

Interest paid on funds borrowed for installing power plant allowable irrespective of commencement of production

Summary – The Ahmedabad ITAT in a recent case of Core Health Care Ltd., (the Assessee) held that Payment of interest in relation to money borrowed for installing captive power plant for expansion of existing pharmaceuticals business of assessee was allowable as deduction under section 36(1)(iii) irrespective of fact whether such power plant had commenced production or not in year under consideration

Facts

- The assessee company was engaged in the manufacturing and sales of pharmaceuticals products. The assessee had made borrowings to finance the cogeneration power plant and utility project which were held by the company for divestment. The assessee claimed an amount on account of interest expenditure as 'deferred revenue expenditure' in the books of account but claimed the same as 'revenue expenditure' in the statement of income filed with the return of income.
- The Assessing Officer observed that the assessee had wrongly claimed deduction of interest concerning power project which was different from its main stream of business of pharmaceutical products. The Assessing Officer also noted that the expenditure was pre-operative in nature pertaining to assets before it being put to use. The Assessing Officer accordingly invoked *Explanation - 8* to section 43 and held that interest paid prior to the date of such asset being put to use required to be capitalised. Accordingly interest claim on borrowings attributable to power projects was disallowed in the hands of the assessee.
- On appeal, the Commissioner (Appeals) confirmed the rejection of claim of interest.
- On second appeal:

Held

- The substantive issue involved for adjudication is allowability of interest expenditure incurred by the assessee on borrowed funds utilized for installation of captive power plant which has not been put to use during the assessment years in question. It is the case of the assessee that it wanted to install a captive power plant for generation of electricity for the purposes of its on-going and existing pharmaceutical business. In order to implement the captive power plant, it obtained certain loans from banks and financial institutions. The interest on borrowed funds has been claimed as revenue expenditure for the purpose of taxation in departure with the position taken in the books of account where it was treated as a capital item. The Assessing Officer had refused to accept the claim of the assessee towards interest expenditure on borrowed funds as a revenue expenditure on the broad grounds, namely; (i) the plant had not been installed and the assets have not been put to use; (ii)

there was no generation of electricity from that plant; (iii) as per the note in the financial statements, the power plant has been marked for disinvestment by the assessee.

- As borne out from the orders of the authorities below, it is the claim of the assessee that power plant was sought to be installed for captive power consumption in the larger context of the business necessity to cut down the costs of power consumption of its existing and on-going pharmaceutical business. It is the claim of the assessee that due to financial difficulties, the power plant was marked for dis-investment and finally sold to the financial (IDBI) and taken back on lease by way of Sale & Lease Back Agreement during the financial year 1996-97 (Assessment year 1997-98) *vide* Agreement dated 26-9-1996.
- In the context of the facts noted above, one advert to purport of section 36(1)(iii). As noticed judicially by precedents, the deduction under section 36(1)(iii) is dependent on the fact whether capital borrowed is for the purpose of the business of the assessee or not. If it is found that the capital was borrowed for the purpose of business of the assessee, the interest payable thereon is admissible under the said section and it is immaterial whether the utilization of the borrowed funds is in the nature of capital expenditure or revenue expenditure and if the expenditure is a business expenditure relating to any stage of the business activity carried on by the assessee, it is an admissible deduction under section 36(1)(iii). If the borrowed funds have been utilized for acquisition of asset which is closely related to the carrying on of the business, the interest expenditure has to be regarded as an expenditure for the purposes of business. The assessee, had not started any new business of generation of power but the power plant was sought to be built to assist the rationalisation of costs involved in existing pharmaceutical business. Therefore, the captive power plant in consideration was only an expansion or extension of the existing business by way of integration of the activities. Needless to say, the question whether the particular expenditure is revenue expenditure incurred for the purpose of business must be viewed in the larger context of the business necessity or expediency. If the outgoing or expenditure is so related to the carrying on or conduct of the business, it may be regarded as an integral part of revenue earning process and thus, a revenue expenditure.
- The claim of the assessee is that the power plant is nothing but the expansion of its existing pharmaceutical business under the same management and administration and at the same place where the pharma unit is in operation.
- The Assessing Officer, keeping in view, the fact that loan was raised for setting up a power plant which is akin to creating a capital asset, which is yet to come into production of power, has disallowed the interest for the period prior to its being put to use as revenue expenditure. For doing so, *Explanation 8* to section 43(1) was relied upon. It is the case on behalf of the revenue that all expenditures including interest which has been incurred to bring power plant into existence and to put in operation is required to be capitalised and cannot be claimed as revenue expenditure. One is not impressed by such approach of the Assessing Officer. The issue is required to be examined in the light of the plea of the assessee that erection of power plant is only an expansion of the existing

business to bring efficacy in revenue generation. The assessee is carrying on the business as a running concern and the loans raised by the assessee for power plant was not before the commencement of production but at a later stage. Therefore, there does not appear to be any impediment to the assessee for claiming of interest as revenue expenditure.

- What is relevant for the purpose of section 36(1)(iii) is the user of capital and not the user of the asset which comes into existence as a result of borrowed capital. Significantly, in the instant case, one is concerned for various assessment years prior to the insertion of proviso of section 36(1)(iii) added *vide* Finance Act, 2003 with effect from 1-4-2004. The aforesaid proviso calls for disallowance of interest on money borrowed for the capital asset till the date on which such asset was put to use. As observed, the case in hand relates to assessment years prior to the amendment and insertion of proviso. The existing position of law thus is that deduction of interest is allowed in respect of capital borrowed for acquisition of capital assets for the purpose of expansion of existing unit whether or not the interest is capitalised in the books of account. In view of the decision of the Supreme Court in assessee's own case, if the existing unit borrows money for expansion, interest paid on such borrowing is an allowable expenditure. The existing section 36(1)(iii) as applicable to the assessment years in question, nowhere stipulates that borrowing has to be on revenue account. Therefore, in terms of erstwhile provisions of section 36(1)(iii) interest for the period prior to the day on which the asset is put to use is also allowable on revenue account.
- The plea on behalf of the revenue is that power plant was intended for dis-investment and therefore cannot be regarded as extension of business. Such plea lacks both the legal and factual basis. As already noted, the condition that borrowing must have been made for the purpose of business being carried on by the assessee in the previous year is implicit or inbuilt in section 36(1)(iii) itself. The captive power plant was intended for pharmaceutical business as per the consistent stand of the assessee since inception. There is no rebuttal on this account. It is a matter of record that the assessee has entered into Sale & Lease Back Agreement of captive power plant with the lenders with a view to reduce financial costs. Notwithstanding, the assessee throughout is engaged in the business of pharmaceutical and therefore, interest incurred on power plant incidental to pharma unit is allowable deduction on revenue account. The power plant ultimately taken back on lease is nothing but the expansion/incidence of existing business. Thus, dis-investment and gaining control over the asset by way of lease would not, change the character of claim. Thus, there is no any infirmity in the order of the Commissioner (Appeals) in adjudicating the issue in favour of the assessee.
- This apart, one also take note of significant plea raised on behalf of the assessee that the assessee executed sale & lease back - equipment lease agreement with Industrial Development Bank of India relevant to assessment year 1997-98. There is merit in the alternative plea raised in this regard that where the equipment was sold and company is not the owner of the asset at all, the interest on subsisting loans/borrowing cannot be attributed any longer to the assets so divested. While the power generation asset has been sold, the subsisting loans/borrowings has remained and continued

in the books of account and used for the purpose of existing and ongoing business of the assessee company in revenue account. Thus, interest on loan amount presently used in ongoing pharma business is allowable otherwise also.

- In view of the aforesaid discussion, there is no any good reason to assail the conclusion drawn by Commissioner (Appeals).