Expenditure relatable to business of assessee having given some enduring benefit cannot be regarded as capital expenditure

Summary – The Mumbai ITAT in a recent case of Perfect Engineering Products Ltd., (the Assessee) held that where expenditure in question are relatable to business of assessee then simply for reasons that these have given some enduring benefit to assessee, same cannot be regarded as capital expenditure.

Facts

- The assessee-company was engaged in the business of manufacturing of automobile parts. It had incurred certain expenditure and had treated them as research and development expenditure eligible for deduction under section 35(1)(i) and 35(1)(iv). In the computation, depreciation at the rate of 100 per cent had been claimed thereon.
- During the course of assessment proceedings the assessee dropped its claim regarding 100 per cent depreciation; however, it continued to claim them as expenditure incurred on research and development. Alternatively, it was claimed that the same was allowable as revenue expenditure under section 37.
- The Assessing Officer held that the assessee could not produce any evidence to show that those expenses had been incurred for scientific research and development and thus such expenditure could not be allowed under section 35.
- Thereafter, the Assessing Officer observed that the assessee incurred the expenditure which were relatable to business of the assessee and could be viewed as having enduring benefit to the assessee. Therefore, he treated the entire amount of expenditure as capital expenditure and allowed depreciation at the rate of 25 per cent thereon.
- The Commissioner (Appeals) observed that the auditor of the assessee-company had stated 'N.A.' against the amount stated to be admissible under section 35 and in the earlier years the assessee had capitalized similar expenditure on ground that it was a new line of business. Keeping in view the above fact, he observed that any expenditure prior to the commencement of the business would be capital in nature, therefore, such claim of the assessee could not be allowed under section 37.
- On second appeal.

Held

- The Commissioner (Appeals) has just simply relied upon the fact that in the audit report in the column described for expenditure to be incurred under section 35 the auditor had mentioned 'N.A.'. In the earlier years the assessee had capitalized similar expenditure on the ground that it was a new line of business. However, no such material exists on record according to which it can be said that any expenditure has been incurred by the assessee in the new line of business.

- These observations of Commissioner (Appeals) are also contrary to the observation of Assessing Officer as Assessing Officer has observed that the expenditure incurred by the assessee is relatable to its business.
- As per well established law, treatment in the account books is not conclusive factor to determine the nature of the expenditure. As per decision of the Apex Court in the case of *Empire Jute Company Ltd.* v. *CIT* [1998] 124 ITR 1/3 taxman 69 the true test to ascertain the nature and import of expenditure is to examine the same from commercial perspective. Even if, it is being accepted that the expenditure results in an enduring benefit to the assessee, yet every incidence of enduring benefit would not result in a classification of expenditure as a capital expenditure. In the said decision it was observed that there may be cases where expenditure even if incurred for obtaining an advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may breakdown. It 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 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 the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be of revenue account, even though the advantage may endure for an indefinite future.
- The ITAT observed that as found from the details of expenditure, these expenditure are incurred on raw material, sub-contracting charges, power and fuel, salary and wages, bonus, P.F., ESI, LWF, leave encashment, canteen, telephone expenses, printing and stationary, foreign travel expenses and interest. None of these expenditure can be said to have formed a new asset and Assessing Officer has admitted that these expenditure are relatable to the business of the assessee then simply for the reasons that these have given some enduring benefit to the assessee cannot be regarded as capital expenditure.
- In view of the above discussions, the expenditure claimed by the assessee are revenue expenditure and are allowable in the year under consideration under section 37(1).
- In the result, the appeal filed by the assessee is allowed.