

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Chowgule and Co. Pvt. Ltd

(B.P. Saraf and S Jhunjhunwala, JJ.)

01.12.1994

JUDGMENT

B.P. Saraf J.

1. By this reference under section 256(1) of the Income-tax Act, 1961, made at the instance of the Revenue, the Income-tax Appellate Tribunal has referred the following questions of law to this court for opinion:

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that the expenditure of Rs. 99,52,440 incurred on the repairs of the ship 'Maratha Transhipper' is a revenue expenditure without appreciating the fact that the total expenditure together with written down value of the ship exceeds the original cost and confers on the assessee benefit of an enduring nature and which also involved the replacement of substantial part of asset?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that loans should not be deducted in computing the capital for the purpose of granting relief under section 80J of the Income-tax Act, 1961?

3. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that section 40(c) is applicable and not section 40A(5) to the directors?"

2. Counsel for the parties are agreed that question No. 2 is covered by the decision of the Supreme Court in *Lohia Machines Ltd. v. Union of India*¹, and following the same, it should be answered in the negative and in favour of the Revenue. Counsel are further agreed that since question No. 3 is also covered by the decision of this court in *CIT v. Hico Products P. Ltd*². it should be answered in the affirmative and in favour of the assessee. Having regard to the above position, we answer these two questions accordingly. The only controversy that survives for our

consideration is the one raised in question No. 1. In that view of that matter, we shall briefly refer to those facts which are material for answering the said question.

3. The assessee is a private limited company doing the business of export of iron ore, manganese ore, iron ore pellets and manufacture of yarn. It also derives income from loading, power supply and up-topping ships, etc. In the previous year relevant to the assessment year 1974-75 to which this reference relates, the assessee effected major repairs to one of its vessels "Maratha Transhipper" which resulted in an expenditure of Rs. 99,52,440. The assessee claimed deduction in computation of its income in respect of the above amount as expenditure on current repairs. In the course of assessment, the Income-tax Officer noticed that the assessee had also lodged a claim with the insurance company for recovery of a part of the above expenditure amounting to Rs. 24,44,000, out of which it had received on January 16, 1975, a sum of Rs. 11,50,000. In view of the fact that the total claim made by the assessee was Rs. 24,44,000 out of which it had actually received Rs. 11,50,000 and the final claim was yet to be determined, the Income-tax Officer disallowed the sum of Rs. 24,44,000 out of the claim of Rs. 99,52,440 and allowed deduction on account of the balance as expenditure on repairs of the vessel.

4. The Commissioner of Income-tax, Bangalore, on perusal of the assessment order, being of the opinion that the above order of the Income-tax Officer was erroneous and prejudicial to the interests of the Revenue, issued notice under section 263 of the Income-tax Act, 1961 ("the Act") to the assessee asking it to show cause as to why the order of the Income-tax Officer should not be set aside. In response to the said notice, the assessee's representative appeared before the Commissioner of Income-tax and gave his objections. It was contended by the assessee before the Commissioner that the expenditure incurred on repairs to the vessel "Maratha Transhipper" amounting to Rs. 99,52,440 was revenue in nature and no portion of it could be disallowed as capital expenditure. In support of this contention, the assessee relied on the observations of the Inspecting Assistant Commissioner in his directions under section 144B(4) of the Act to the effect that though the amount was large, it was only for the upkeep of the vessel; that the entire expenditure had been actually incurred and that no new asset had come into existence and that despite the fact that a large amount was involved, the expenditure in question was revenue expenditure and not capital in nature. It was also contended that there was no authority for the proposition that when the total expenditure added to the written down value exceeds the original cost, such excess has to be disallowed. The assessee also contended that the quantum of expenditure was not material for determining whether it was to be allowed as a deduction or not. Lastly, it was contended that the repairs in question were for the purpose of preserving or maintaining an already existing asset and did not bring into being a new asset or enduring advantage and, therefore, the proposal to disallow any portion of the expenditure in question over

and above the disallowance made by the Inspecting Assistant Commissioner in his directions under section 144(B)(4) should be dropped. The Commissioner, however, did not accept the above contention of the assessee as he was of the opinion that the expenditure in question had been incurred with a view to bringing into existence an asset or advantage of enduring benefit to the business of the assessee. Considering the huge amount spent, the Commissioner did not agree that the expenditure in question was on current repairs as contended by the assessee. In arriving at the above conclusion, the Commissioner also observed that the written down value of the vessel as on April 1, 1973, being only Rs. 1,12,21,713 the amount spent, viz., Rs. 99,52,448, was for replacement of certain parts. The Commissioner, therefore, rejected the assessee's contention and directed the Income-tax Officer to disallow expenditure of Rs. 75,88,440 incurred by the assessee on account of repairs to the vessel which had been earlier allowed by the Income-tax Officer.

5. Being aggrieved by the above order of the Commissioner of Income-tax, the assessee appealed to the Income-tax Appellate Tribunal ("the Tribunal"). It was contended, inter alia, by the assessee that the ship in question had been acquired by it in the year 1970 and to maintain and conform to its international standards of classification, it was necessary to carry out certain repairs. As it was not possible to carry out the repair in India, the ship was sent to Japan. The total expenditure incurred thereon came to Rs. 99,52,440. The Income-tax Officer in the draft order sent for approval of the Inspecting Assistant Commissioner under section 144B had suggested disallowance of the said expenditure on the ground that it was of capital nature. The Inspecting Assistant Commissioner, however, examined the whole matter in the light of the entire correspondence in this connection and held that the expenditure in question was not capital in nature. It was submitted that the Commissioner was not justified in holding it to be a capital expenditure merely because the amount of expenditure on repairs together with its written down value exceeded the original cost of the ship. The Tribunal, on a perusal of the facts of the case, accepted the contention of the assessee and held that the Commissioner was not justified in interfering with the findings of the Income-tax Officer in respect of the expenditure in question. While saying so, the Tribunal perused the entire record of the case and observed that the details of the expenditure incurred by the assessee on repairs were thoroughly gone into by the Inspecting Assistant Commissioner before holding that it was not an expenditure of capital nature. The Tribunal further observed that the Commissioner did not give any reason as to why he considered any part of the expenditure to be of capital nature except saying that the total expenditure on repairs together with the written down value of the ship exceeded its original cost. The Tribunal, therefore, set aside the order of the Commissioner of Income-tax and restored the original deduction allowed by the Income-tax Officer. Hence, this reference at the instance of the Revenue.

6. We have perused the order of the Commissioner of Income-tax passed on revision under section 263 of the Act as also the order of the Tribunal setting aside the same. We find that the Commissioner held the expenditure on repairs and replacements in the instant case to be expenditure of capital nature considering the magnitude of the amount spent vis-a-vis the original cost of the ship. The Tribunal set aside the same as according to it that was not a relevant consideration. The Tribunal the nature of the expenditure and held it to be expenditure on current repairs which is an admissible deduction under section 31 of the Act. On a careful consideration of the two orders, for the reasons set out below, we find ourselves in agreement with the conclusion arrived at by the Tribunal.

7. Section 31 of the Act provides for deduction in respect of amounts paid on repairs of machinery, plant, etc. It reads:

"31. Repairs and insurance of machinery, plant and furniture. - In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business of profession, the following deductions shall be allowed -

(i) the amount paid on account of current repairs thereto;

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof."

8. On a plain reading of the above section it is clear that in order to entitle an assessee to claim deduction under section 31 of the Act, the amount must be paid on account of "current repairs". The expression "current repairs" has not been defined in the Act. It has, therefore, to be taken in its popular or commercial sense. In commercial parlance, it means repairs which are undertaken in the normal course of user for the purpose of preservation, maintenance or proper utilisation. It does not mean 'petty repairs' or repairs necessitated by wear and tear during the particular year. Payments on account of "current repairs" must be understood in contradistinction to payments for "additions" or "improvement". As observed by Chagla C.J. in *New Shorrock Spg. and Mfg. Co. Ltd. v. CIT*³ the simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as an expenditure for repairs what is really being done is to preserve and maintain an already existing asset. The object of the expenditure should not be to bring a new asset into existence nor to obtain a new or different advantage. The quantum of expenditure incurred on the repairs is not relevant for determining whether it is an expenditure on current repairs or not, because the extent of repairs and the amount spent would depend upon various factors. Similarly, by the mere fact that old parts were replaced by new parts, it cannot be said that a new asset is brought into existence.

9. We are supported in our above conclusion by the decision of the Punjab and Haryana High Court in *CIT v. Sheikhpura Transport Co. Ltd*⁴. where expenditure incurred by a transport company in fitting new bodies in place of worn out ones to five of its lorries was held to fall within the definition of "current repairs" under section 10(2)(v) of the Indian Income-tax Act, 1922 (corresponding to section 31 of the Income-tax Act, 1961), and the decision of the Madras High Court in *CIT v. Coimbatore Motor Transport Co-operative Society for Ex-servicemen* [1968] 70 ITR 165, where expenditure incurred by the assessee, who was engaged in transport of goods and passengers, on complete renovation of the body of a motor vehicle by putting a new body on an old chassis, was held to be a case of "current repairs" and hence an allowable deduction. Similarly, in *CIT v. Khalsa Nirbhai Transport Co. (P.) Ltd*⁵. expenditure incurred by a private limited company carrying on the business of transport on replacement of the petrol engines of its buses by diesel engines was held by the Punjab and Haryana High Court to be revenue expenditure and an allowable deduction as "current repairs". To the same effect is the decision of the Madras High Court in *C. R. Corera and Brothers v. CIT*⁶ In this case, the assessee had incurred heavy expenditure in repairing its cargo boat. The repairs involved were caulking, replacement of underwater planking and copper sheathing As a result of the repairs, the boat was structurally not altered nor was there any improvement in its loading capacity, performance or other features. On these facts, it was held that the expenditure was allowable as "current repairs". It was observed that the nature of expenditure on any repair claimed to have been effected has to be viewed as a whole and in the proper perspective, in order to determine whether such repairs have only had the effect of restoring the machinery to its original condition or whether they have introduced any additional advantage or features which have improved its income earning capacity. It was also observed that merely because a large sum is expended on repairs, it cannot be taken as a matter of assumption that it must necessarily amount to reconstruction. In *CIT (addl.) v. Desai Bros*⁷. the Gujarat High Court was also required to construe the expression "current repairs" appearing in section 31 of the Act. In the above case, the assessee who was engaged in the business of manufacturing of bidis had replaced a petrol engine by a diesel engine in a truck which was being used in the business and claimed the expenditure incurred on such replacement to be expenditure on current repairs deductible in the computation of its income. It was held that the expenditure did not bring into existence a new asset nor were there substantial repairs or renovation. The expenditure had been incurred in preserving and maintaining the asset for the purposes of its business. It was, therefore, held to be a revenue expenditure on current repairs to the machinery of the assessee and deductible under section 31 of the Act.

10. It may also be expedient at this stage to consider the relevance of the original cost of the asset vis-a-vis the expenditure on repairs to determine whether it is a revenue expenditure on "current repairs" or expenditure of capital nature. In the instant case, the Commissioner held the

expenditure not to be a revenue expander on current repairs in view of the fact that the amount of expenditure on repairs together with the written down value of the ship exceeded its original cost. This, in our opinion, is not the correct approach to determine the nature of the expenditure. The original cost of the ship or machinery or plant is not indicative of its value at the time when the repairs were undertaken. If the value of the machinery or plant or the ship is a relevant factors in deciding whether the repairs amounted to current repairs or results in an addition to or improvement of the existing asset, it would be the "replacement value" and not the "original cost". It is common experience that the replacement value of an asset is often much higher than the original cost-some-times so high that the figure of the original cost loses its relevance. For example, the original cost of an Ambassador car in the mid-seventies was around Rs. 28,000. If such a car was used for business, its written down value after few years of purchase would be insignificant. Repairs undertaken on such car might often involve expenditure of an amount much higher than the original cost of the car itself. But that cannot be a factor to hold the expenditure to be an expenditure of capital nature. The "replacement value" of an asset might, however, at times throw some light on the true nature of the expenditure on repairs. Turning to the same illustration of an Ambassador car, the replacement cost of the motor car at present is over Rs. 2,00,000. An expenditure of Rs. 50,000 to Rs. 75,000, on repair of such car cannot be said to bring into existence a new car or result in an addition to such car, though such expenditure evidently is more than double the original cost of the car. Expenditure on repairs and replacement, therefore, cannot be held to be an expenditure of capital nature considering the magnitude of the amounts spent vis-a-vis the original cost of the asset.

11. The propositions that emerge from the above discussion may be summed up thus :

- (i) The amount should be paid on account of current repairs.
- (ii) "Current repairs" means repairs undertaken in the normal course of user for the purpose of preservation, maintenance or proper utilisation or for restoring it to its original condition.
- (iii) "Current repairs" do not mean only petty repairs or repairs necessitated by wear and tear during the particular year.
- (iv) Such repairs should not bring into existence nor obtain a new or different advantage.
- (v) Neither the quantum of expenditure nor the fact that in the process of repairs, there was substantial replacement of the parts of the machine or ship, is decisive of the true nature of the expenditure.
- (vi) The original cost of the asset is not at all relevant for ascertainment the true nature of the

expenditure on repairs.

(vii) The replacement cost of the asset may, however, at times be used as an indicator of the true character of the expenditure. If the expenditure on repairs added to the written down value or disposal value exceeds the replacement cost of the asset, a presumption is possible that it is not a revenue expenditure but expenditure of capital nature. Such a presumption, of course, would be rebuttable.

(viii) The expression "current" preceding "repairs" appears to have been used by the Legislature with a view to restricting the allowance to expenditure incurred for preservation and maintenance thereof in its current state in contradistinction to that incurred on any improvement or an addition thereto.

12. In the present case, the Tribunal, on an investigation of the nature of the repairs undertaken by the assessee, recorded a categorical finding of fact that it did not result in the emergence of a new ship but amounted, in substance, to current repairs to the existing ship. These findings have not been challenged before us by the Revenue. The fact that old parts of the ship were replaced by new parts, in our opinion, is not relevant for determining whether the expenditure was on "current repairs" or not. The replacement of the old parts by new parts does not mean that a new asset was brought into existence in relation to the ship in question. The replacement of the parts was only in the process of current repairs of the ship. The expenditure claimed in this case, therefore, amounts to "current repairs" which is allowable as a deduction under section 31 of the Act.

13. In view of the above, we answer question No. 1 in the affirmative and in favour of the assessee.

14. This reference is disposed of accordingly.

15. There shall be no order as to costs.

Case Referred.

1[1985] 152 ITR 308

2(No. 1) [1993] 201 ITR 567

3[1956] 30 ITR 338 (Bom)

4[1961] 41 ITR 336

5[1971] 82 ITR 741 (P & H)

6[1963] 49 ITR 188

7[1977] 108 ITR 14 (Guj)