.2 to 3.6 raised before it, which is perverse in nature and liable to be set aside ?
>
> 2.Whether on the facts and in the circumstances of the case and in law the Appellate Tribunal was right in deletion of the disallowance made on account of scientific expenses in the absence of assessee furnishing any proof for having paid the sum to a research association, which has as its object the undertaking of scientific research or to a university, college or other institutions to be used for scientific research?"
>
> 3.Whether on the facts and in the circumstances of the case and in law the Hon'ble ITAT was right in allowing the alternate claim of the assessee toward scientific expenses u/s 35(1) of the Act as Revenue expenditure in the absence any documentary evidences?
>
> 4.Whether on the facts and in the circumstances of the case and in law, the order of the Hon'ble ITAT is perverse, when the assessee for the first time claimed alternate deduction u/s 37(1) of the Act before the CIT(A) which was not claimed before the Assessing Officer and no opportunity was afforded to the Assessing Officer under Rule 46A of the IT Rules ?

3. The learned Tribunal dismissed the appeal of the Revenue and allowed the expenditure incurred by the Assessee

to the extent of Rs.11,24,32,995/- as “Business Expenditure” under Section 37 of the Act, even though initially, the Assessee claimed the said amount as “Scientific Expenditure” under Section 35(1) of the Act.

4. The relevant reasons given by the learned Tribunal in its order dated 29 July 2016 are quoted below for ready reference :-

> 9.With reference to AY 2007-08, the Revenue raised an additional issue relating to scientific expenses under Section 35(1) of the Act. Briefly stated relevant facts in this regard are that in the AY 2007-08, Assessee claimed deduction of Rs.11,24,32,995/- under the head “scientific expenditure”. In the assessment, AO observed that the amount claimed was not allowable since neither the Assessee has not obtained any approval from the scientific authority nor the amount was paid to any university or research organization and hence not eligible for deduction u/s 35(1)(ii) of the Act and disallowed the said amount. Matter was carried to be in appellate authority. During the first appellate proceedings, after considering the submissions of the assessee, CIT (A) discussed the issue at length and directed the AO to allow the said expenditure as an allowable revenue expenditure. Paras 4S and its sub-paras are relevant in this regard. Aggrieved with the said decision of the CIT (A), Revenue is in appeal before the Tribunal.
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> 10. During the proceedings before the Tribunal, Ld DR for the Revenue relied on the order of the AO.
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> 11. On the other hand, Ld Counsel for the assessee heavily relied on the order of the CIT (A) and reiterated the submissions made before the Lower authorities.
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> 12. After hearing both the parties and on perusal of the orders of the Revenue Authorities in general and decision of the CIT (A) vide paras 4.5 and its sub-paras are relevant in this regard. Considering the significance of the said

paras for the sake of completeness of this order, we extract the relevant para 4.5.11 of the impugned order for the AY 2007-2008 as under:

> "4.5.11. Therefore, the above 'product perfection expenses", which are classified by the assessee as 'scientific expenses' in its books, are essentially revenue expenses incurred by the assessee during the regular course of the existing business of 'automobile component manufacturing'. Hence, these expenses are allowable as normal business expenses, for the purpose of computing the taxable income under the head 'income from business' The Assessing Officer is directed to allow the above expenditure of Rs.11,24,32,995/ as an aIlowable revenue expenditure. The assessee succeeds in the appeals in this regard."

13. Considering the above, we are of the opinion that the decision taken by the CIT (A) is fair and reasonable and it does not call for any interference. Accordingly, relevant ground raised by the Revenue for the AY 2007-2008 is dismissed.

5. The learned Commissioner of Income Tax (Appeals) had also allowed the appeal of the Assessee on this count, with the following observations :-

> 4.5.5 The next claim of the assessee is that though the above amount was claimed under the head 'scientitic expenditure', it was actually regular revenue expenditure incurred by the Assessee in respect of product perfection process. As explained by the assessee, the company is manufacturing various parts of automobile components required by Hyundai Motors etc. As per the models and specifications given by them, the assessee has to manufacture and supply the automobile components. Since these components are high precision required in

car manufacturing, the Assessee has to first produce them on trial basis and supply to the Hyndai Motors etc. for their quality checking and approval. If they are not upto their satisfaction and specifications, the Assessee has to carry out necessary modifications in the moulds etc. used for manufacturing the components, and produce the components once again and supply to Hyndai Motors for approval. This process continues till the customers (Hyundai Motors) etc. are finally satisfied with the quality, specifications and the precision of the components. All the components models produced up to the final approval by the customer have no sale value and becomes waste.

4.5.6 Thus, the above expenses, claimed by the assessee under the head 'scientific expenses', are actually incurred for the purpose of 'perfecting the process of manufacturing the components' as per the designs and specifications and to the satisfaction of the customers. Hence, these expenses are nothing but "product perfection expenses", which are basically revenue expenses in nature.

4.5.7 In the field of automobile industry the designs and the models of the cars are fast changing. Consequently, the components required for their manufacture also keep on changing frequently. Hence, the customers keep on requesting the assessee for manufacture and supply of components as per the new designs and specifications. And, for every new design and specification, the assessee has to modify and make necessary changes in its plant and machinery (like moulds etc.) and manufacture the components on trial and supply for quality approval. Only after such approval, the assessee can go for commercial production of the components.

4.5.8 The above process is a continuous process and the assessee has to undertake it for each and every new component/ specification ordered by the customers. These expenses are incurred during the ordinary course of business and for running the business. All the components i.e. newly designed ones as well as the old (already under commercial manufacturing) ones are manufactured from the same factory and by using the same plant and machinery. The only difference is in the designing of certain moulds etc. which are product (component) specific. Since the major plant and machinery are used for manufacturing the new components as well as the old components, the production of new components (specification) cannot even be considered as new line of manufacturing.

4.5.9 Further, as furnished by the assessee, the details of expenses incurred by the assessee in the above process of "product perfection", and classified by the Assessee under "scientific expenses" are

1. Raw material : Rs. 9, 72,11,824/
2. Power and Fuel : Rs.85,20,396/
3.Raw material cleaning charges: Rs.13,94,558/
4. Freight Charges : Rs.3,50,338/
5. Labour Charges : Rs.26,44,806/
6. Consumables &SPA : Rs.7,33,527/
7. Repairs & Maintenance : Rs.12,80,697/
8. Repairs & Maintenance Electrical : Rs.2,97,389

Total: Rs.11,24,32,995/-

4.5.10 Thus, the above scientific expenses are basically (mainly) cost of raw material,labour charges, power 8:. fuel charges, etc. These expenses are essentially 'revenue expenses' in character. Further by incurring these expenses, the assessee is not generating any 'capital asset' in any form and hence the expenses cannot be termed as capital expenses. Further, since the designs and specifications of the components required to be manufactured by the assessee keep on changing at frequent intervals, no design/specification is long-lasting. The assessee has to keep-on "perfecting the

> product" every time the design/ specifications. are changed. Hence, it is even difficult to presume that the above expenses have enduring benefits for a number of years.
>
> 4.5.11 Therefore, the above "product perfection expenses", which are classified by the assessee as 'scientific expenses' in its books, are essentially revenue expenses incurred by the assessee during the regular course of the existing business of 'automobile component manufacturing'. Hence, these expenses are allowable as normal business expenses, for the purpose of computing the taxable income under the head 'income from business'. The Assessing Officer is directed to allow the above expenditure of Rs.11,24,32,995/ as an allowable revenue expenditure. The assessee succeeds in its appeals in this regard."

6. The learned Counsel for the Revenue Mr.Karthik Ranganathan urged before us that though the Assessee could not satisfy the conditions for claiming the said expenditure as "Scientific Research Expenditure" under Section 35 of the Act, as neither the project was approved by the Competent Authority, as required under Section 35 of the Act, nor the payment in question was made to any approved organization for research purposes. But even if such expenditure was also to be allowed as a "Business Expenditure" under the residuary provisions of Section 37 of the Act, the matter was required to be examined again by the learned Assessing Authority as the sum of Rs.11,24,32,995/- might have included the replacement of plant and machinery of capital nature and it required investigation and since such investigation was made earlier by the Assessing Authority while disallowing the said expenditure under Section 35 of the Act, the matter deserves to be remanded back to the Assessing Authority.

7. Per contra, the learned Counsel for the Respondent / Assessee supported the impugned order and submitted that even if the conditions of the claim under Section 35 was not satisfied, there is no dispute that the expenditure in question was incurred in the ordinary course of business for creating new designs of moulds etc. to the satisfaction of customers viz., Hyundai Motors and since it involved constant process of perfecting the process of manufacturing the components, it was entirely 'Revenue Expenditure' incurred by the Assessee during the year in question, which was

undoubtedly allowable under Section 37 of the Act and therefore, the two Appellate Authorities have rightly allowed the same and the appeal of the Revenue does not give rise to any question of law, requiring consideration of this Court.

8. Having heard the learned Counsel for the parties, and having gone through the orders of the two authorities as quoted above, and having perused the details of the expenditure incurred to the extent of Rs.11,24,32,995/-, we are satisfied that no question of law arises in the appeal filed by the Revenue.

9. The Assessee gave up its claim of deduction under Section 35 of the Act as admittedly, the conditions required for claiming the same under Section 35 was not satisfied by the Assessee. Nonetheless, the Assessee was entitled to claim the said expenditure in the "Residuary Provisions" of Section 37 of the Act. Section 37 permits such allowance of "Business Expenditure" incurred in the ordinary course of business, if they are not allowable otherwise by Section 30 to 36 of the Act. Unless the expenditure is of the capital in nature, resulting in creation of assets of enduring nature, the same cannot be disallowed under Section 37 of the Act. There is no dispute that the said expenditure was incurred in the ordinary course of business. We are unable to find any material on record which would indicate any capital expenditure incurred in the details of said sum of Rs.11,24,32,995/- by the Assessee. The redesigning of the moulds to create new designs of the components manufactured by the Assessee, to the satisfaction of the customer M/s. Hyundai Motors is nothing but 'Revenue Expenditure' incurred in the ordinary course of business of the Assessee. Therefore, the finding of the learned CIT (Appeals) as well as the learned Tribunal are findings of fact, which cannot be said to be wrong or perverse in any manner.

10. In our considered opinion that they do not give rise to any question of law, requiring our further consideration under Section 260A of the Act. The appeal of the Revenue is thus found to be devoid of merits and is liable to be dismissed and accordingly, it is dismissed. No costs.

Sd/-
Assistant Registrar(CCC)

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Sub Assistant Registrar

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To

1. The Income Tax Appellate Tribunal,
   'D' Bench, Chennai.

2. The Commissioner of Income Tax,(Appeals-6)
   No.121, Mahatma Gandhi Road,
   Nungampakkam, Chennai-600 034.

3. The Deputy Commissioner Income Tax
   Company Circle -II(2)
   Room No.512, Vth Floor Wanaparthy Block
   "AAYAKAR BHAVAN"
   No.121, Uttamar Gandhi Salai,
   Chennai.

T.C.A.No.11 of 2017

VSN II(CO)
GMY(01/10/2020)
GMY(05/10/2020)