

Exp. on replacement of tools held as revenue exp. in accordance with provisions of AS-2 and AS-10

Summary – The Chennai ITAT in a recent case of Ucal Machine Tools (P.) Ltd., (the Assessee) held that assessee had been maintaining a mercantile system of accounting, treatment of emergency spares in accordance with revised Accounting Standard (AS) 2 and (AS) 10 would be in consonance with mercantile system of accounting which under Act, revenue was required to look at for computing income of assessee chargeable under head 'Profits and gains' from business, thus, expenditure incurred by assessee on replacement of tools was to be allowed as revenue expenditure

Facts

- The assessee company was engaged in manufacture of automobile component and also making dyes & moulds, jigs and fixtures and special purpose tools as per customer's requirements. It incurred expenditure on replacement of tools.
- The Assessing Officer treated expenditure on tools as capital expenditure.
- However, according to the assessee the life of the tools was very short like screw drivers, spanners which were purchased along with machineries. According to him these items by wear and tear, got worn out and had to be replaced and such replacement were revenue expenditure only and could not be considered as capital expenditure.
- On appeal to the Tribunal:

Held

- As per the provisions of Accounting Standards (AS) 2 and (AS) 10, the machinery spares which are not specific to any fixed asset and can be used generally should be treated as part of inventory and charged to profit and loss account as and when they are consumed during the ordinary course of business. On the other hand, if the machinery spares are of the nature of capital spares/insurance spares which are specific to a particular item of fixed asset and their use is irregular, then, they should be capitalized separately and depreciated on a systematic basis over a time frame not exceeding the useful life of the fixed asset to which they relate. As a matter of fact, in case the fixed asset to which they relate, is discarded, the machinery spares will also have to be disposed of as these spares are integral parts of the fixed asset. These accounting standards are mandatory in nature and applied to accounts prepared after April 1, 1999 and were thus applicable to the assessee for the assessment year under consideration.
- Furthermore, the provisions of sub-sections (3A), (3B) and (3C) of section 211 of the Companies Act, 1956, clearly provide that every profit and loss account and balance-sheet of a company shall comply with the Accounting Standards prescribed.

- Therefore, the assessee was obliged to capitalise the entire cost of spares in consonance with the mandatory provisions of Accounting Standards (AS) 2 and (AS) 10.
- The assessee has been maintaining a mercantile system of accounting, therefore, the treatment of emergency spares in accordance with the revised Accounting Standard (AS) 2 and (AS) 10 would be in consonance with the mercantile system of accounting which under the Act the revenue is required to look at for computing income of the assessee chargeable under the head " Profits and gains" from business.
- Thus, expenditure on tools is to be allowed as revenue expenditure.