IN THE HIGH COURT OF JUDICATURE AT BOMBAY
NAGPUR BENCH, NAGPUR.

INCOME TAX REFERENCE NOS. 150 OF 1993.

Applicant : **The Commissioner of Income-tax,** Vidarbha, Nagpur.

-- *Versus* --

Respondent : **M/s. Manganese Ore India Limited,** Nagpur.

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Shri A.J. Bhoot, Adv. with Shri Anand Parchure, Adv. for the Applicant
Shri K.P. Dewani, Advocate for the Respondent
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CORAM : **B.P. DHARMADHIKARI &**
V.M. DESHPANDE, JJ.

DATE : **11th FEBRUARY, 2016.**

ORAL JUDGMENT :- *(Per B.P. Dharmadhikari, J.)*

01] By this reference under Section 256(1) of the Income-tax Act, 1961 at the instance of the department, following four questions have been referred to this Court:

"(ι) *Whether on the facts and in the circumstances of the case, the I.T.A.T. was correct in*

holding that the payments of Rs.86,554/- made to D.S. Basu of M/s Dastur & Co., and others is a revenue expenditure ?

(2) *Whether on the facts and in the circumstances of the case, the I.T.A.T. was correct in holding that the payment of Rs.81,885/- made to Mountain States Research & Development U.S.A. is a revenue expenditure ?*

(3) *Whether on the facts and in the circumstances of the case, the I.T.A.T. was correct in holding that the payment of Rs.8,06,254/- made to Seltrust Engineering Co. Ltd. is a revenue expenditure ?*

(4) *Whether on the facts and in the circumstances of the case, the I.T.A.T. was correct in holding that an amount of Rs.29,52,638/- incurred in construction of house of labourer is a revenue expenditure ?"*

02] Accordingly, we have heard Shri Anand Parchure with Shri A.J. Bhoot, learned Advocates for the applicant-department and Shri K.P. Dewani, learned Advocate for the respondent-assessee.

03] Shri Bhoot, learned Advocate points out that the first two questions are answered in favour of the department by C.I.T. (Appeals) also, while the later two questions are answered by that authority as also

by the I.T.A.T. against the department.

04] He contends that the distinction between an existing project or services, consultation etc. utilized in relation thereto and similar services for the proposed/new project cannot stand on different footing, insofar as nature of expenditure is concerned. The nexus of said expenditure with the object can never be lost site of. Even if the new project can not be established, the amount spent therefor remains capital expenditure. He points out that in the present facts, the payment of Rs.86,554/- to Shri D.S. Basu of M/s. M.N. Dastur & Company ought to have been treated as capital expenditure. He relies upon the facts, which have looked into by the Income-tax Officer as also the appellate authority for said purpose.

05] While drawing the attention to consideration on same lines by the ITAT on question No.2, he submits that for same reasons, payment of Rs.81,885/- ought not to have been treated as revenue expenditure.

06] He also submits that when such expenditure, may be towards traveling is undertaken in relation to new project, question whether such project materializes or not is entirely an irrelevant fact. He, therefore, states that the answers given to remaining to these questions by the appellate authority and by the I.T.A.T., therefore, cannot be sustained. According to him, the erection of residential quarters for its workforce is definitely an investment which is capital in nature and last question should

have been answered in favour of the department. He has invited our attention to certain judgments and will be making reference to the same at appropriate juncture.

07] Shri Dewani, learned Advocate for the respondent, on the other hand, invites attention to the fact that none of the questions referred to this Court allow it to open any findings on facts recorded by the I.T.A.T. He, in this background, submits that when expenditure is found to be incurred in relation to existing project, it has been rightly treated as revenue expenditure. He adds that the fact whether it is for existing project or for a proposed project, is not in dispute before this Court and, hence, the facts or premise on the basis of which the I.T.A.T. has proceeded further, needs to be maintained. He has taken us through the relevant observations of the I.T.A.T. to urge that none of the questions, which have been referred, can be answered in favour of the department. He has also relied upon certain judgments and will be making reference to the same little later.

08] In the backdrop of questions mentioned *supra*, it will be appropriate to first refer to the order of the Income-tax Officer. In his order, dated 30/03/1984, the said Officer has in paragraph 16 considered this aspect. He has found that most of the expenses were not revenue in nature and incurred to set up of a ferro manganese plant or for beneficiation and agglomeration and for the purpose of setting up of ferro

manganese plant. He has also recorded that this ferro manganese plant, however, has not been set up due to certain reasons. He has recorded that the assessee was called upon to show how these expenses could be allowed under the head "Research and Development" as claimed, and according to him, expenses clearly were of capital nature. He has thereafter mentioned two letters dated 14/02/1984 and 12/03/1984. He has reproduced contents thereof. In the process, he has also reproduced paragraphs 6 and 7 of the letter, dated 29/02/1984 sent by the assessee, wherein the assessee has pointed out the scope of work entrusted to consulting firm relates to upgrading of the quality of ore increasing the productivity of labour and also increasing the percentage of recovery from the crude ore. The assessee thereafter had pointed out that all these directly related to existing business of the company. In concluding part, while mentioning the payments, he has noted that the assessee furnished details of amount of Rs.3,45,008/- only in Statement No.22, while it should have given details of research and development expenses amounting to Rs.12,19,822/-. Therefore, the assessee did not give details of amount of Rs.8,74,814/-. In the information furnished before him, thereafter the assessee disclosed amount debited to M/s. Seltrust Engineering Ltd. at Rs.7,16,818.93, while in the statement filed along with letter dated 14/02/1984, that amount was mentioned as Rs.5,12,008.98 only. Further consideration in this respect is contained in paragraph 20 of that order. The details of amount debited by the assessee on account of construction

of quarters are given therein and then again explanation furnished by the assessee to treat it as revenue expenditure on 14/02/1984, has been looked into. In the face of this material, he has not accepted the stand of the assessee that the amount stands qualified as revenue expenditure. The material is not in dispute though inference or findings recorded on its strength are seriously in debate.

09] The C.I.T. (Appeals) has addressed this question in its order dated 30/08/1985 from paragraph 22 onwards. It has extracted the payments made to M/s. M.N. Dastur & Company, M/s. M.M. Suri Associates and M/s. Seltrust, U.K., which were claimed to be revenue in nature by the assessee and then noted that the I.T.O. found that claim related to new capital projects i.e. proposed ferro manganese plant, beneficiation/agglomeration plant etc. and, therefore, had disallowed that amount. It has also taken note of the fact that the I.T.O. allowed only Rs.87,027/-, out of last item and disallowed the rest. Then it has in paragraph 23 noted submission of the assessee and its reasons are contained in paragraph 24 onwards.

10] In paragraph 24 (a), it has given chronological sequence of three contracts and then in paragraph (b), it has noted that contract with M/s. M.N. Dastur & Company related to feasibility report and engineering services for the proposed beneficiation/agglomeration plants at Balaghat/Ukwa. It has also pointed out its scope. In sub-para (c), it has

then dealt with contract with M/s. M.M. Suri Associates and noted that it was for feasibility report and engineering services for the proposed electrolytic manganese dioxide and electrolytic manganese metal plants at Dongri Buzurg. It has then briefly mentioned stages thereof.

11] In sub-paragraph (h), it has then noted that the assessee is engaged in two lines of action insofar as its research and development expenses were concerned. First line is found to be considering possibility of setting up a ferro manganese plant as well as beneficiation/ agglomeration plant, while second line is found to be developing the Ukwa mine operations by choosing better mining methods to optimize its production etc.

12] It has observed that second item or line is clearly in the course of carrying on existing business, by way of improvising its operations and profitability and, therefore, expenditure thereon qualifies as revenue expenditure. However, while dealing with first line or first item, it held that it would constitute capital expenditure as the same was aimed at acquisition of a new plant i.e. new capital assets. Thus, it has partly allowed the appeal of the assessee.

13] In further challenge at the instance of the assessee, the I.T.A.T. has passed the order on 21/01/1991. It needs to be mentioned that before the I.T.A.T., the department had filed a cross-appeal and questioned the

order of C.I.T. (Appeals) insofar as answers given by it to question Nos.3 and 4 before us is concerned.

14] The findings of the I.T.A.T. can be seen from paragraph 6 onwards. The I.T.A.T. has confirmed the findings of the C.I.T. in relation to consultation charges paid to both viz. M/s. M.N. Dastur & Company and M/s. M.M. Suri Associates as capital expenditure on the ground that the same were for the purposes of establishing a new plant or project. Thus, dis-allowance of payment of Rs.1,58,000/- made up on this account was confirmed by it. However, insofar as the expenditure on travelling expenses of employees of these two concerns are concerned, it held that it cannot be treated as capital Rs.86,560/-expenditure and the order of C.I.T. to that extent was found unsustainable. Thus, air fare, cost of foreign change and foreign tour expenses have been treated as revenue expenditure. It has noted that there was no material on record to establish that these expenses by themselves secured for the assessee any benefit of an enduring nature. It found that these tours have not resulted in securing for the assessee any asset or benefit. It has then made reference to judgment of Bombay High Court in the case of ***Antifriction Bearings Corporation Ltd vs. C.I.T.***, reported at ***114 ITR 335***.

15] Dealing with the payments made to M/s. Mountain States Research and Development, U.S.A., the I.T.A.T. accepted that these

charges were incurred in connection with the assessee's existing business with the intention of improving its profitability. At the end of paragraph 6, therefore, the I.T.A.T. held that expenses on travelling amounting to Rs.86,560/- and expenses made to the firm M/s. Mountain States Research and Development, U.S.A. for testing manganese ore amounting to Rs.81,885/- totalling to Rs.1,68,445/- were liable to be treated as revenue expenditure. These two amounts are forming part of question 1 & 2 before us. In paragraph 9, the I.T.A.T. has considered payments made to M/s. Seltrust Engineering Company Limited, U.K. and found that study undertaken by this foreign company was in connection with working of assessee's existing mines and also noted finding of the C.I.T. that the report submitted by this company related to optimization of the assessee's existing product and did not relate in any way to proposed new plants. It has reiterated its finding again and confirmed finding of the C.I.T. that it was a revenue expenditure.

16] In paragraphs 10 and 11, it has looked into the amount of Rs.29,52,638/- claimed by the assessee as revenue expenditure, which is subject matter of last question. It has taken note of the fact that the assessee spent that amount on construction of A-Type quarters. Total amount spent is Rs.49,44,263/- and against it, the assessee received Government subsidy of Rs.19,44,750/-. The assessee was under obligation to provide quarters for labour and for that the assessee gave on lease

various plots of land in Balaghat, Chikla and Beldongri to the Union of India on long leases. The Government undertook construction of quarters thereon and cost thereof was not to exceed Rs.8,025/- to Rs.8,493.75 per unit. The Union of India, however, appointed the assessee as its agent for said purpose. The excess amount over this, if any, was to be borne by the assessee. There is a specific finding that the ownership and title in the structure vested in the Government and the assessee was liable to pay a rent of Rs.2.50/- per unit per month to the Government. The assessee was found to be only a lessee and its employees were entitled to occupy the quarters during their tenure as such. In this background, the expenditure has been found to be revenue in nature.

17] We have mentioned the facts from order of either by the C.I.T. (Appeals) or the Income Tax Officer, as these findings on fact are not in dispute before us. At this stage it will be apt to refer to certain precedents.

18] Shri Bhoot, learned Advocate has drawn support from the judgment of the Division Bench of this Court, dated 15/06/2012 in Income Tax Reference No.67 of 1989 to urge that, where the expenditure is incurred for project/ feasibility report in connection with exploring the feasibility of a new business, it is capital in nature. We find that the Division Bench there has relied upon earlier judgments in the matter of ***C.I.T. vs. J.K. Chemicals Ltd.,*** reported at ***207 ITR 985*** and ***Trade Wings***

Limited vs. C.I.T., reported at ***185 ITR 267***. However, the judgment dated 15/06/2012 does not show whether a new project or venture in relation to which feasibility studies were carried out did actually materialize or not. Our attention has also been invited to the judgments of Delhi High Court in the matter of ***Triveni Engineering Works Ltd. vs. Commissioner of Income-tax*** reported at ***232 ITR 639***. There the Division Bench of Delhi High Court has observed that when expenditure is incurred to bring an asset or advantage into existence, which has enduring benefit, that expenditure is capital expenditure. It has also observed that merely because project did not materialize, the nature of the expenditure would not undergo any change. It has found that in case before it, the amount spent was on project report and not for the purpose of facilitating the assessee's existing trading operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably. It can be seen that these observations answered part of questions referred to us as far as expenditure qua the existing project is concerned, against the department itself.

19] At this stage, Shri Bhoot, learned Advocate has also invited our attention to the judgment of Gujarat High Court in the matter of ***Commissioner of Income Tax vs. Shri Digvijay Cement Co. Ltd.,*** reported at ***159 ITR 253***. By placing reliance upon Placitum-B, he states that the view reached by the Delhi High Court was also taken by the Gujarat High

Court and, hence, even if the project does not materialize or an asset is not created, expenditure on steps in that direction must be treated as capital expenditure.

20] So far as this controversy is concerned, we find that the judgment of Supreme Court relied upon by Shri Dewani, learned Advocate in the matter of ***Commissioner of Income Tax vs. Madras Auto Service (P) Ltd.,*** reported at ***(1998) 233 ITR 468*** clinches the controversy. There while considering the issue, the Division Bench of Madras High Court finds that the assessee could not have claimed it as capital expenditure, as there was no capital asset generated by spending said amount. The expenditure has been held rightly classified as revenue expenditure. Paragraphs 4 and 5 in judgment of Hon. Apex Court reads as under :

> *"4. The assessee in the present case has spend the amounts in question in order to construct a new building after demolishing the old building. The new building, however, from inception was to belong to the lessor and not to the assessee. The assessee,, however, had the benefit of the existing lease in respect of the new building at the agreed rent for a period of 39 years. The Tribunal has found, as a fact, that the rent as stipulated in the lease was extremely low. It has said that the area of the building was somewhere about 7000 sq.ft. The rental rate for the area in which the building was situated was much higher and would be not less than*

Rs.12,000 as against which the maximum rent the assessee would be paying was only Rs.2,000. This concessional rent was on account of the fact that the new building was constructed by the assessee at its own costs.

5. In order to decide whether this expenditure is revenue expenditure or capital expenditure, one has to look at the expenditure from a commercial point of view. What advantage did he assessee get by constructing a building which belonged to somebody else and spending money for such construction? The assessee got a long lease of a newly constructed building suitable to its own business at a very concessional rent. The expenditure, therefore, was made in order to secure a long lease of new and more suitable business premises at a lower rent. In other words, the assessee made substantial savings in monthly rent for a period of 39 years by expending these amounts. The saving in expenditure was a saving in revenue expenditure in the form of rent. Whatever substitutes for revenue expenditure should normally be considered as revenue expenditure. Moreover, assessee in the present case did not get any capital asset by spending the said amounts. The assessee, therefore, could not have claimed any depreciation. Looking to the nature of the advantage which the assessee obtained in a commercial sense, the expenditure appears to be revenue expenditure."

21] The Division Bench of this Court, while explaining what can be treated as a benefit of enduring nature, in paragraph 20 of the judgment in

the matter of ***Commercial of Income Tax vs. National Rayon Corporation Ltd.,*** reported ***(1985) 155 ITR 413*** accepted that unless the expenditure is directly related to a capital asset, acquired or to be acquired in the near future, it cannot be said to have brought about an enduring benefit and to be of capital in nature. Discussion in paragraph 15 to 17 of this ruling shows that the question was about allowing expenditure of Rs. 48.947/- on travelling of Manging Director & Works Manager to Italy for the purposes of bringing down the foreign exchange component in its proposed expansion. This expenditure has been accepted to be revenue in nature.

22] Shri Bhoot, learned Advocate has pointed out other judgment of Division Bench of this Court in the matter of ***Ciba of India Ltd. vs. Commissioner of Income-Tax,*** reported at ***202 ITR 1***. In the said judgment, assessee was setting up a new plant and expenditure incurred on travel of foreign expert to help the assessee in the matter has been held to be capital expenditure. The facts there show that during the years under consideration, the assessee had set up a new plant at Bhandup for manufacturing additional pharmaceutical goods. Thus, a capital asset there had come into existence & thus expenditure was directly relatable to it.

23] Here the capital assets has never come into existence and the

I.T.A.T. has allowed travelling expenses or ore testing charges only as revenue expenditure. This treatment is only in dispute before us. The travelling expenses or manganese ore testing charges pertaining to the existing mine allowed by the I.T.A.T. in the present facts cannot be directly co-related with the acquisition of any capital asset. We, therefore, do not find anything wrong with said exercise undertaken by the I.T.A.T. & its answers to question no. 1 & 2.

24] In so far as answer to question no. 3 is concerned, it is clear that study undertaken by the foreign company ie M/s. Seltrust Engineering Company Limited, U.K. was in connection with working of assessee's existing mines and optimization of the assessee's existing product. It did not relate in any way to proposed new plants. In view of undisputed findings on facts mentioned supra, the above logic also holds good here.

25] The learned Counsel for the department has relied upon the judgment of Division Bench of this Court in the matter of ***Commissioner of Income-Tax vs. National Machinery Manufacturers Ltd.*** reported at ***191 ITR 483*** to submit that there, when employer made contribution towards cost of construction of tenements to be allotted to his employees, the expenditure is found to be capital expenditure. Perusal of said judgment shows that the assessee-company had entered into an agreement with Maharashtra Industrial Development Corporation. The Maharashtra

Industrial Development Corporation was to construct houses for industrial employers (assessee) to solve the problem of housing their workmen, the assessee there paid sum of Rs.1,56,800/- to M.I.D.C. as its contribution towards the cost of certain tenements in return for the right to allot the same to its workmen. The scheme provided that the ownership of the houses would vest in the State Government or the Housing Boards, as the case may be. The allotment of houses was to be done by the Managing Committee, which had representatives of the employer as also employees with a chairman nominated by the Government. The employer was empowered to allot 15% of tenements out of turn to the workers, who were eligible workers, as per rules. The question which cropped up was whether this contribution of Rs.1,56,800/- was a revenue expenditure. The Division Bench has found that the assessee had a right to allot tenements to its employees for all times to come and there was no finding of fact that the assessee made contribution to MI.D.C. for providing tenements to its workmen as a matter of commercial expediency. It was, therefore, held to be a capital expenditure.

26] This reported judgment, therefore, shows that the scheme framed by the State Government and the M.I.D.C. basically was to construct houses for industrial employers. In the matter before us, the employer is put under obligation and accordingly on a nominal premium of Rs.1/-, it has leased out certain lands to the Central Government. The

houses upon it are constructed by the Central Government and assessee has been treated as lessee thereof. The ownership and title of the structure vested in the Government and the assessee has to pay rent of Rs.2.50 per unit per month to the Government. After expiry of period of lease, the assessee has option to purchase said structure or then it is open to the Government to remove the same and to return back the land. Thus, the basic difference in scheme before us & one looked into in ***Commissioner of Income-Tax vs. National Machinery Manufacturers Ltd.*** (supra) is apparent. In this situation, when the structure does not vest in the assessee and it has to pay monthly rent thereof to the Government, the expenditure incurred by the assessee thereon has been rightly treated as a revenue expenditure.

27] In the light of this discussions, we find that all four questions mentioned *supra* need to be answered against the applicant/revenue i.e. in favour of the assessee.

JUDGE **JUDGE**

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