REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.4579 OF 2009
[Arising out of SLP©No.13264 of 2007]

Commissioner of Income Tax, Madurai ..Appellant

Versus

M/S. Sri Mangayarkarasi Mills (P) Ltd. ..Respondent

J U D G M E N T

TARUN CHATTERJEE, J.

1. Leave granted.

2. This appeal has been filed by the appellant to challenge the judgment and order of the High Court of Madras dated 18th of December, 2006 whereby the High Court had dismissed the appeal filed by the revenue holding that the expenditure on replacement of machinery was revenue in nature and thus, allowable as deduction under the Income Tax Act, 1961 (hereinafter referred to as the 'Act').

3. The relevant facts as arising from the case made out by the parties, leading to the filing of this appeal, and which will help us in understanding the controversy involved, can be summarized as under :-

The Respondent in this appeal is engaged in the manufacture and sale of cotton yarn. During the assessment year 1995-1996 the assessee claimed an amount of Rs. 61, 28,150/-, being expenditure incurred on replacement of machinery, as revenue expenditure. The assessee believed that such expenditure was merely expenditure on replacement of spare parts in the spinning mill system and, therefore, amounted to revenue expenditure.

4. The Assessing Officer (AO) did not, however, accept this view of the assessee because, according to him, each machine in a spinning mill does a different function and the product from one machine is taken and manually fed into another machine and the output is taken, all the machines are, thus, not integrally connected. Based on this reasoning, the AO disallowed the above claim of the assessee and held the said expenditure to be of a capital nature. The AO, in passing this order dated 31st of December, 1997, followed the decision of the Income Tax Appellate Tribunal (ITAT) Madras "C" Bench in the case of ***M/s. Nagammal Mills Ltd.*** V. ***DCIT*** dated 31st of October, 1997 (rendered in I.T.A. No. 2774/Mds/93/90-91) and also the decision of this Court in ***Ballimal Naval Kishore and Another*** v. ***CIT*** **(224 ITR 414)** in which it was held that any capital expenditure claimed by the assessee for acquiring plant and

machinery, buildings, fixed assets, etc., cannot be treated as repairs or renewals, and, therefore, it cannot be held as revenue expenditure in the year of acquisition of such fixed assets. The AO further held that the assessee had treated the said expenditure as capital expenditure by capitalizing the assets in the books of account and had, thus, shown profit in its profit and loss account to third parties, like bankers, financial institutions, creditors, shareholders, etc. However, from the tax point of view, the respondent wanted to reduce the net profit and the total taxable income by claiming such huge expenditure in the statement of total income computation for acquisition of fixed assets, as revenue expenditure. Therefore, he disallowed such expenditure of the assessee to be covered under section 31 of the Act or as revenue expenditure under section 37 of the Act. The AO further held that the assessee could claim depreciation on the said assets as per the income tax rules.

5. An appeal was preferred by the Respondent against the said order of the AO before the Commissioner of Income Tax (CIT) (Appeals)-I, Madurai. The Commissioner of Income Tax (CIT) (Appeals)-I, Madurai, by its order dated 12th of March, 1998 in Appeal No. 324/97-98, allowed the appeal of the assessee, inter alia, holding that replacement of machinery by the assessee in

this case constituted revenue expenditure. In allowing the claim of the assessee, the CIT (Appeals) followed its own order for the Assessment Year 1991-92 wherein a similar allowance was granted in favour of the assessee.

6. Against this order of the CIT (Appeals), the revenue department went in appeal before the Tribunal. The appeal was disposed of by the ITAT, Chennai Bench-C in ITA No. 1139/Mad/1998 by its order dated 16th of June, 2004. The tribunal followed the decision of the Madras High Court wherein it was decided that replacement of ring frame is only replacement of part of the machinery in the textile mills. The tribunal, thus, upheld the order of the CIT (Appeals) and dismissed the appeal of the revenue.

7. Aggrieved by the said order of the Tribunal, the revenue filed an appeal under section 260A of the Act before the High Court of Judicature at Madras.

8. The High Court, relying on its own decision in ***CIT* v. *Janakiram Mills Ltd.* (275 ITR 403)** and ***CIT* v. *Loyal Textile Mills Ltd.* (284 ITR 658),** by its order dated 18th of December, 2006, dismissed the appeal filed by the revenue and held that the expenditure on replacement of machinery was revenue in nature. The High Court further held that the question whether

the expenditure on replacement of machinery was capital or revenue in nature was not determined by the treatment given to it by the assessee in the books of accounts or in the balance sheet. The claim has to be determined only by relying on the provisions of the Act and not by the accounting practice followed by the assessee.

9. The main question that needs to be decided in this appeal may be formulated as follows : -

> "Whether expenditure incurred on replacement of machinery, in the facts and circumstances of this case, amounts to 'revenue expenditure' deductible under section 37 of the Act or 'current repairs' deductible under section 31 of the Act."

10. It is pertinent to mention here that the respondent only stated that its claim was limited to the expenditure being of a revenue nature and thus allowable under section 37 of the Act. Nowhere had the Respondent claimed that the said expenditure amounted to 'current repairs' under section 31 of the Act. Further, the appellant itself had restricted the issue to that of revenue expenditure in its appeal to the High Court of Madras, against which it has now filed this appeal. According to the Respondent, there is no issue regarding the expenditure

amounting to 'current repairs' under section 31 of the Act. We are not inclined to uphold this submission of the Respondent. The fact that the appellant has contended before the courts below that each of the item of machinery in a spinning mill is independent, that the respondent has argued against it, and has given evidence to try to support its contention, and also that the assessee believes that replacement is only of spare parts in the entire system of the spinning mills, makes it clear that a question has arisen here as to whether replacement of one or more items of machinery amounts to repair of the entire integrated machinery of the spinning mill or acquisition of a new independent machinery.

11. The learned counsel for the appellant submitted that the courts below erred in rejecting the contention of the department that each item of machinery in a textile mill should be treated as independent and not an integral part of the whole plant of the spinning mill. The Madras High Court has held in the case of ***Commissioner of Income Tax vs. Madras Cements Ltd..*****(255 ITR 245)** that each item of machinery in a cement factory has to be considered as being an independent machinery. Learned counsel for the appellant, further, contended that the scheme of production in a textile mill is similar to the integrated scheme of

production in a cement factory, where no independent commodity can be said to have been produced before it, which is a ground in a roller mill. As per the learned counsel for the appellant, the courts below erred in distinguishing this decision of the Madras High Court. Thus, given that each item of machinery is independent, the replacement of any such machine will amount to acquisition of a new asset and not 'repair' of the entire integrated machinery of the spinning mill. In this connection, reliance was placed on a decision of this Court in ***Ballimal Naval Kishore*** **(supra)** wherein it is clearly held that 'current repairs' under the Act means expenditure on machinery, plant or furniture which is not for the purpose of renewal or restoration but which is only for the purpose of preserving or maintaining an already existing asset and that does not bring a new asset into existence or does not give to the assessee a new or different advantage. Learned counsel for the appellant further contended that replacement of old machinery with new machinery cannot be considered as current repairs as such or even revenue expenditure, since it gives an enduring benefit to the assessee. Also, if in every case such replacement is allowed as revenue expenditure the principle of allowing depreciation will lose its significance. Learned counsel further submitted that the

courts below erred in overlooking the definitions of 'assets' and 'block of assets' under explanation 3 of section 32(1)(ii) of the Act and thus, misconstruing the provision for composition of the 'block of assets' as per the definition of 'written down value' as given under section 43(6)(C) of the Act, which aid the charging section 28, as to the assessability of income from business and profession. Learned counsel for the appellant further contended that the courts below had gone wrong in equating the complicated machinery of a spinning mill with a tube-light in relying on the Boards' Circular No. 69 dated 27th of November, 1957 on "tube-lights" which stated that only first time purchase of a tube-light amounts to capital expenditure, and subsequent replacement would only be revenue expenditure. Lastly, learned counsel for the appellant emphasised that the reliance on the decision in ***Janakiram Mills*** **(supra)** case by the High Court was misplaced, in as much as the High Court had failed to appreciate that an appeal had already been filed against it before this Court and thus the decision of the High Court in the ***Janakiram Mills*** **(supra)** case was not final and binding.

12. The learned counsel for the respondent submitted that the respondent had incurred expenditure for replacing the old and worn out parts of machinery of the spinning mill. They are

merely parts of the spinning mill, dependent on other parts of the textile mill, and the replaced machinery cannot function independently. Further, the learned counsel for the respondent argued that the High Court rightly distinguished the ***Madras Cements Ltd.*** **(supra)** case because in that case the whole plant was relocated and in its place a whole new plant was installed. The learned counsel for the respondent further argued that the case of ***Ballimal Naval Kishore*** **(supra)** is not applicable here because in that case a ginning factory was converted to a cinema theatre and what the assessee there did was not replacement of machinery parts of an integrated plant but total conversion into a theatre. The learned counsel for the respondent has contended that the provisions relating to 'assets' and 'block of assets' are immaterial in the instant case, which deals with revenue expenditure on replacement of machinery and would not come under 'block of assets'. Further, the learned counsel for the respondent also relied on the Boards' Circular No. 69 dated 27th of November, 1957 which, the respondent claimed, is still valid and as per which, replacement of worn out parts, even if the same is in a textile mill, would constitute revenue expenditure. The learned counsel for the respondent has also argued that the argument of enduring benefit to the

respondent, taken by the appellant, is no longer a good law. Lastly, learned counsel for the respondent submitted that the High Court was right in relying on its own judgment in the case of ***Janakiram Mills Ltd.*** **(supra)** because this Court, by its order dated 21st of August, 2007 in Civil Appeal No. 7594/2005, has already pronounced upon the validity of the judgment of the High Court in that matter and has disposed of the appeal in the same.

13. 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.

14. 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 intermediate 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 298)**. 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 **process** 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.

15. 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.*** **(supra)** 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 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 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 Mills*** **(supra)** 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*** **(supra)** 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*** **(supra)** 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*** **(supra)** 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 101)**, 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*** **(supra)** 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 ***Saravana Mills*** **(supra)** case that if replacement was held to be 'current repair' in such cases, section 31(i) will be completely redundant and absurdity will creep in because repair implies existence of a part of the machine which has malfunctioned, 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*** **(supra)** case.

16. 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*** **(supra)** 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 assessees' 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.

17. 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*** **((1997) 2 SCC 20)** this Court held that expenditure is of a capital nature when it amounts to an 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 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.

18. As far as reliance on the High Court decision in ***Janakiram Mills*** **(supra)** case is concerned, the ***Saravana Mills*** **(supra)** case has clearly set aside the said judgment of the Madras High Court by its finding on the scope of 'current repairs' under section 31 of the Act. In ***CIT*** **v.** ***Ramaraju Surgical Cotton Mills*** **(MANU/SC/8156/2007)**, where this court decided on the validity of the Madras High Court judgment in ***Janakiram Mills*** **(supra)**, this court clarified that this High Court judgment has been set aside in the ***Saravana Mills*** **(supra)** case mainly on the ground that section 31 and section 37 of the Act, operate in different spheres and the tests applicable to section 31 cannot be read into section 37 of the Act. Further, even in the ***Ramaraju*** **(supra)** case, where this Court distinguished the ***Saravana Mills*** **(supra)** case on the ground that that appeal was with respect to deduction only under section 37 of the Act unlike the ***Saravana Mills*** **(supra)** case, this court set aside the High Court judgment in ***Janakiram Mills*** **(supra)** case and remitted the matter to the Commissioner (Appeals) to dispose of the matter in accordance with law. In the light of the observations made herein above, it is thus clear that the High Court decision in

***Janakiram Mills* (supra)** case is not good law on which reliance may be placed.

19. Consideration of the definition of 'assets' and 'block of assets' and the concept of depreciation under the Act is not required to be decided upon whether the expenditure incurred by the assessee is a deductible expenditure or not. Hence we are not inclined to discuss the same.

20. It is clear on record that the assessee has sought to treat the said expenditure differently for the purposes of computing its profit and for the purpose of payment of income tax. The said expenditure has been treated as an addition to the existing assets in the former and as revenue expenditure in the latter. Though accounting practices may not be the best guide in determining the nature of expenditure, in this case they are indicative of what the assessee itself thought of the expenditure it made on replacement of machinery and that the claim for deduction under the Act was made merely to diminish the tax burden, and not under the belief that it was actually revenue expenditure.

21.For the reasons aforesaid, we set aside the impugned judgment of the High Court, thereby restoring the judgment of the AO disallowing the claim of deduction of the respondent.

22.The appeal is accordingly allowed. There will be no order as to costs.

……J.
[Tarun Chatterjee]

New Delhi;
July 21, 2009

……J.
[Aftab Alam]