AFR
Chief Justice's Court

Case :- INCOME TAX APPEAL No. - 220 of 2014

Appellant :- Additional Commissioner Of Income Tax Bareilly
Respondent :- M/S Dhampur Sugar Mill Pvt. Ltd.
Counsel for Appellant :- Dhananjay Awasthi
Counsel for Respondent :- Suyash Agrawal

Hon'ble Dr. Dhananjaya Yeshwant Chandrachud, Chief Justice
Hon'ble Pradeep Kumar Singh Baghel, J.

This appeal by the revenue has arisen from a decision of the Income Tax Appellate Tribunal[1] dated 31 January 2014. The assessment year to which the appeal relates is AY 2008-09. The following questions of law have been formulated on behalf of the revenue:

> (1) Whether the Tribunal erred in law in deleting the addition made on account of disallowance under Section 14A of the Income Tax Act, 1961[2] read with Rule 8D of the Income Tax Rules, 1962[3], without appreciating the language and provision of these Sections, more so when the expenditure was with respect to amount of interest expenses which was directly attributable to dividend income and which did not form part of total income;
>
> (2) Whether the Tribunal erred in law in deleting the addition made under Section 36(1)(iii) ignoring the fact that the assessee was not charging interest on funds

1 the Tribunal
2 the Act
3 the Rules

given as loans and advances to its sister concerns/subsidiaries when there was no specific business purpose for which these interest free loans and advances were given;

(3) Whether the Tribunal erred in law and fact in deleting the disallowance made by the Assessing Officer on account of expenses incurred on transmission lines and contribution paid to the Uttar Pradesh Power Corporation Limited[4], without appreciating the fact that, these expenses were in the nature of capital expenditure as they were for providing enduring benefits to the assessee and would remain an asset with the assessee for indefinite period, hence these were not deductible as per the provisions of Section 37 (1) of the Act; and

(4) Whether the ITAT erred in law and facts in allowing appeal with respect to computation of book profit under Section 115JB of the Act made by the Assessing Officer as a result of disallowance of interest and other expenses under Section 14A of the Act amounting to Rs 66,79,000/- in computation of book profit under Section 115 JB.

Re Question No 1

The assessee is engaged in the business, inter-alia, of the manufacture and sale of sugar, chemicals and power, and has a distillery. The return of income was initially processed under Section 143 (1). The case was selected for scrutiny and resulted in an order under Section 143 (3) of the Assessing Officer dated 27 December 2010. The Assessing Officer held that the assessee had invested some of its funds in shares and

4 UPPCL

the dividend income which had been or was receivable on these investments did not form part of the total income. Holding that certain expenses, such as on account of interest, were directly attributable to the exempt income, the Assessing Officer came to the conclusion that such expenditure could not have been debited to the profit and loss account in view of the provisions of Section 14A of the Act. The Assessing Officer made a disallowance of Rs 67.75 lacs. In appeal, the Commissioner (Appeals) deleted the disallowance. The Commissioner (Appeals) observed that certain shares of Kashipur Sugar Mills Ltd were acquired in 1993 out of the own funds of the assessee. The term loans on which interest was paid during the year under consideration were received for specific purposes and the cash credit account was used for the working capital of the business. Hence, it was held that a disallowance under Section 14A read with Rule 8D of the Rules could not be justified. In regard to the investment which was made by the assessee in Dhampur Distillery Pvt Ltd, the Commissioner (Appeals) held that there was no material which would establish that the investment in shares was made out of interest bearing funds but that it was made from fresh share capital raised in the period under consideration. The finding of the Commissioner (Appeals) can conveniently be extracted herein below:

> "The facts reveal that the investment in Dhampur Distillery Pvt Ltd was not a direct investment in the form of liquid capital. The assets including land, plant and machinery in the business premises etc were acquired out of share capital raised during the year. This

fact was submitted by the assessee along with evidence for the source of investment made by its promoters before the AO. Therefore, the finding of the AO that the assessee invested certain amount of fund in shares of the above company and any income received or receivable on these investments in the form of dividend would not form part of total income and the expenses in the form of interest paid which were directly attributable to the exempt income would not be eligible for deduction by virtue of Section 14A of the Act, was factually not correct. The AO did not dispute the source of investment by the appellant in Dhampur Distillery Pvt Ltd. The appellant furnished evidence of raising fresh share capital during the year for the purpose of funding its Ethanol Unit. There is nothing on the record which could establish that the AO gathered any evidence to substantiate his funding that the appellant made investment in the share capital of Dhampur Pvt Ltd out of interest bearing funds. As a matter of fact, the AO applied the provisions of Section 14A without establishing the requirement of law. The provisions of Section 14A(2) lay down that, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act, then he shall not allow deduction in respect of such expenditure incurred by the assessee. The source of investment in the shares of Dhampur Distillery Pvt Ltd was clearly proved by the assessee with the explanation that it was invested from the fresh share capital raised in the period under consideration.

> This explanation of the assessee was not disputed by the AO. In view of such facts and circumstances of the case and position of law, denial of claim of deduction of expenses in the form of interest on the ground that they were attributable to exempt income, was not sustainable."

In the appeal, the Tribunal has confirmed the finding. The Tribunal has observed that the findings of the Commissioner (Appeals) were not controverted on behalf of the revenue. Once it was duly established that no borrowed funds on which interest was paid had been invested for earning tax free income, no disallowance was permissible under Section 14A. The Tribunal has observed that under Rule 8D(2)(ii), a proportionate disallownace out of interest expenditure would be made in respect of interest expenditure which is not directly attributable to any particular income or receipt. Since the entire interest expenditure, in the present case, was attributable to business in which the resultant income was assessable to tax, a disallowance could not be made. The Tribunal, consequently, deleted a disallowance to the extent of Rs 66.79 lacs out of a total disallowance of Rs 67.75 lacs made by the Assessing Officer under Section 14A, sustaining the balance of Rs 0.96 lacs on account of other expenditure to the extent of 0.5 percent of the average value of investment. The order of the Tribunal in regard to the disallowance of Rs 0.96 lacs has been confirmed by this Court by a judgment dated 1 September 2014 in an appeal[5] filed by the assessee.

5 Income Tax Appeal No 131 of 2014 (Dhampur Sugar Mills Ltd, Bijnor Vs Commissioner of Income Tax, Bareilly)-

We have no reason to differ with the view which has been taken by the Commissioner (Appeals) and which has now been affirmed by the Tribunal. Under sub-section (1) of Section 14A, no deduction can be allowed in respect of expenditure incurred by the assessee in relation to income which does not form a part of total income under the Act. Sub-section (2) of Section 14A enables the Assessing Officer to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the Act in accordance with the method as prescribed under the Rules, if the Assessing Officer is not satisfied with the correctness of the claim of the assessee. In the present case, the specific finding of the Tribunal is that as regards the disallowance of Rs 67.75 lacs which was made under Section 14A by the Assessing Officer, the interest expenditure was attributable to the business of which the income was assessable to tax. Once this be the position, the view of the Tribunal is consistent with the provisions of Section 14A and does not warrant any interference.

Re Question No 2

Insofar as this question is concerned, the Tribunal has observed that in Assessment Years 2003-04, 2004-05 and 2005-06, the same issue was before the Tribunal in regard to disallowances made by the Assessing Officer, of interest paid on borrowed funds. The learned counsel appearing on behalf of the assessee has placed on record a judgment of a Division Bench of this Court dated 28 April 2005 pertaining to the assessee in **Commissioner of Income Tax, Lucknow Vs Dhampur**

Sugar Mills Ltd, Bijnor[6] which has been followed by another Division Bench in a judgment dated 16 December 2013 in **Commissioner of Income Tax, Moradabad Vs Dhampur Sugar Mills Ltd**[7]. The judgment of the Division Bench dated 16 December 2013 decides the same issue in Question No 3 which has been answered as follows:

> "Question No.3
>
> Whether on the facts and circumstances of the case the Tribunal is justified in law in deleting the disallowance made by Assessing Officer out of interest paid on borrowed capital?
>
> The question is covered by Income Tax Reference No.65 of 1996, CIT v. Dhampur Sugar Mills Ltd., Bijnor decided on 28.04.2005 inter party. The question is decided in favour of the assessee and against the revenue."

The learned counsel appearing on behalf of the revenue has been unable to make any distinction that would warrant this Court to take a different view for the year under consideration.

Re Question No 3

The principal bone of contention in the appeal has been in relation to this issue. During the year under consideration, the assessee made a payment of Rs 8.48 crores to UPPCL towards the construction of a transmission line and other supporting work. The assessee started generating power which had to be sold to UPPCL which was the only customer. Agreements were entered into by the assessee in similar terms

6 Income Tax Reference No 65 of 1996
7 Income Tax Appeal No 443 of 2011

on 11 August 2006 in relation to its three units which stipulated that the entire expenditure for erection and installation of power transmission lines, towers and ancillaries from the point of power generation to the Sub Grid Station would be incurred by the assessee. UPPCL was to ensure quality control of the equipment and material and the work was to be carried out subject to the its supervision and prior approval. The agreement stipulated that the entire power transmission line including the towers, after erection, would be the property of UPPCL which would provide for the subsequent supervision and maintenance. The assessee claimed the entire expenditure as a deduction under Section 37(1). The Assessing Officer held that, in the present case, since the work of the transmission line and other ancillary work was carried out at the business premises of the assessee and it could not be used by any other person except the assessee, it was absolutely clear that it would be the property of the assessee. On this ground, the Assessing Officer made a disallowance. The Commissioner (Appeals), while deleting the disallowance, observed as follows:

> "As discussed above, the assessee has right to use the power line for transmitting power generated in its factory to UPPCL but it would not enjoy ownership right on the asset. The ownership on the asset would be with UPPCL in future. Thus, the assessee acquired right to make use of the asset for facilitating efficient conduct of its business and making it more profitable but without getting any advantage of enduring benefit to itself. He did not acquire any asset as envisaged in

> Section 32 of the Act. Therefore, the expenditure incurred was of revenue nature..."

The view of the Commissioner (Appeals) has been confirmed by the Tribunal.

Now, it is trite law as laid down by the House of Lords in **British Insulated and Helsby Cables Ltd Vs Atherton**[8], that where an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason, in the absence of special circumstances leading to an opposite conclusion, to treat it as an expenditure properly attributable not to revenue but to capital.

In **Empire Jute Co Ltd Vs Commissioner of Income Tax**[9], the Supreme Court held that the true test is to consider the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable:

> "...There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. lt is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If

8 [(1925) 10 TC 155 (HL)]
9 (1980) 124 ITR 1

> the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assesse's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case..."

In other words, if the advantage which had accrued to the assessee was to facilitate its trading operation or the conduct of its business while leaving the fixed capital untouched, the expenditure would be on the revenue account. The same principle was laid down in a decision in **L H Sugar Factory and Oil Mills (P) Ltd Vs Commissioner of Income Tax**[10], where before the Supreme Court, there was a case in which the assessee had made a contribution for meeting the cost of construction of roads in the area around its sugar factory under a sugarcane development scheme. The Supreme Court held as follows:

> "Now it is clear on the facts of the present case that by spending the amount of Rs 50,000, the assessee did not acquire any asset of an enduring nature. The roads which were constructed around the factory with the help of the amount of Rs 50,000 contributed by the assessee belonged to the Government of Uttar Pradesh and not to the assessee. Moreover, it was only a part of

10 [(1980) 125 ITR 293 (SC)]

> the cost of construction of these roads that was contributed..."

This decision was sought to be distinguished on behalf of the revenue by contending that in that case, only a part of the expenditure was contributed by the assessee. We are unable to make any distinction based on that ground. The true test is whether the expenditure which has been incurred by the assessee is for the purpose of obtaining a commercial advantage in the capital field. In the present case, it is clearly evident that the power transmission lines which were laid by the assessee were, upon erection, to constitute the exclusive property of UPPCL. UPPCL was the only consumer of the electricity generated by the assessee.. The assessee incurred the expenditure to facilitate its own business. The fixed capital of the assessee was untouched and there was no capital accretion for the assessee. This was exactly the position before the Supreme Court in **L H Sugar Factory** (supra).

At this stage, it would be appropriate for the Court to also make a reference to a decision of the Gujarat High Court in **Commissioner of Income Tax Vs Gujarat Mineral Development Corporation**[11] where the assessee had laid out an expenditure which was paid over to the Gujarat Electricity Board for laying electric transmission lines and other ancillary facilities. The Gujarat High Court took note of the fact that the transmission lines were to be the property of the Board and that the assessee was not acquiring a benefit of an enduring nature. Applying the

11 (1981) 132 ITR 377

test laid down by the Supreme Court in **Empire Jute Co Ltd** (supra), the Gujarat High Court held as follows:

> "Applying the test laid down by the Supreme Court in Empire Jute Co's case (1980) 124 ITR 1 to the facts before us, it is clear that even if securing electric supply for a period of seven years and longer, if the agreement to supply is not terminated by the Electricity Board, is a benefit of an enduring nature, if the advantage consisted in facilitating the assessee's trading operation and enabled the assessee to conduct its business more efficiently and more profitably, then the expenditure would still be on revenue account and not on capital account. The peculiar feature in this case is that the amount was spent for securing electric supply for the Beneficiation Plant which was intended to enable the assessee-company to carry on its business more efficiently and more profitably. It was a business which was being previously carried on by the assessee-company, namely of extracting fluorspar ore and selling it but in order to enable it to carry on that business more efficiently and more profitably, the Beneficiation Plant was proposed to be installed and the electric cables and supply lines were laid or that Beneficiation Plant as has been pointed out by the Tribunal in its order. Once the purpose of the Beneficiation Plant is properly understood, it is obvious that the advantage consisted merely in facilitating the conduct of the assessee's business and enabling the assessee to carry on its business more efficiently and more profitably but the capital, in the sense of the block capital was remaining untouched by the expenditure of this amount of Rs 2046

> lakhs Hence, in the commercial sense, it was not an advantage in the capital field. Since it left the fixed capital of the assessee employed for the main business of mining untouched and the advantage was not in the capital field, it could not be said to be an expenditure of a capital nature. As we have pointed out, while arriving at this conclusion, we are prepared to proceed on the footing that the advantage which the assessee-company got was an advantage of an enduring nature, but applying the test culled out by the Supreme Court in Empire Jute Co's case (1980) 124 ITR 1, it is obvious that, in spite of the presumption, it can be held on the facts and circumstances of this case that the expenditure was not of a capital nature but was of a revenue nature."

The decision of the Gujarat High Court has been confirmed by the Supreme Court in **Commissioner of Income Tax Vs Gujarat Mineral Development Corporation**[12]. A similar principle has been laid down in a Division Bench judgment of the Madras High Court in **Commissioner of Income Tax Vs Coats Viyella India Ltd**[13]**,** where the expenditure incurred by the assessee by way contribution to the government for building a new bridge for providing access to the factory of the assessee was held to be on the revenue account. The Madras High Court held as follows:

> Here, the bridge is one, which is built across the river. The bridge is not owned by assessee. It is built by the government, and the assessee does not acquire any rights of ownership over the bridge in the short-term or

12 (2001) 249 ITR 787
13 (2002) 253 ITR 667

> in the long run by reason of the contribution that it agreed to pay towards the construction of the bridge. So far as the assessee is concerned, the payment made is an outgo in return for which it receives no addition to the value of any of the assets owned by it. The bridge merely facilitates the movement of the workmen to gain access to the assessee's factory and to return home, and also for the movement of the goods over the bridge. The facts of this case are such as to bring it within the ratio of the decision in the case of L. H. Sugar Factory and Oil Mills (P) Ltd. v. CIT, (1980) 125 ITR 293 (SC). We, therefore, do not see any justification for calling for a reference. The Tribunal has rightly held that the amount is to be treated as revenue expenditure. The assessment year is 1991-92. The petitions are dismissed."

Similarly, in a judgment of the Rajasthan High Court in **Commissioner of Income Tax Vs Hindustan Zinc Ltd**[14], it was held that the erection of power lines by the assessee was for facilitating its routine operations and for smooth functioning of its business. The power lines remained the property of the Electricity Board. The Rajasthan High Court came to the conclusion that the assessee had not acquired a capital asset or any enduring benefit or advantage.

Following the principle of law which has been laid down by the Supreme Court, we hold that the expenditure which was incurred by the assessee in the laying of transmission lines was clearly on the revenue account. Upon the erection of transmission lines, they were to vest

14 (2009) 221 CTR 637

absolutely in UPPCL. The expenditure which was incurred by the assessee was for facilitating the efficient conduct of its business since the assessee had to supply electricity to its sole consumer UPPCL. This was not an advantage of a capital nature. The Tribunal was, in these circumstances, correct in affirming the view of the Commissioner (Appeals).

Re Question No 4

The learned counsel appearing on behalf of the revenue fairly states that Question No 4 is merely consequential to the first question. In view thereof, the question has not been separately canvassed on behalf of the revenue.

For these reasons, we hold that the appeal will not given rise to any substantial question of law.

The appeal is, accordingly, dismissed. There shall be no order as to costs.

Order Date :- 5.11.2014
AHA

(Dr D Y Chandrachud, CJ)

(P K S Baghel, J)