KERALA HIGH COURT

Commissioner of Income-Tax

Vs

Premier Cotton Spinning Mills

(V Kamat, C.J. G Sivarajan, J.)

19.03.1996

JUDGMENT

G. sivarajan, J.

1. The Income-tax Appellate Tribunal, Cochin Bench, has referred the following question for decision of this court as per the directions of this court in 0. P. No. 2951 of 1981 under Section 256(2) of the Income-tax Act, 1961 :

> "Whether, on the facts and in the circumstances of the case, the expenditure incurred by the assessee is a capital expenditure or a revenue expenditure ?"

2. The assessee is a public limited company and it had formulated a scheme for providing houses to its employees. For the said purpose 11 acres, 22 cents, of land belonging to one Chinnappa Gounder bearing Survey Nos. 446/6, 452/2, 252/2, 452/4, 452/2 and 452/6 in Puthussery West Village, Palghat Taluk, was acquired. The said land was divided into 124 plots and allotted to the employees for this purpose. The company advanced money to the employees for the purchase of plots and to build houses on the same. Such advances were repayable in monthly instalments. The sale deed in respect of the property allotted to each employee was executed by the owner of the property, namely, Chinnappa Gounder, in favour of each of the employees. The assessee-company made arrangements for laying roads, constructing water tanks and pumps, drainage, digging wells and such other work in the lands left after allotment to the employees who had constructed buildings in the lands allotted to and purchased by them. It is also a fact that the lands in which roads were laid, water tanks and pump sets constructed, drainage, digging wells and such other works done was transferred by the said Chinnappa Gounder to the Puthusseri Panchayat. For laying down the roads, etc., in the said land, the assessee-company had incurred an expenditure of Rs. 48,524 during the accounting year ended March 31, 1973, and debited the said expenditure to the "workmen and staff welfare expenses" account.

3. For the assessment year 1973-74, the assessee-company filed the return declaring an income of Rs. 26,89,891 and, inter alia, claimed deduction of a sum of Rs. 40,388 as revenue expenditure. The balance of Rs. 7,864 incurred for construction of water tanks and installation of pump sets was treated by the assessee as capital expenditure. The assessing authority in the assessment year 1973-74 disallowed the claim for deduction of the said sum of Rs. 40,388 on the

ground that the roads, wells, etc., constructed in the land which were handed over to the Puthusseri Panchayat belonged to the assessee. He was also of the view that the expenditure incurred on road construction, etc., was of capital nature. The assessee took up the matter in appeal before the Appellate Assistant Commissioner of Income-tax, Trichur. It was contended by the assessee before the Appellate Assistant Commissioner that the roads and wells in question did not belong to it and that the expenditure incurred in respect thereof should have been allowed as a revenue expenditure. It was also contended before the Appellate Assistant Commissioner that the roads constructed and the wells dug were handed over to the Puthusseri Panchayat, that the assessee at no point of time was the owner of the said land and that the assessee had not acquired any asset of an enduring value by incurring the above expense. The Appellate Assistant Commissioner accepted the said contention of the assessee and held that since the assessee did not acquire any capital asset by incurring such expenditure, it was to be treated as revenue expenditure. Being aggrieved by the order of the Appellate Assistant Commissioner deleting the said addition, the Department preferred an appeal before the Tribunal. The specific contention taken by the Department before the Tribunal was that the expenditure in question had resulted in the acquisition of certain assets of an enduring nature and hence was of capital nature. In support of the said contention, the Department urged that the roads, wells and the pipe lines, etc., belonged to the assessee. The Tribunal, on a consideration of the facts and circumstances of the case, found that the land in question did not belong to the assessee and that it cannot be said that the works belong to the assessee. It further found that the expenditure in question should be viewed merely as a staff welfare expenditure and hence allowed as a deduction. Dissatisfied with the decision of the Tribunal, the Department sought reference of the following question for decision by this court in R. A. No. 109/(Coch) of 1977-78 ;
" Whether, on the facts and circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that Rs. 40,388 was towards staff welfare expenses and allowing the same as a deduction in computing the income of the year ?"

4. The High Court, by judgment dated December 7, 1979, in I. T. R. No. 159 of 1977, declined to answer the question. While doing so, this court observed that the Tribunal has not approached the consideration of the question from the correct perspective, that there was no discussion by the Tribunal as to whether the expenses were of a capital nature or were of a revenue nature. Its conclusion was that the expenditure should be viewed as staff welfare expenditure in which the assessee had no interest. This court further observed that if the expenditure was not to be considered as a capital expenditure, the Tribunal should address itself to the next question whether the expenditure was incurred wholly and exclusively for the purpose of the business under Section 37 of the Income-tax Act, 1961. The Tribunal was directed to consider the matter afresh in the light of the said observations.

5. The contentions of the Department and of the assessee are referred to in paragraph 6 of the appellate order. Thereafter, the Tribunal considered the matter in paragraph 7 of the appellate order and the Tribunal came to the conclusion that the construction of the wells, water tanks, pump sets and pipe lines, etc., did not belong to the assessee. The Tribunal also considered the decisions of the Madras High Court in *CIT v. T. V. Sundaram Iyengar and Sons (P.) Ltd*[1]. and the decision of the Andhra Pradesh High Court in *CIT v. Singareni Collieries Co. Ltd*[2]*,* to the effect that the expenditure incurred primarily for the welfare of the employees of the assessee-company is not expenditure of a capital nature and that it is revenue expenditure under Section 10(2)(xv) of the Indian Income-tax Act, 1922. The Tribunal thereafter in paragraph 10 of the appellate

order entered a finding to the following effect :

> " Having regard to our findings that no asset of an enduring nature had accrued to the assessee in the instant case by incurring the above expenditure and applying the principle laid down in the abovementioned two decisions of the Madras High Court and the Andhra Pradesh High Court, we have no doubt that the expenditure incurred by the assessee was not capital expenditure, but only revenue expenditure."

6. The Tribunal after entering the finding that the roads, tanks, wells, etc., constructed in the property transferred to the Panchayat did not belong to the assessee and, therefore, no asset of an enduring nature had accrued to the assessee-company in the instant case by incurring the above expenditure then addressed the question as to whether the expenditure incurred could be said to have been laid out exclusively for the purpose of the assessee's business. The Tribunal, in that context, observed that the expenditure was incurred for the purpose of providing roads, water tanks, etc., to the workmen employed by the assessee who availing themselves of the scheme formulated by the assessee-company, had put up constructions on the plots acquired by them from Chinnappa Gounder with monies borrowed from the assessee-company. Relying on the decision of the Supreme Court in CIT v. Malayalam Plantations Ltd. [1964] 53 ITR 140 which held that the expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits" and the further observation that it will include expenditure in respect of acts incidental to the carrying on of business the Tribunal held that the expenditure in question had been incurred by the assessee wholly and exclusively for the purposes of its business and that it is an allowable deduction.

7. It is against these findings of the Income-tax Appellate Tribunal in the appellate order that the Department got reference of the question for our answer.

8. As already pointed out earlier, this court in the order of remand, clearly focussed the points to be considered for deciding the said question. The first question, according to this court to be considered, is as to whether the expenses on which the deduction is claimed is of a capital nature or is a revenue expenditure. If it is found that the expenditure is not of a capital nature, this court further observed that the Tribunal should address itself to the next question whether the expenditure was incurred wholly and exclusively for the purpose of the business under Section 37 of the Act.

9. For considering the first question, it is necessary to bear in mind the principles governing the determination of the question as to whether a particular expenditure is of a capital nature or of revenue expenditure. To formulate the precise rules for distinguishing capital expenditure from revenue expenditure has always been a difficult problem. The Supreme Court in this context had observed that the line of demarcation has been found to be very thin. The Supreme Court in *Assam Bengal Cement Co.Ltd. v. CIT*[3] *and Sitalpur Sugar Works Ltd. v. CIT*[4] and in a number of other decisions had adopted the test laid down by the House of Lords in *Atherton v. British Insulated and Helsby Cables Ltd*[5]. to the effect (at page 40 of 23 ITR) :

> "When an expenditure is made .... with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital. "

10. After quoting the above passage in Assam Bengal Cement Co.'s case [1955] 27 ITR 34 (SC), it was further observed (at page 45) :

> " If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. If it was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it would be of the nature of revenue expenditure."

11. We had also occasion to consider the said question in our judgment *in I. T. R. Nos. 2 to 5 of 1991 (CIT v. Polyformalin (P.) Ltd[6].)*. In those cases also, we had considered the principles laid down by the Supreme Court in the abovementioned decisions and directed the Income-tax Appellate Tribunal to consider the question involved therein in the light of the principles discussed in our judgment.

12. Now, coming to the order passed by the Income-tax Appellate Tribunal after remand by this court, we find that the Appellate Tribunal had posed the first question as to whether the expenditure incurred by the assessee in the construction of roads, digging of wells and laying pipe lines was of capital expenditure in paragraph 5 of the order and adverted to the respective contentions of the Department and the assessee in paragraph 6 of the said order. As could be seen from the contentions raised by the Departmental representative before the Tribunal, the contention that the expenditure incurred was of a capital nature is made only on the assumption that the roads, wells, pipe lines, etc., belonged to the assessee. The Income-tax Officer also had rejected the claim of the assessee for deduction of these expenses only on the ground that the assets belonged to the assessee. The Appellate Tribunal considered the question as to whether the roads, wells, tanks and pipe lines constructed by the assessee belonged to the assessee-company in paragraph 7 of its order and had come to the categoric finding that it cannot be said that these works belonged to the assessee and hence are its assets. The said discussion and finding contained in paragraph 7 of the appellate order is extracted below :

> " As already stated, the entire land of 11 acres, 22 cents, belonged to Chinnappa Gounder. In pursuance of a scheme formulated by the assessee-company to enable its employees to build houses by advancing moneys the said land was divided into 124 plots and the plots were sold to such of those employees who desired to avail of the benefit of the scheme. Moneys were advanced by the assessee by way of loan to such employees for acquiring

the plots and building houses thereon. But certain portion of the land was kept for the purpose of formation of roads, digging wells and other common purposes. Roads were constructed, wells were dug and water tanks were constructed, pump sets were put up and pipelines were laid by the assessee incurring an expenditure of Rs. 48,254. The assessee, however, claimed deduction of only Rs. 40,338 being the expenditure incurred for the construction of roads, digging of wells and laying of pipelines. That was because it had capitalised the expenditure incurred for construction of water tanks and pump sets. It is not disputed that no sale deed was executed by Chinnappa Gounder in favour with the assessee in respect of the land. The sale deeds that were executed by the owner, Chinnappa Gounder in favour of the employees were in respect of plots which were conveyed to them. That does not mean that the land on which the roads were constructed and wells were dug became the property of the assessee. On the other hand, there is evidence to show that Chinnappa Gounder had handed them over to Pudussery Panchayat. At any rate, this is not disputed by the Department. Therefore, it is clear that no portion of the land in question belonged to the assessee. Though the entire expenditure had been incurred by the assessee, it cannot be said that wells dug by it, water tanks put up, pump sets and pipelines laid by it and the roads constructed by it belonged to it. As already stated, they have been constructed on the land which has been handed over to Pudussery Panchayat. Therefore, it cannot be said that these works belong to the assessee and hence are its assets."

13. It can be seen from the above discussion by the Tribunal that the only contention of the Department was that the expenditure in question had resulted in the acquisition of certain assets of an enduring character and, therefore, a capital expenditure. It is clear that the Appellate Tribunal had borne in mind the test laid down by the Supreme Court in deciding the question as to whether a particular expenditure is of a capital or revenue nature and that it had rightly come to the conclusion that since the assets brought into existence did not belong to the assessee, there is no question of bringing into existence any asset of an enduring nature. In other words, in order to satisfy the test laid down by the Supreme Court to determine the question as to whether a particular expenditure is an expenditure of a capital nature, it has to be established that the assessee has brought into existence an asset or an advantage of an enduring nature for its business. The Department had no case that by providing roads, tanks, wells, etc., for the benefit of the employees under the scheme propounded by the assessee-company any advantage of an enduring nature had been acquired by the assessee-company. There was also no material before the authorities or before the Tribunal to consider the question as to whether an advantage of an enduring nature has been brought into existence by the company even though the assessee had not brought into existence an asset of an enduring nature. There was no such plea either. So the answer to the question whether the expenditure is of a capital nature will depend on the findings as to whether the roads, tanks, wells, etc., constructed did belong to the assessee or to a third party, The Appellate Tribunal on a consideration of the factual situation arrived at the finding that the expenditure did not result in bringing into existence any asset to the assessee-company.

14. Notwithstanding the above categoric finding by the Appellate Tribunal, learned senior counsel appearing for the Revenue contended for the first time before us that even if by the expenditure an asset is brought into existence in favour of a third party still the expenditure must be considered to be of capital nature. For making the said submission, he drew inspiration from the decision of the Supreme Court in *Travancore-Cochin Chemicals Ltd. v. CIT*[7] Apart from the

fact that the Department did not take any such plea at the lower levels and before the Tribunal we find that the factual situation in the said decision is entirely different. That was a case where the assessee in that case along with three other public undertakings, in order to improve the transport facilities to their premises approached the Kerala Government for laying a new road to that area. The Government bore the cost of acquisition of land and 25 per cent. of the cost of construction of the road. The total cost to be shared by the four concerns came to Rs. 1,04,500 of which the assessee's contribution came to Rs. 26,100. The assessee sought deduction of this amount as a business expenditure in computing its profits, The Appellate Tribunal held that this amount is entitled to be deducted as revenue expenditure but the High Court, on reference, held that the appellant obtained an enduring advantage by the construction of the road and, therefore, the amount contributed was capital expenditure. The Supreme Court affirmed the said decision on the facts, that by having the new road constructed for the improvement of its transport facilities, the assessee acquired an enduring advantage for its business and the expenditure incurred by the assessee is of a capital nature. Here, in the instant case, the Department had no case that by the construction of the roads, pipelines, etc., for the benefit of the employees the assessee acquired an enduring advantage for its business nor is there any material to show that, by this, the assessee had obtained any enduring advantage for its business. Thus the decision of the Supreme Court cannot have any application to the facts of the present case. The said decision is distinguishable.

15. In the above circumstances, we are of the view that unless the very asset which has been brought into existence did belong to the assessee, it cannot be said that the assessee acquired an enduring advantage for its business.

16. Regarding the second question to be considered as to whether the expenses in question has been incurred for the purpose of the business of the assessee, the Income-tax Appellate Tribunal in paragraph 11 of its order observed that the expenses had been incurred by the assessee as part of the scheme formulated by the assessee-company for providing houses to its employees. In that connection, the Appellate Tribunal relied on the principles laid down by the Supreme Court in *CIT v. Malayalam Plantations Ltd*[8]. Regarding the scope of the expression "for the purpose of business", the Supreme Court observed that the expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits". The Supreme Court further observed that its range is wide ; it may take in not only the day-to-day running of a business but also the rationalisation of its administration and modernisation of its machinery ; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title ; it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for the carrying on of a business ; it may comprehend many other acts incidental to the carrying on of the business. The expenditure in question had been incurred by the assessee-company wholly and exclusively for the purpose of its business and that it is an allowable deduction.

17. In this connection, the observations of the Appellate Assistant Commissioner in paragraph 10 of the appellate order is relevant. It is as follows : "It is common ground that the expenditure was incurred wholly and exclusively for the purpose of the business of the appellant company".

18. It is well-known that each case turns on its own facts. It is also relevant to note that the Tribunal had adverted to the two questions directed to be considered by this court and that the Tribunal has borne in mind the relevant principles governing the determination of the said two

questions. The resultant findings entered by the Tribunal on the two questions, according to us, are findings of facts entered by the Tribunal on a consideration of the relevant factual situation.

19. On the facts found by the Tribunal, we are also clearly of the opinion that the expenditure incurred on roads, wells, etc., was only for the benefit of the employees who purchased properties and constructed buildings in it, that this did not bring into existence an enduring advantage for the assessee's business and that the expenditure being in the nature of a staff welfare expenditure is an expenditure incurred wholly and exclusively for the purposes of the assessee's business. The Tribunal, according to us, has rightly held that the expenditure is an allowable deduction in the computation of the assessee's income for the assessment year under consideration.

20. In view of the above, we hold that the expenditure incurred by the assessee is revenue expenditure. The question is answered accordingly in favour of the assessee and against the Revenue.

21. A copy of this judgment under the seal of the court and the signature of the Registrar will be forwarded to the Income-tax Appellate Tribunal, Cochin Bench, for passing consequential orders as required by law.

Cases Referred.

1 [1974] 95 ITR 428
2[1980] 121 ITR 466
3[1955] 27 ITR 34
4[1963] 49 ITR (SC) 160
5[1925] 10 TC 155 (HL)
6[1996] 221 ITR 276
7[1977] 106 ITR 900
8[1964] 53 ITR 140