

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**R/TAX APPEAL NO. 1389 of 2007****FOR APPROVAL AND SIGNATURE:****HONOURABLE MR.JUSTICE AKIL KURESHI****and****HONOURABLE MR.JUSTICE B.N. KARIA**
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1	Whether Reporters of Local Papers may be allowed to see the judgment ?	
2	To be referred to the Reporter or not ?	
3	Whether their Lordships wish to see the fair copy of the judgment ?	
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?	

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THE COMMISSIONER OF INCOME TAX-I

Versus

ARVIND PRODUCTS LTD.

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Appearance:

MRS MAUNA M BHATT(174) for the PETITIONER(s) No. 1

MRS SWATI SOPARKAR(870) for the RESPONDENT(s) No. 1
=====**CORAM: HONOURABLE MR.JUSTICE AKIL KURESHI**

and

HONOURABLE MR.JUSTICE B.N. KARIA**Date : 02/05/2018****ORAL JUDGMENT****(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)**

1. This appeal is filed by the Revenue challenging the judgment of the Income Tax Appellate Tribunal

dated 09.03.2007. At the time of admission of the appeal, following substantial questions of law were framed.

"A. Whether the Appellate Tribunal is right in law and on facts in accepting the claim of the assessee for deduction of Rs.2,70,05,729/- incurred as product development expenses, as revenue deduction?

B. Whether the Appellate Tribunal has seriously erred in law and on facts in not appreciating that the produce development expenses amounting to Rs.2,70,05,729/- gave enduring benefits to the assessee and hence was capital expenditure in nature?"

2. Brief facts are as under.

3. We are concerned with the assessment year 2001-02. The respondent assessee is a company registered under the Companies Act and is engaged in the business of manufacturing of textiles. For the said assessment year, the assessee had filed the return of income on 30.10.2001 declaring loss. The assessee had expended a sum of Rs.2.70 crores (rounded off) for project development and claimed it as revenue expenditure. The Assessing Officer doubted whether the expenditure could be treated as a revenue expenditure. He called for the response from the assessee. The assessee contended that the said

amount was paid to Arvind Mills Limited on actual cost basis for product development. This product development was in the nature of improvement of different types of fabrics produced by the assessee. The expenditure was in relation to improvement of the existing products of the assessee and not for development of new product. The expenditure was therefore revenue in nature.

4. The Assessing Officer did not accept such contentions. He was of the opinion that the benefit of newly developed or improved product would be available to the assessee for long duration. Such expenditure therefore would be resulting into enduring benefits. He therefore disallowed such expenditure and instead treated it as capital expenditure.

5. The assessee carried the matter in appeal before the Commissioner of Income Tax (Appeals) and reiterated the contentions raised before the Assessing Officer. It was pointed out that the expenditure was incurred in respect of improvement of different variety of clothes produced by the

assessee. The whole purpose was to improve its quality. Since the expenditure was incurred in relation to assessee's existing business of cloth manufacturing, the expenditure was a business expenditure. The assessee placing reliance on the decision of the Supreme Court in case of **Empire Jute Co. Ltd vs Commissioner of Income Tax** reported in **[1980] 124 ITR 1** contended that the enduring nature test in a given case may break down if it is found that the advantage is in the commercial sense and not in the capital field. Assessee also relied on the judgment of the Supreme Court in case of **Alembic Chemical Works Co. Ltd. v. CTT** reported in **[1989] 177 ITR 377 (SC)**. The Commissioner of Income Tax (Appeals) however, was not convinced. He was of the opinion that the expense incurred was with respect to development of product and it cannot be denied that such expenditure would not result into enduring benefit. He therefore confirmed the view of the Assessing Officer.

6. The assessee carried the matter in appeal before the Tribunal. Tribunal noted the relevant facts and held that the expenditure was revenue expenditure.

Whether the expenditure would result into advantage to the company may depend on various factors such as how well the products are marketed, how the market receives it and presence of similar products in the market. If there are superior products already in the market, the advantage of the assessee may be neutralized. The Tribunal was essentially of the opinion that whether any advantage would accrue to the assessee or not out of such product development being highly uncertain, the expenditure cannot be treated as capital in nature.

7. Having heard learned counsel for the parties and having perused documents on record, what emerges is that the assessee who was engaged in manufacturing textile products, had expended the amount in question for product development undertaken by a sister concern of the assessee on its behalf. The research work did not involve development of a new product or even a new technique or technology to manufacture existing product more efficiently. He is aimed at improving the quality of the existing products of the assessee. Essentially thus, the expenditure was for the assessee's existing business and was for the

purpose of improving the quality of the existing products.

8. As rightly pointed out by the counsel for the assessee, in somewhat similar situations, three High Courts have held that the expenditure should be treated as revenue expenditure.

9. In case of ***Commissioner of Income-tax, Faridabad v. Escorts Auto Components Ltd.*** reported in [2011] 197 TAXMAN 42 (Punj & Har.), Division Bench of Punjab and Haryana High Court considered the expenditure by the assessee for modification of existing products/development of new products under the same management with the same workforce and expertise. The Court held that the expenditure incurred, by no stretch of imagination, can be regarded as capital expenditure.

10. In case of ***Commissioner of Income-tax, Bangalore v. Tejas Networks India (P.) Ltd.*** reported in [2014] 52 taxmann.com 513 (Karnataka), Division Bench of Karnataka High Court considered a case where the assessee was engaged in the business of dealing and selling optical networking products. The assessee

had incurred expenses towards the development of a certain product and claimed his revenue expenditure. The department opposed his claim. The High Court held that lifespan of such products was very short due to severe competition, constant up-gradation of original products was required and the expenditure was therefore treated as revenue expenditure.

11. Division Bench of Delhi High Court in case of ***Commissioner of Income-tax-I v. ACL Wireless Ltd.*** reported in ***[2014] 361 ITR 210 (Delhi)***, held and observed that an expenditure which enables profit making structure to work more efficiently leaving the source of profit making structure untouched, would be revenue in nature.

12. Under the circumstances, both the questions are answered against the Revenue. Before closing, however, we may observe that we should not be seen to have approved the entire decision making process adopted by the Tribunal though we confirm the final conclusions contained in the impugned judgment. We say so because without full material on record, the Tribunal has expanded on the nature of uncertainty of

the benefits of the product development. Since the assessee had not led any evidence in this respect, the Tribunal's conclusions could not have been based on such uncertainty.

13. Subject to above observations, Tax Appeal is dismissed.

(AKIL KURESHI, J)

(B.N. KARIA, J)

ANKIT SHAH

