Preoperative exp. incurred to expand existing business was revenue exp.

Summary – The High Court of Delhi in a recent case of SRF Ltd., (the Assessee) held that where assessee company expanded its existing business and claimed said expenses as pre-capitalisation cost, same was to be treated as revenue expenditure

JUDGMENT

S. Ravindra Bhat, J. - The Revenue is aggrieved by the impugned order of the Income-tax Appellate Tribunal ("the ITAT") dated September 6, 2013, in I.T.A. No. 4454/Del/2010. The assessee had claimed the sum of Rs. 7,03,95,000 as pre-capitalisation expenses towards expansion of its business. This was disallowed by the Assessing Officer ("the AO") as well as the Commissioner of Income-tax (Appeals) concurrently. The Revenue urges that the Income-tax Appellate Tribunal's decision, reversing the view of the lower authorities is contrary to law.

2. Briefly the facts are that the assessee engages itself in the manufacturing of nylon tyre cord fabrics, packaging film, fluorochemicals, chloromethane and refrigerant gases. During the year in question, i.e., 2005-06, it sought to expand its business in polyester films at Indore, pharma chemical business at Bhiwadi and industrial fabrics business at Trichy. Towards these, it claimed the expenses to the tune of Rs. 7,03,95,000 as pre-capitalisation costs. The Revenue treated this as properly falling in the capital side and disallowed the expenditure. At the same time, the Revenue also permitted the allowable depreciation. The Commissioner of Income-tax (Appeals) confirmed the findings of the Assessing Officer. The Income-tax Appellate Tribunal, after considering the existing business and the expansion sought to be urged by the assessee in support of its claim, that the pre-capitalisation expenditure is really revenue in nature, held that there was an element of interlacing and intermingling of funds between the new or expanding venture and the existing venture, and, consequently, the expenses had to be treated as falling on the revenue side.

3. Learned counsel for the Revenue urges that the Income-tax Appellate Tribunal plainly proceeded on erroneous premise and did not properly appreciate the decision of the Supreme Court in *Challapalli Sugars Ltd.* v. *CIT* [1975] 98 ITR 167. He also urged that the setting up of an entirely new line of business cannot be treated as expansion of the existing business and relied upon the judgment of this court in *CIT* v. *Food Specialities Ltd.* [1982] 136 ITR 203/[1981] 7 Taxman 86 (Delhi) and *CIT* v. *J.M.A. Industries Ltd.* [1981] 129 ITR 373/6 Taxman 236 (Delhi). He also relied upon the decisions of other High Courts.

4. Learned counsel for the assessee, on the other hand, relied upon the judgment in *Jay Engg. Works Ltd.* v. *CIT* [2009] 311 ITR 405/[2008] 166 Taxman 115 (Delhi) to say that seemingly diverse and disparate lines of business can yet be treated as part of the same business provided certain important parameters are kept in mind that both should have the common management and that the funds used for the purposes of the existing business as well as the new entity should be common. Applying these tests, urged learned counsel, the assessee was squarely covered by the ruling in *Jay Engg. Works Ltd.* (*supra*). In *Jay Engg. Works Ltd.* (*supra*), a Division Bench of this court relied upon a large number of previous judgments, including the judgments of this court and held as follows (page 410 of 311 ITR) :

"Finally, in *Veecumsees* v. *CIT* [1996] 220 ITR 185 (SC), the assessee ran a jewellery business and then commenced business in the exhibition of cinematographic films. The assessee obtained loans for building a cinema theatre and the question was whether the interest payable on the loans borrowed for the new business was a revenue expenditure or not. While answering the question in favour of the assessee, the Supreme Court found that the two businesses were composite in the sense that there was interconnection, interlacing or interdependence between the jewellery business and the cinema business.

On an appreciation of the law laid down by the various decisions referred to above, it is clear that the nature of the new business is not a decisive test for determining whether or not there is an expansion of an existing business. The nature of the business could be as distinct as a jewellery business and a business of cinematographic films ; it could be as different as manufacture of metal alloys and manufacture of rubber products. What is of importance is that the control of both the ventures, the existing venture as well as the new venture, must be in the hands of one establishment or management or administration. The place of business of the existing business and the new business may not be in close proximity-it could be as far apart as Baroda and Bangalore. However, the funds utilised for the management of both the concerns must be common as reflected in the balance-sheet of the company.

In other words, there may be several permutations and combinations that may arise for determining whether the expenditure is revenue or capital and each case must, of course, be dealt with on the broad principles that have been accepted by the courts as are mentioned above.

Applying these principles to the present case, it is quite clear to us that the control over the two units is in the hands of the same management and administration. There is no doubt on this score and in fact, the annual report of the assessee, which has been shown to us by learned counsel, makes a reference to the project at Hyderabad. There can be no dispute from the facts that have been placed before us on record that the new venture was managed from common funds and there is the necessary unity of control leading to an interconnection, interdependence and interlacing of the two ventures such that it can be said that the fuel injection equipment project is only an extension of the existing business of the assessee and, therefore, the expenditure incurred by the assessee on this project is a revenue expenditure."

5. This court notices that in *Jay Engg. Works Ltd.* (*supra*) itself, the *Challapalli Sugars Ltd.* (*supra*) holding was noticed and at the same time distinguished in the light of the previous ruling in *India Cements Ltd.* v. *CIT* [1966] 60 ITR 52 (SC). The important point of distinction noted by the court in *Jay Engg. Work's Ltd.* (*supra*), to say that *Challapalli Sugar Ltd.* (*supra*) was inapplicable, was that in that case the assessee had borrowed considerable sums of money for installation of plant and machinery, and interest was sought to be loaded on the cost of plant and machinery. The Assessing Officer had rejected the assessee's claim and held that the interest was an important part of revenue expenditure and no depreciation could be claimed as was done in that case. The assessee's contention in that respect was accepted by the Supreme Court. As would appear from *Jay Engg. Works Ltd.* (*supra*), the previous rulings were cited and properly dealt with. *Jay Engg. Sugar Ltd.* (*supra*), has affirmed the basis of the decision of the Income-tax Appellate Tribunal impugned in this case. We are, therefore, of the opinion that no substantial question of law arises for consideration. The appeal is, accordingly, dismissed.