

THE FOOD CORPORATION OF INDIA
HEAD QUARTERS : NEW DELHI

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CIRCULAR NO. 662/ACCTS

Sub.: Capital or revenue expenditure – clarification there of

Legal decisions taken by the Hon'ble Courts in the cases CIT versus Madras Spinners Ltd. (1994) and Navejeevan Udyog Mandir Private Ltd., versus CIT (1994) published in the journal of Institute of Chartered Accountants of India for the month of July, 1994 are enclosed for guidance and correct treatment to account for expenditure under capital or revenue.

Sd/-
(A.K. CHAKRABORTY)
JT. MANAGER (ACCTS.)

CASE STUDIES

CIT vs Madras Spinners Limited (1994) 207 ITR 35 (Ker)

Capital or revenue expenditure

Facts/Issues : The assessee was a textile manufacturing company. It claimed certain expenditure incurred by it on modernizing its machinery. The assessing officer was of the view that this amount having been incurred by the assessee for installation of new machinery was of capital nature. On appeal, the Commissioner reversed the decision of the assessing officer. The tribunal found that the expenses incurred by the company were for renovating and replacing the old and worn out machinery and were of a revenue nature. Further it held that in view of the fiercely competitive nature of the present business, the need for the modernization of the machinery could not be over-emphasised and that the expenses incurred by the assessee company on modernizing its machinery by replacing the old, worn out and unserviceable parts in order to run its business carefully, efficiently and profitably was allowed as revenue expenditure.

Decision : The High Court upheld the decision of the Tribunal.

Navjeevan Udyog Mandir Pvt. Ltd., vs CIT (1994) 207 ITR 40 (Guj.)

Facts/Issues : The assessee company which maintained its accounts on the mercantile system manufactured and sold electrical domestic grinding machines. The assessee was required to pay excise duty under section 3 of the Central Excises and Salt Act, 1944, which it recovered from the customers. The amount paid as excise duty was accounted for in a separate account called 'Central Excise Duty Account'. The assessee did not treat the amounts recovered from the customers as a trading receipt by including it in the sale price and thereby in the profit and loss account. The assessee challenged the levy of excise duty in the High Court and the Exice Department conceded that the grinders manufactured by the assessee were not liable to duty. The assessee received refunds of excise duty amounting to Rs. 6,06,879/- paid during the years 1971 to 1975. The assessee contended before the assessing officer that the amount of excise duty belonged to the various customers to whom it was repayable and some of them had collected the amount by way of adjustment against service charges due to the assessee company and some had filed sutis for recovery which were compromised by the assessee accepting the liability that the customers had been appraised of the position regarding the amounts kept in deposit on their behalf which

they might otherwise collect in cash or adjust against future sales services and that, therefore, there is no taxable income under Section 41(1) of the Income Tax Act, 1961. The assessing officer, however, assessed the refund of excise duty as income under Section 41(1) of the income Tax Act, 1961. The Commissioner (Appeals) allowed the claim of the assessee. The Tribunal held that deduction of the expenditure had been clearly granted to the assessee in the respective years and therefore, the provisions of Section 41(1) were attracted to the case of the assessee. Since out of the total amount of Rs.606,879 of excise duty received as refund by the assessee a sum of Rs. 1,16,898 was refunded to the customers by the assessee, the tribunal restored the order of the assessing officer substituting Rs. 5 lakhs for Rs. 6,06,879.

Decision : It was held that the refund of excise duty received by the assessee was taken in the balance sheet in an account called excise duty refundable to customers retained as deposit against free services to be rendered. Thus, the assessee had intimated all the customers about the fact of excise duty being refunded by the government in view of the proceedings before the High Court and that the amounts were credited by way of deposits in their accounts from the date they were received. The assessee undertook to adjust the amount towards service charges which might become payable by the customers. The fact that service cards were issued to the customers are also borne out from the record. Earlier, when excise duty was collected from the customers, it was separately mentioned in the bills which were issued to the customers.