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IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.2392 OF 2013

Commissioner of Income Tax-7 ..Appellant
Versus
M/s. Nicholas Piramal (India) Ltd. ..Respondent

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Mrs. S. V. Bharucha for the Appellant.
Mr. J. D. Mistri, Senior Counsel, a/w Niraj Seth & Atul Jasani for the Respondent.

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CORAM: M. S. SANKLECHA &
A. K. MENON, JJ.

DATE : 12TH APRIL, 2016

P.C.:

1. This Appeal under Section 260A of the Income Tax Act, 1961 (the Act) challenges the order dated 15th March, 2013 passed by the Income Tax Appellate Tribunal (the Tribunal). The impugned order is in respect of Assessment Year 1998-99.

2. This appeal raises the following questions of law for our consideration :-

> *"(a) Whether on the facts and circumstances of the case and in law, the Tribunal was justified in allowing the aggregated expenses of Rs.15,25,73,928/- on account of VRS payments,*

gratuity payments and payment on account of other terminal benefits as revenue expenditure?

(b) Whether on the facts and circumstances of the case and in law, the Tribunal was justified in holding that pre commencement interest on capital borrowed for a new glass manufacturing unit, which was capitalized by the Assessing Officer be allowed as revenue expenditure?

(c) Whether on the facts and circumstances of the case and in law, the Tribunal was justified in holding that the expenses of Rs.2,84,10,992/- pertaining to closed down Thane unit incurred after closure of unit are allowable under section 37 of the Income Tax Act, 1961?

(d) Whether on the facts and circumstances of the case and in law, the Tribunal is justified in holding that the entire investment in tax free bonds were made out of the own funds and there was no utilization of borrowed funds without appreciating the fact that assessee had failed to establish the direct nexus of the said investment with interest free fund?"

3. **Regarding question (a):-**

(i) Ms. Bharucha, the learned counsel for the Revenue very fairly states that the question as formulated is concluded against the Respondent-Revenue by the decision of this Court in ***CIT Vs. Bhor Industries Ltd. 264***

ITR 180. We find that in the impugned order, the Tribunal also has placed reliance upon the decision of this Court in Bhor Industries Ltd. (supra) to dismiss the Revenue's Appeal on the above issue.

(ii) Accordingly, question no.(a) as formulated does not give rise to any substantial question of law. Thus, not entertained.

4. **<u>Regarding question no.(b):-</u>**

(i) The Respondent-Assessee is in the business of manufacturing pharmaceuticals, bulk drugs and glass bottles. During the subject assessment year the Respondent-Assessee sought to expand its glass business and for that purpose set up and commissioned a new plant to manufacture glass bottles at Jambusar in Gujarat.

(ii) In its Return of Income the Respondent-Assessee claimed interest paid of Rs.21.70 crores on loan taken for the purposes of setting up a new glass manufacturing plant as a revenue expenditure. The aforesaid interest of Rs.21.70 crores was payable on the loan upto the date of commencement of manufacture/production of glass bottles at its new plant in Jambusar, Gujarat. The Assessing Officer by his order dated 28th February, 2001 passed under Section 143(3) of the Act rejected the aforesaid claim of interest by placing reliance upon Explanation(8) to Section 43(1) of the Act in support of its conclusion that the interest has to be capitalized till the asset has been first put into use. Thereafter it is alone allowed as Revenue expenditure. The Assessing Officer also relied upon a subsequent event viz. the glass manufacturing activity of the Respondent-Assessee was spun of as a separate company to hold it is a separate business. Besides holding that the three activities viz. pharmaceutical, bulk drugs and glass bottles of the Respondent-Assessee are not interlinked by common Management, funds and control.

(iii) Being aggrieved, the Respondent-Assessee filed an appeal to the Commissioner of Income Tax (Appeals) [CIT(A)]. By order dated 22nd May, 2001 the CIT (A) held that the setting up of a plant for glass manufacturing was an expansion of existing business of the assessee. Therefore interest on loans borrowed for such expansion was allowable as deduction under section 36(1)(iii) of the Act. Besides he also holds that all the three business of the Respondent-Assessee were part of the Respondent-Assessee's business in view of unity of control, Management and intermingling of funds. In the above view, CIT(A) deleted the disallowance made by the Assessing Officer of Rs.21.70 crores on account of interest.

(iv) On further appeal by the Revenue, the Tribunal on consideration of the facts came to the conclusion that the setting up of a new glass manufacturing plant at Jambusar, Gujarat was an expansion of the existing business of the Respondent-Assessee. Thus upheld the order of the CIT (A).

(v) Ms. Bharucha, the learned counsel for the Revenue in support of the appeal placed reliance upon Explanation(8) to Section 43(1) of the Act to contend that all payments of interest made prior to the plant being commissioned has necessarily to be capitalized. This according to her is evident from the prohibition of the interest payment made post the asset being put to use being capitalized.

(vi) We find that the contention of the Revenue on basis of the Explanation(8) to Section 43(1) of the Act, as urged by Ms. Bharucha is no longer res-integra. This is so in view of the decision of the Supreme Court in ***Deputy Commissioner of Income Tax Vs. Core Health Care Ltd. 298 ITR 194*** wherein on almost an identical fact situation, in the context of deduction of interest on borrowed capital under Section 36(1)(iii) of the Act, the Apex Court held as under:-

"According to the Department, section 36(1)(iii) of the 1961 Act being general in nature has to give way to special provisions contained in Explanation 8 to section 43(1) of the 1961 Act. According to the Department, in none of the earlier judgments this Court has considered the true scope of Explanation 8 to section 43(1) vis-a-vis section 36(1)(iii) of the Act. We find no merit in this contention. Section 43 groups together all provisions in the nature of definitions or interpretations relevant to the computation of income under the head "Profits and gains of business". Section 43(1) defines "actual cost". The definition of "actual cost" has been amplified by excluding such portion of the cost as is met directly or indirectly by any other person or authority. Explanation 8 has been inserted in section 43(1) by the Finance Act, 1986 (23 of 1986), with retrospective effect from April 1, 1974. It is important to note that the words "actual cost" would mean the whole cost and not the estimate of cost. "Actual cost" means nothing more than the cost accurately ascertained. The determination of actual cost in section 43(1) has relevancy in relation to section 32 (depreciation allowance), section 32A (investment allowance), section 33 (development rebate allowance), and section 41(balancing charge). <u>The "actual cost" of an asset has no relevancy in relation to section 36(1) (iii) of the 1961 Act.</u> This reasoning flows from a bare reading of section 43(1). Section 43 defines certain terms relevant to income from profits and gains of business and, therefore, the said section commences with the

words "In sections 28 to 41 and unless the context otherwise requires" "actual cost" shall mean the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. In other words, Explanation 8 applies only to those sections like section 32, 32A, 33 and 41 which deal with concepts like depreciation. The concept of depreciation is not there in section 36(1)(iii). That is why the Legislature has used the words "unless the context otherwise requires". Hence, Explanation 8 has no relevancy to section 36(1)(iii). It has relevancy to the aforementioned enumerated sections. Therefore, in our view Explanation 8 has no application to the facts of the present case."

(emphasis supplied).

Further we find that both the CIT (A) and the Tribunal have rendered a finding of fact that the Respondent–Assessee was carrying on business of glass manufacturing plant at Jambusar in Gujarat and setting up the new business was a mere expansion of its existing business. Further, both the Authorities also found that as a matter of fact there was a functional integrity between all the three business viz. Pharma business, bulk drugs business and glass manufacturing business with interlinking of management and funds. This finding of fact rendered by the Tribunal has not been shown to be perverse or arbitrary.

(vii) In the above view, the issue as urged before us is settled by the Apex Court in Core Health Services (supra). Moreover the finding of fact rendered by the CIT(A) and the Tribunal about glass manufacturing being existing business and commonality of management and funds not being shown to be perverse, the question as formulated does not give rise to any substantial question of law. Thus, not entertained.

5. **Regarding question (c):-**

(i) The Respondent-Assessee was engaged in manufacturing of pharmaceutical drugs at its Thane plant. In September, 1996 the Respondent-Assessee had to close down its manufacturing unit at Thane in view of failing to meet the standards required by the Food Drug Administration. The closure of its Thane plant resulted in shifting of its manufacturing activity at Thane to other units of the Respondent-Assessee shifted at Mahad, Pithampur and Hyderabad all of which resulted in expenditure to the extent of Rs.2.84 crores.

(ii) In its return of income the petitioner had inter alia claimed an amount of Rs.2.84 crores (Rs.1.29 crores staff cost + Rs.1.54 crores other corpus) as deduction under Section 37 of the Act. The Assessing Officer by his order dated 28th February, 2001 disallowed the same on the ground that they are incurred for closing down the business operation and thus could not be considered as expenses incurred for running of the business.

(iii) Being aggrieved the Respondent-Assessee carried the issue in appeal before the CIT (A). The CIT (A) has rendered a finding of fact that the the manufacturing activity at Thane ceased as the Respondent-Assessee had failed to satisfy the standards set by the Food and Drugs Administration. The business which was closed at Thane plant had been shifted to other manufacturing units of the Respondent-Assessee. Besides reliance was placed upon the decision of the Apex Court in ***K. Ravindranathan Nair Vs. Commissioner of Income Tax 247 ITR 178*** to allow the Respondent-Assessee's appeal by order dated 22nd May, 2011 and delete the disallowance of Rs2.84 crores done by the Assessing Officer.

(iv) Being aggrieved, the Revenue carried the issue in appeal to the Tribunal. The Tribunal found on facts that the Respondent-Assessee had stopped its manufacturing activities at Thane on account of statutory compulsion. Further it also found that the Respondent-Assessee stopped its business at Thane but had shifted its manufacturing business from

Thane to its other manufacturing units. In the above view, the order of the CIT (A) was upheld.

(v) We find that the CIT (A) and the Tribunal have rendered a concurrent finding of fact that the closure of the manufacturing unit at Thane was on account of statutory compulsion. Further, the business of manufacturing at Thane had not ceased but had been shifted to other locations/units of the Respondent-Assessee. Moreover the CIT (A)as well as the Tribunal had by applying the decision of the Apex Court in K. Ravindranathan Nair (supra) concluded that the business of manufacturing drugs at different units constituted a single business and closing down of one unit and shifting its activity to other units, would be expenditure incurred was for the purposes of business. The closure of Thane unit was out of business necessity arising out of statutory compulsion. Thus the expenditure was incurred with regard to carrying on its business and thus allowable under Section 37(1) of the Act.

(vi) In view of the Apex Court decision in K. Ravindranathan Nair (supra) on law and the concurrent finding of facts which are not shown to be perverse, the question as proposed does not give rise to any substantial question of law. Thus, not entertained.

6. **<u>Regarding question no.(d):-</u>**

(i) In the subject assessment year the Respondent-Assessee had made an investment of Rs.38.32 crores in shares, mutual funds and tax free bonds. The Assessing Officer during the course of assessment found that of the total funds available with the Respondent for the relevant period, 57% were borrowed funds. Therefore applying the aforesaid ratio the Assessing Officer by order dated 28th February, 2001 concluded that an amount of Rs.21.82 crores out of Rs.38.32 crores invested in shares, mutual funds and tax free bonds would come out of borrowed funds. On the aforesaid basis, he disallowed interest Rs.1.32 crores attributable to the borrowed funds (Rs.21.82 crores) utilized for making tax free investment and disallowed the same.

(ii) Being aggrieved, the Respondent–Assessee carried the issue in appeal to the CIT (A). On examination the CIT (A) found that the entire investment in shares, mutual funds and tax free bonds were not made out of borrowed funds but made out of issue of fresh capital at a premium as was found on examining the resolutions of the Board of Directors as well as the balance sheet for the relevant period. Thus the order dated 22nd May, 2001 of the CIT (A) held that since the entire investment made in shares, mutual funds and tax free bonds were from its own interest free funds, there could be no question of disallowance of interest payable on the borrowed funds. In the above view, by order dated 22nd May, 2001 the disallowance of interest to the extent of Rs.1.32 crores was deleted.

(iii) In further appeal to the Tribunal by the Revenue, the Tribunal reiterated the finding of fact arrived at by the CIT (A). In fact the impugned order dated 15th March, 2013 of the Tribunal also records that the Revenue was unable to controvert the finding of the CIT (A) that the entire investment made in shares, mutual funds, tax free bonds were out of its own tax free funds and not out of borrowed funds. In the above view, the Tribunal upheld the order of the CIT (A).

(iv) We find that the CIT(A) as well as the Tribunal have come to concurrent findings of fact that the investment made in the shares, mutual funds and tax free bonds were not made out of borrowed funds but out of the Respondent-Assessee's own funds. The Revenue has not been able to show that the aforesaid finding of fact is in any manner perverse.

(v) In the above view, the question as formulated does not give rise to any substantial question of law as it raises issue in respect of which there are concurrent finding of fact which is not shown to be perverse.

Accordingly the question no.(d) is not entertained.

7. In the result, the Appeal is dismissed. No order as to costs.

(A. K. MENON, J.) **(M. S. SANKLECHA, J.)**

Wadhwa