MAD HC: Where Machinery Replacement Confers Long-Term Benefits, The Expenditure Is Capital In Nature

Super Spinning Mills Ltd., a Coimbatore-based manufacturer of cotton and blended yarn, had for several years been engaged in a systematic programme of replacing aging plant and machinery as part of its modernisation drive. For AY 1996-97, the assessee claimed Rs. 6,19,43,673/- as revenue expenditure on machinery replacement. A similar claim of Rs. 13,10,00,563/- was made for AY 1997-98. In both years, the replaced items had been capitalised in the company's own books of account, but the amounts were simultaneously claimed as revenue deductions for income-tax purposes.

Issue Involved

The Assessing Officer rejected the revenue claims, holding that the replaced machinery comprised independent, sophisticated, and modern machines capable of delivering higher production and quality — plainly capital in nature. Depreciation was allowed instead. The CIT(A) upheld the AO's view in both years, with limited relief only for replacement of defective spare parts. Before the ITAT, however, both parties agreed that the issue was covered by the Madras High Court's ruling in CIT v. Janakiraman Mills Ltd. (2005) 275 ITR 403, which had held that expenditure on replacement of worn-out machinery could qualify as expenditure on 'current repairs' and was therefore allowable as revenue expenditure. Relying solely on Janakiraman, the ITAT decided in favour of the assessee without independent analysis.

Held

By the time the Revenue's appeals came up for final hearing before the High Court the factual and legal landscape had shifted materially. The judgment in Janakiraman Mills had been reversed by the Supreme Court in CIT v. Saravana Spinning Mills (P) Ltd. (2007) (293 ITR 201), a position subsequently affirmed in CIT v. Ramaraju Surgical Cotton Mills (2008) (166 Taxman 356) (SC). The Court also noted the Supreme Court's ruling in CIT v. Sri Mangayarkarasi Mills (P) Ltd. (2009) 182 Taxman 141, which had expressly upheld the Saravana Spinning Mills view.

The legal test that emerged from those Supreme Court decisions is straightforward: each machine in a textile mill is an independent asset. Replacement of any such machine creates a new, independent asset and cannot be characterised as 'current repairs' merely because the old machine was worn out. Current repairs, properly understood, cover only expenditure that preserves or maintains an existing asset without creating a new one or conferring an enduring advantage. To bring a machinery replacement within the scope of current repairs, the assessee must demonstrate either that the original parts were no longer available in the market or that the machinery had been in use for 50 to 60 years — the threshold drawn in CIT v. Mahalakshmi Textile Mills Ltd. (1967) 66 ITR 710 (SC).

Since the ITAT had decided the matter solely on the strength of a precedent that had since been overruled, the High Court held that the ITAT orders were unsustainable. The Revenue's appeals were allowed; the matter was remanded to the appellate authority for fresh adjudication. The assessee was given an opportunity to place on record material showing how the replacements could qualify as revenue expenditure in the light of the Supreme Court guidelines.

Citation:

CIT v. Super Spinning Mills Ltd. | [TS-562-HC-2026(MAD)] | Madras High Court

Our Comments:

Nature of expenditure on replacement of machinery or parts thereof has always been a vexed issue. As a matter of fact, an Explanation has been added to s 31 to provide that expenditure on current repairs shall not include capital expenditure. What is capital expenditure would however be a question of fact requiring application of well-known tests such as enduring and new advantage, once and for all versus recurring etc.