

A.F.R.

ORDER

OD – 1

IN THE HIGH COURT AT CALCUTTA
SPECIAL JURISDICTION (INCOME TAX)
ORIGINAL SIDE

ITA/373/2009
NAGREEKA EXPORTS LIMITED
VERSUS
ASSISTANT COMMISSIONER OF INCOME TAX,
CIRCLE-6, KOLKATA & ORS.

BEFORE :

THE HON'BLE JUSTICE SURYA PRAKASH KESARWANI
AND
THE HON'BLE JUSTICE RAJARSHI BHARADWAJ

Date : 27th February 2024.

Appearance:

Mr. Ranjeet Kr. Murarka, Advocate
Mr. S.D. Verma, Advocate
Mr. Ananda Sen, Advocate
Mr. Vivek Murarka, Advocate
... for the appellant.

Mr. S. Roychowdhury, Advocate
Mr. Soumen Bhattacharjee, Advocate
... for the respondents

1. Heard Sri Ranjeet Murarka, learned counsel for the appellant assessee and Sri S. Roychowdhury, learned senior standing counsel for the respondents.
2. This appeal was admitted by this Court by order dated 04.02.2010, on the following substantial questions of law:-

“I. Whether on the facts and circumstances of the case the order of the Tribunal is erroneous as being perverse in reversing the order of

the C.I.T.(A) on the basis of the decision of the Hon'ble Supreme Court where the question for consideration was not allowability under Section 37(1) of the Act as was in the present case?

II. Whether on the facts and in the circumstances of the order of the Tribunal was erroneous in not properly appreciating the decision of the Hon'ble Supreme Court in RE: Ramaraji Surgical Cotton Mills, (294 ITR 328) a later decision of the Hon'ble Supreme Court and specifically referred to in the petitioner's submission before the Tribunal?"

3. After hearing learned counsel for the parties, the substantial questions of law is re-framed as under:-

“Whether under the facts and circumstances of the case, expenditure incurred by the assessee on replacement of nine “ring frames” is a revenue expenditure and allowable as deduction under Section 37 of the Income Tax Act, 1961?”

4. Briefly stated, the facts of the present case are that the appellant assessee is a manufacturer of cotton yarns and had established a manufacturing unit in which the plant and machinery were installed in 1994-95 which included a ring frame unit also. As per South India Textile Research Association report dated 19.12.2003 in a textile spinning mill, cotton fibres are converted to yarns and the process of fibre to yarn conversion comprises of various stages being blow room, carding process, lap former, combing process, drawing, fly frames, **ring frames** and cone winding. During the assessment year in question i.e. assessment year 2005-06, the

appellant assessee replaced nine ring frames out of total twenty-six ring frames earlier installed by him. The total expenditure incurred on replacement of nine ring frames came to Rs.2,26,67,804/-, which the assessee reduced by Rs.56,06,159/- representing the sale proceeds of old frames and thus, claimed balance sum of Rs.1,70,61,645/- as revenue expenditure as cost of replacement of machinery i.e. ring frames. The assessing officer rejected the claim of the appellant assessee holding that it is not a revenue expenditure under Section 37 of the Income Tax Act, 1961 [hereinafter referred to as 'Act 1961'] and accordingly disallowed the expenditure so claimed.

5. In the appeal filed by the appellant assessee, the CIT(A) allowed the appeal of the assessee on the aforesaid issue. Aggrieved with the order of the CIT(A), the revenue filed ITA No.1474/KOL/2008 [Deputy Commissioner of Income Tax, Circle-6, Kolkata v. Nagreeka Exports Limited, Kolkata]. A cross objection No.102/KOL/2008 was also filed by the appellant assessee against confirmation of disallowance of Rs.1 lakh under the head 'bad debts'. In the present appeal, we are not concerned with the issue raised in the cross objection. By the impugned order dated 21.08.2009, the appeal of the revenue on the issue of assessee's claim of replacement cost as revenue expenditure was allowed by the ITAT and the order of the CIT(A) was set aside. Aggrieved with the aforesaid order of the ITAT, the appellant assessee has filed the present appeal.

6. Learned counsel for the appellant assessee submits that the expenditure incurred for replacement of ring frames is a revenue expenditure liable for deduction under Section 37 of the Act 1961. He submits that the judgment of Hon'ble Supreme Court in the case of Commissioner of Income Tax v. Sri Mangayarkarasi Mills (P) Limited [2009] 315 ITR 114 (SC) is not applicable inasmuch as in subsequent judgment in Commissioner of Income Tax v. Hindustan Textiles [2010] 190 Taxman 294 (SC) [paragraph 6], Hon'ble Supreme Court directed the High Court to consider the tests laid down in Commissioner of Income Tax v. Sugavaneeshwara Spinning Mills Ltd. 293 ITR 20 (SC), Commissioner of Income Tax v. Ramaraju Surgical Cotton Mills [2007] 294 ITR 328 (SC) and Sri Mangayarkarasi Mills (P) Limited case (supra) for de novo consideration of the case of the assessee of that case. He, therefore, submits that the question as to whether the expenditure incurred for replacement of nine ring frames is a revenue expenditure or capital expenditure, needs reconsideration.
7. Learned Counsel for the revenue supports the impugned order of the ITA.
8. We have considered the rival contentions of learned counsels for the parties and perused the records of the appeal.
9. We find that in Sri Mangayarkarasi Mills (P) Ltd. supra) (supra) two issues were considered by the Hon'ble Supreme Court, namely, firstly, ***whether each machine in a textile is an independent item and/or part of a***

spinning mill and thus, the replacement of asset would amount to current repairs under Section 31 of the Act, 1961; and, secondly, whether the expenditure incurred for replacement of ring frame is of revenue in nature or capital nature. The Hon'ble Supreme Court held as under :

"We have heard and considered all these contentions of the learned counsel for the parties and also perused the materials on record and also examined the impugned order passed by the High Court.

The first issue that needs to be resolved is whether each machine in a textile mill is an independent item or merely a part of a complete spinning mill, which only together are capable of manufacture, and there is no inter- mediate marketable product produced. In our view, this issue has been satisfactorily answered by the recent decision of this court in CIT v. Saravana Spinning Mills P. Ltd. [2007] 7 SCC 2983. In that case, this court has held unambiguously that "each machine in a segment of a textile mill has an independent role to play in the mill and the output of each division is different from the other." Dealing with a ring frame in a textile mill, this court has held that it is an "independent and separate" machine. Further, it is accepted that each machine in a textile mill is part of the integrated pro- cess of manufacture of yarn and is integrally connected to the other machines in the mill for production of the final product. However, this Interconnection does not take away the independent identity and distinct function of each machine. Thus, each machine in a textile mill should be treated independently as such and not as a mere part of an entire composite machinery of the spinning mill. As stated above, it can at best be considered part of an integrated manufacture process employed in a textile mill

Moving on to the issue of "current repairs" under section 31 of the Act, the decision of this court in *CIT v. Saravana Spinning Mills P. Ltd.* [2007] 7SCC 298, is again relevant. This court has laid down that in order to determine whether a particular expenditure amounts to "current repairs" the test is "whether the expenditure is incurred to preserve and maintain" an already existing asset and not to bring a new asset into existence or to obtain a new advantage. For "current repairs" determination, whether the expenditure is "revenue or capital is not the proper test." It is our opinion that the entire textile mill machinery cannot be regarded as a single asset, replacement of parts of which can be considered to be for the mere purpose of "preserving or maintaining this asset. All machines put together constitute the production process and each separate machine is an independent entity. Replacement of such an old machine with a new one would constitute the bringing into existence of a new asset in place of the old one and not repair of the old and existing machine. Also, a new asset in a textile mill is not only for temporary use. Rather it gives the purchaser an enduring benefit of better and more efficient production over a period of time. Thus, replacement of assets as in the instant case cannot amount to "current repairs". The decision in *Saravana Mill's* case clearly mentions that replacement of a derelict ring frame by a new one does not amount to "current repairs". Further, in *Ballimal Naval Kishore* this court has held that a new asset or new/different advantage cannot amount to "current repairs", which has been subsequently approved in the *Saravana Mills* case. For these reasons, the expenditure made by the assessee cannot be allowed as a deduction under section 31 of the Act. The judgment of this court in the *Saravana Mills'* case mentions two exceptions in which replacement could amount to current repairs, namely: "Where old parts are not available in the market (as seen in

the case of CIT v. Mahalakshmi Textile Mills Ltd., AIR 1968 SC 1013, or Where old parts have worked for 50-60 years."

In the instant case, the assessee has not claimed any of the above stated exceptions. The Saravana Mills case also restricts the scope of "current repairs" to repairs made to machinery, plant and/or furniture. In this case replacement of machine can at best amount to a repair made to the process of manufacture of yarn, Further, this court has also observed in Saravane Mills case that if replacement was held to be "current repair" in such cases, section 31(1) will be completely redundant and absurdity will creep in because repair implies existence of a part of the machine which has mal functioned, which is impossible in the case of such replacement. Thus, this replacement expenditure cannot be said to be "current repairs" after the decision in the Saravana Mills' case.

Given that section 31 of the Act is not applicable to the said expenditure of the assessee, the next issue is whether it can be considered "revenue expenditure" of the nature envisaged under section 37 of the Act. The Saravana Mills case' holds that expenditure is deductible under section 37 only if it: (a) is not deductible under sections 30-36, (b) is of a revenue nature, (c) is incurred during the current accounting year, and (d) is incurred wholly and exclusively for the purpose of the business. We are satisfied that the assessee's expenditure satisfies requirements (a), (c) and (d) as stated above. The dispute is with respect to the nature of expenditure, that is, whether it is revenue or capital in nature.

We are of the opinion that the expenditure of the assessee in this case is capital in nature and there is sufficient judicial precedent to support this view. In the case of Travancore Cochin Chemicals Ltd. v. CIT [1977] 2 SCC 20 this court held that expenditure is of a capital

nature when it amounts to enduring advantage for the business and repair is different from bringing a new asset for the business. Further, in Lakshmiji Sugar Mills P. Co. v. CIT, AIR 1972 SC 159 it has been held by this court that bringing into existence a new asset or an enduring benefit for the assessee amounts to capital expenditure. We have already explained why replacement, in this case, amounts to bringing into existence a new asset and also an enduring benefit for the assessee. It is clear then that the expenditure of the assessee here is not of a revenue nature and thus, cannot be claimed as a deduction under section 37 of the Act.”

10. Thus, as per law settled; **ring frame** in a textile mill is an “independent and separate” machine. Each machine in a textile mill is part of the integrated process of manufacture and is integrally connected to the other machine in the mill for production of the final product. But this interconnection does not take away the independent identity and distinct function of each machine. Therefore, each machine in a textile mill is liable to be treated independently as such and not as mere part of an entire composite machinery of the spinning mill. Thus “ring frame”, at best, is part of an integrated manufacture process employed in a textile mill. Therefore, replacement of an old ring frame by a new one would constitute the bringing into existence a new asset in place of the existing ring frame. Such a new asset in the assessee’s textile mill is not for temporary use but it gives an enduring benefit of better and more efficient production over a period of time. In Lakshmi Sugar Mills P. Co. v. CIT,

AIR 1972 SC 159, Hon'ble Supreme Court has held that bringing into existence a new asset or an enduring benefit for the assessee amounts to capital expenditure. In Travancore Cochin Chemicals Ltd. v. CIT [1977] 2 SCC 20, Hon'ble Supreme Court has held that an expenditure is of capital nature when it amounts to enduring advantage for the business. Repair is entirely different as it does not bring into existence a new asset. Thus, amount spent by the assess on replacement of existing old ring frames by a new one is not of revenue nature rather it is capital in nature. Hence the amount so spent is not an allowable expenditure under Section 37 of the Act, 1961.

11. For all the reasons aforestated, we do not find any merit in this appeal. The substantial question of law is answered against the assessee and in favour of the revenue. The **Appeal is dismissed.**

(SURYA PRAKASH KESARWANI, J.)

(RAJARSHI BHARADWAJ, J.)

S. Kumar / S. Das

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