

Exp. incurred to replace various parts of machinery treated as revenue exp. as no new asset brought into existence

Summary – The High Court of Madras in a recent case of Neyveli Lignite Corporation Ltd., (the Assessee) held that Expenditure on replacement and overhauling parts of boilers/BWEs which was incurred for preserving and maintaining already existing assets and object of such expenditure not being to bring a new asset into existence, same could not be treated as capital expenditure

Facts

- The assessee was a Public Sector Undertaking engaged in the business of generation of electricity and mining of lignite. It incurred expenditure on Life Extension Program of Thermal Power Station-I (TPS-I) and rejuvenation of Bucket Wheel Excavator (BWE) and claimed the expenditure to be revenue expenditure allowable under section 37 or as current repairs under section 31(i).
- The Assessing Officer, while completing scrutiny assessment under section 143(3) for the assessment years 1993-94 to 1999-2000, held these expenses to be capital in nature, on the ground that these expenses were incurred after the lifespan of the machinery, giving the assessee an enduring advantage.
- On appeal, the Commissioner (Appeals) confirmed the disallowance made by the Assessing Officer.
- On the second appeal by the assessee, the Tribunal remanded the matter back to the Assessing Officer to consider the issue *de novo*.
- The Assessing Officer went into the issue afresh and once again disallowed the expenditure treating the same as capital expenditure.
- On appeal, the Commissioner (Appeals) allowed the assessee's claim, holding that there was no increase in the production or generation of power capacity, even after the life extension program was carried out and that therefore, the same could not be treated as capital expenditure.
- On revenue's appeals before the Tribunal, the Tribunal dismissed the appeals, holding that the expenditure on replacement and overhauling parts of the boilers/BWEs was incurred for preserving and maintaining the already existing assets and that the object of such expenditure was not to bring a new asset into existence.
- On appeal by revenue to the High Court:

Held

- Section 31(i) entitles an assessee to a deduction on the amount paid on account of current repairs, in respect of plant or furniture used for the purpose of business or profession. The *Explanation* to section 31 makes it clear that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

- After providing for deduction on various types of expenditure, the Act also contains a residuary provision in section 37(1) which states that any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head profits and gains of business or profession.
- Though sections 31 and 37 use the expressions capital expenditure and current repairs, both these terms are also not defined anywhere in the Act. Therefore, Courts have repeatedly battled with these expressions, to find out whether an assessee is entitled to deduction or not.
- Though different tests had been formulated by Courts, the application of those tests had posed lot of difficulties, depending upon the facts and circumstances of each case. This is why the Supreme Court pointed out in *CIT v. Saravana Spg. Mills (P.) Ltd.* [\[2007\] 293 ITR 201/163 Taxman 201](#) that the answer to the question would depend upon the facts and circumstances of each case.
- Under section 31, the amount paid on account of current repairs to plant or furniture used for the purpose of business or profession shall be allowed as deduction. But, the *Explanation* to section 31 qualifies the general rule by stating that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.
- Though the Act defines the expression income, it does not define either the expression expenditure or the expression repairs or current repairs. However, several heads of expenditure are separately dealt with under sections 35 and 35A to 35E.
- Section 37(1) states that any expenditure laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the head profits and gains of business or profession. But, section 37(1) excludes three items of expenditure. They are (i) expenditure of the nature described in sections 30 to 36, (ii) expenditure in the nature of capital expenditure, and (iii) expenditure in the nature of personal expenses of the assessee.
- Therefore, if an item of expenditure falls within any of the categories indicated in sections 30 to 36, the same is entitled to deduction as per the provisions of those sections. But, any expenditure which does not fall within the scope of sections 30 to 36, but which may still qualify while computing the income chargeable under the head profits and gains of business or profession, will be covered by section 37(1).
- But, what is important to note is that under both provisions, namely section 31 as well as section 37(1), capital expenditure is excluded. If an amount paid on account of current repairs is in the nature of capital expenditure, section 31 cannot be invoked. Similarly, section 37(1) cannot also be invoked.
- Keeping the above in mind, on having a look at the order of the Tribunal, it could be seen that admittedly the assessee's power generation plant was installed in the years 1962-1970 comprising of 9 units. The power generation plant cumulatively accounted for 600 MW of capacity. The

assessee's case was that they had erected one boiler for each 50 MW of power generation and the boilers worked for 12 years. Each boiler contained several parts, some of which were replaced.

- During the assessment years 1993-94 to 1999-00, the assessee incurred expenditure towards replacement of various components in boilers and components of BWE.
- The Tribunal thought that so long as the assessee had not replaced the entire boiler/BWE and what were replaced were only part of the boiler, the expenditure incurred towards the same was only to preserve and maintain the existing assets without any enduring advantage. In such a view, the Tribunal held in favour of the assessee. The Tribunal also went on the footing that if a new plant has to be commissioned, it would cost Rs.4.5 crores per MW and that the total project cost for 600 MW would run to Rs.2700 crores. Hence, the Tribunal found that the amount of expenditure actually incurred by the assessee, could not be taken to be of such a huge nature as to project it as capital expenditure.
- The question whether a particular expenditure would fall within the definition of the expression current repairs under section 31(i) or not, does not depend upon what the assessee did or did not. After all if the expenditure is capitalised, the assessee takes the benefit of depreciation. If the expenditure is treated as revenue expenditure, it is either taken as an expenditure under section 37(1) for computing income chargeable under the head profits and gains of business or profession or treated as current repairs entitled to deduction under section 31(i).
- There was a clear finding in the order of assessment that the assessee had two options. The first option was to install a new plant which would have cost about Rs.4.5 crores per MW with a longer gestation period. The second option was to go in for the life extension program at a cost of Rs.0.44 crores per MW with a shorter gestation period. These findings of fact recorded by the Assessing Officer are accepted by the revenue.
- After having found that there were two options open to the assessee and that the assessee had gone in for a cheaper option (almost 1/10th of the cost of first option), the Assessing Officer fell into an error in treating both options to be of the same nature. This error in the reasoning of the Assessing Officer was rejected by both the Appellate Authorities on the basis of the principles of law enunciated in various cases. Therefore, the Commissioner (Appeals) as well as the Tribunal were right in deciding in favour of the assessee. Appeals are dismissed.