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2025:DHC:1577-DB

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IN THE HIGH COURT OF DELHI AT NEW DELHI

Judgment reserved on: March 04, 2025
Judgment pronounced on: March 11, 2025

\+ ITA 660/2018

VODAFONE MOBILE SERVICES LTD. .....Appellant

Through: Mr. Sachit Jolly, Sr. Adv. with Ms. Soumya Singh, Ms. Disha Jham and Mr. Abhyudaya Shankar Bajpai, Advs.

versus

DEPUTY COMMISSIONER OF INCOME TAX .....Respondent

Through: Mr. Indruj Singh Rai, SSC with Mr. Sanjeev Menon, Mr. Rahul Singh, JSCs with Mr. Anmol Jagg, Mr. Gaurav Kumar and Ms. Varsha Sharma, Advs.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE HARISH VAIDYANATHAN SHANKAR

J U D G M E N T

YASHWANT VARMA, J.

1. The assessee as well as the Revenue seek to assail the correctness of the judgment dated 14 March 2018 rendered by the **Income Tax Appellate Tribunal**[1] and in terms of which the two cross appeals of parties have come to be decided. We had in terms of our order of 23 January 2024 admitted these two appeals on the following questions of law:

> **"ITA No. 660/2018**
>
> A. Whether on the facts and in the circumstances of the case and in law, the ITAT erred in upholding the disallowance of depreciation

[1] Tribunal

to the tune of Rs.5,10,79,752/- claimed on account of Asset Reconstruction Cost ["**ARC**'] being an ascertained liability, or alternatively allowing deduction for such expenditure in the year of execution of lease agreements or over the period of the lease?

B. Whether on the facts and in the circumstances of the case and in law, the ITAT erred in holding that installation of cell site towers amounted to 'extension of existing business' as stipulated in proviso to Section 36(1)(iii) of the Income Tax Act, 1961 ["**Act**"] and, thereby warranting proportionate disallowance of interest under that provision?

C. Whether on the facts and in the circumstances of the case and in law, the ITAT erred in misbranding the discount offered by the Appellant to the pre-paid sim-card distributors as commission and hence upholding disallowance made by the AO under Section 40(a)(ia) of the Act?

ITA 634/2019

A. Whether the ITAT erred in law and on facts in deleting the disallowance amounting to Rs. 14,23,29,976/- on account of commission paid to distributors by ignoring the factual matrix of the case and solely relying upon the decision of the DRP, Ahmedabad wherein the claim on commission expenditure was upheld?

B. Whether the ITAT erred in law and on facts in deleting the disallowance of penalty paid to Department of Telecommunications even though penalty expenses, being penal in nature are not allowable u/s 37 of the Act?"

2. Subsequently and when the appeals were taken up for review on 03 April 2024, we had taken note of the contention of Mr. Jolly, learned senior counsel appearing for the assessee, that the Tribunal had undisputedly failed to deal with the alternative plea which was taken by the assessee with respect to **Asset Reconstruction Cost**[2]. The ARC was sought to be factored in while computing depreciation claimed and the same, according to the assessee, being otherwise liable to be accorded recognition by virtue of Section 37(1) of the **Income Tax Act, 1961**[3] in case its stand of the same being covered by Section 32 were to not find

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[2] ARC
[3] Act

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favour. It was thus contended that the Tribunal had clearly committed a manifest illegality in failing to deal with the aforesaid question.

3. Turning then to the issues emanating from Section 36(1)(iii), we had taken note of the submissions addressed by learned counsels appearing for respective sides and who had extensively argued on the meaning liable to be ascribed to the word '*extension*' as appearing in the Proviso thereto. Insofar as Question 'C' as framed in the assessee's appeal was concerned, it was conceded that the issue stands conclusively answered and laid to rest in light of the judgment rendered by the Supreme Court in **Bharti Cellular Ltd. (now Bharti Airtel Ltd.) vs. Assistant Commissioner of Income Tax & Anr**[4].

4. The appeals themselves pertain to Assessment Year 2009-10 and arise in the backdrop of the following facts. The assessee which is a company engaged in providing telecommunication services, had filed a Return of Income on 30 September 2009 declaring NIL income after claiming deductions under Section 80IA and having reported profits as per Section 115JB. The return was thereafter revised on 30 March 2011. We are now left to consider the upward transfer pricing adjustments made by the **Transfer Pricing Officer**[5] and which, in these appeals stand confined to the question of depreciation under Section 32 or alternatively under Section 37 and the interest burden on borrowed capital founded on Section 36(1)(iii) of the Act. It is under these heads that the TPO had inter alia made additions apart from others and which, admittedly, do not survive for our consideration.

5. The Draft Assessment Order framed on 28 March 2013 under Section 144C read with Section 143(3) was assailed before the **Dispute**

[4] [2024 SCC OnLine SC 198]
[5] TPO

Resolution Panel[6] and which vide its directions dated 18 December 2013 accorded partial relief to the assessee under the head of ad hoc disallowance of commission expenditure. This led to the passing of a final assessment order on 30 January 2014. It is this order which formed the subject matter of the two cross appeals which came to be instituted before the Tribunal.

6. Having noticed the principal questions which arise for our consideration, we deem it appropriate to firstly advert to the issue of disallowance of depreciation under Section 32 of the Act. It becomes relevant to note that the disallowance of depreciation constituted Ground no.2 of the assessee's appeal. The depreciation itself was claimed in respect of fixed assets and the ARC that was provisioned for on account of the same being likely to be incurred in purported discharge of an obligation which stood placed upon the assessee to restore the cell sites to their original condition.

7. The assessee appears to have urged that it had capitalized certain sums on account of the ARC obligation, and which represented the estimated cost likely to be incurred at the network sites and office premises in order to restore them to their original condition at the end of the lease period. The appellant had claimed depreciation in this respect in the sum of INR 5.10 crores. The provision itself was made in light of **Accounting Standard 29**[7] on the basis of the same constituting a present obligation and which could be reasonably estimated. However, the AO proceeded to disallow the said provision holding that it was not in the nature of an ascertained liability. It also rejected the alternate plea of the assessee resting on Section 37 of the Act. The

[6] DRP
[7] AS 29

objections which were taken in this respect came to be rejected by the DRP and the view so expressed affirmed ultimately by the Tribunal.

8. The Tribunal records that the appellant had estimated the aforenoted sum as likely to be incurred in the course of restoration of the said sites and which was an obligation which already stood placed upon it. However, it took the view that the word "actual cost" as it appears in Section 32 would have to derive meaning from Section 43(1) of the Act and thus constitute actual cost of assets to the assessee reduced by that portion of the cost as may have been directly or indirectly made. It thus came to conclude that depreciation could have been claimed only if a cost had in fact been incurred. This becomes evident from a reading of Para 17 of the order impugned before us and which is reproduced hereinbelow: -

> "**17**. Having heard both the sides and perused the relevant material on record, we find that the assessee entered into lease agreement with owners of various office spaces for setting up of cell site towers. As per the assessee, it was obliged to restore the site to its original condition at the expiry of the lease period. The assessee estimated a sum to be incurred on restoration and capitalized the same to the cost of cell site towers at the very threshold of entering into lease agreements. Not only this, the assessee also claimed depreciation on such estimated restoration cost capitalized. It is clear from the facts that no such cost was actually incurred by the assessee and a sum was notionally estimated and capitalized for the purpose of depreciation. Section 32(1) provides for depreciation on the actual cost' of block of assets in the first year and, then, on the written down value as prescribed in the provision. Section 43(1) defines 'actual cost' to mean the actual cost of assets to the assessee reduced by that portion of the cost thereof, if any, as has been directly or indirectly made by any other person or authority. On a conjoint reading of the above provisions it is manifest that depreciation can be claimed only on the actual cost of assest 'which is incurred by the assessee.' There is no question of providing depreciation on a notional cost which at the most can be considered as an unascertained liability. Under these circumstances, we are of the considered opinion that the authorities below were fully justified in rejecting the assessee's claim of depreciation of Rs. 5 .10 crore on the so-called asset restoration cost obligation."

9. The Tribunal also construed the relevant provisions of the lease agreement and especially the words *"if any damage is caused"* as being demonstrative of no positive obligation being placed upon the appellant. This becomes evident from a reading of Para 18 and which reads thus: -

> "**18**. In support of the assessee's claim that it incurred an obligation for restoration of site, a copy of an agreement dated 01.10.2010 entered into between the assessee and Upal Developers Pvt. Ltd., was placed on record which provides for monthly rent of Rs. 5,000/- and the further sum of Rs. 5000/- per month towards 'maintenance charges'. Consequences of determination of the agreement have been set out in clause 10, which is the bedrock of the assessee's claim for the asset restoration cost obligation and resultant depreciation. The relevant part of this clause provides that the assessee; "shall at its own cost restore the premises of the said building to its original state, if any damage is caused in the court of the removal of cables, antennas or other equipments." There is absolutely no doubt on the interpretation of clause 10 of the agreement that the assessee will be obliged to incur cost at the time of determination of the agreement only if damage is caused in the course of removal of cables, antennas or other equipments and not otherwise. Damage to the premises, if any, arising on the removal of cables, antennas and other equipments, etc., can be ascertained only at the time of termination of the agreement and not at the time of entering into the agreement. Further, no obligation will be incurred if no loss is caused to the premises at the time of removal of cables etc. as such, we are of the considered opinion that the addition of Rs. 5.10 crore has been rightly made. This ground is not allowed"

10. Insofar as the question of the provision made by the assessee on account of ARC and whether it would be exigible to deduction under Section 32, the dispute revolves upon the usage of the expression '*actual costs*' appearing in Section 32(1)(ii) sub-clause (i). It was in the aforesaid context that Mr. Jolly had sought to draw sustenance from the provisions comprised in Section 43 and which provides that the word '*actual cost*' as appearing in Sections 28 to 41 of the Act, unless the context otherwise require, would mean the actual cost of the assets to the assessee. It is in the aforesaid context that Mr. Jolly had submitted

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that Section 32, as well as the expression '*actual cost*' would not be confined to expenditure in fact incurred, but would include appropriate provisions which may be made in respect of obligations incurred. It was his submission that the provisions which the assesee had made were in accord with AS 29 and which makes provisions with respect to 'liabilities', 'obligating events' and guides assessee's with respect to the incorporation of a provision in the books provided the conditions specified in Clauses 14, 16 and 24 are broadly met.

11. As was noticed by us in our previous orders, it was Mr. Jolly's submission that quite apart from the claim of depreciation which was founded on Section 32, the appellants had also taken an alternate plea of the expenditure so provisioned for being liable to be claimed as a deduction referable to Section 37 of the Act. Section 37, insofar as it is relevant for our purposes is extracted hereunder: -

> "**37. General.**
>
> (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 [***] and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".
>
> [*Explanation 1.*]—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.]
>
> [*Explanation 2.*—For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.]
>
> [*Explanation 3.*—For the removal of doubts, it is hereby clarified that the expression "expenditure incurred by an assessee for any

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purpose which is an offence or which is prohibited by law" under *Explanation 1,* shall include and shall be deemed to have always included the expenditure incurred by an assessee,—

(i) for any purpose which is an offence under, or which is prohibited by, any law for the time being in force, in India or outside India; or

(ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person; or

(iii) to compound an offence under any law for the time being in force, in India or [*outside India*]"

12. Mr. Jolly thus submitted that ARC would constitute expenditure '….laid out or expended…' for the purposes of business and thus liable to be factored in while computing income chargeable under the head of profits and gains of business or profession. It was Mr. Jolly's submission that Section 43 significantly uses the expression actual cost of the assets 'to the assessee' and thus clearly not contemplating costs having been incurred in praesenti or on the date of preparation of the Balance Sheet. It was submitted that the Madras High Court in **M/S Vedanta Limited vs. The Joint Commissioner of Income Tax**[8] had, on a due review of the various precedents rendered in the context of a provision being made as well as the Accounting Standards which apply had come to explain the meaning to be ascribed to the phrase '….laid out or expended..' in the following terms:-

"**20.** The words "**Lay (Laid out)"** or "**Expend (Expended)",** as employed in Section 37(1) of the Act, are defined in the following manner, in the Second Edition of the Oxford English Dictionary published by Clarendon Press-Oxford, in the following manner:

> **"Expend**- to pay out, spend. It differs from spend in being less colloquial, and (in mod.use) in implying some determinate direction or object of outlay.

[8] Tax Case (Appeals) Nos. 2117 to 2119 of 2008

(a) To put away, lay out, spend (money). To spend, make away with, consume in outlay.
(b) To lay out (money) for determinate objects. Const.*in*, upon.

Expendable- Also expendible- That may be expended; considered as not worth preserving or salvaging; normally consumed in use; spec. of military personnel; that may be allowed to be sacrificed to achieve a military objective. hence as sb., an expendable person or object.
Lay-To put away in store; to store up; to save (money).
- To put away for future disposal or for safety.
- To spend, expend, lay out.

21. These definitions indicate that the words Lay, Laid or Expend do not merely include the immediate expenditure or laying out of the funds, but if they are set apart for a determinate and the specific object also, a future actual expenditure is also included in these terms."

13. It was in the aforesaid context that Mr. Jolly had also adverted to the various prescriptions comprised in AS 29 and which regulate the creation of a provision in Balance Sheets. For purposes of evaluating the aforenoted submission, we deem it apposite to extract the following relevant parts of AS 29:-

"**Accounting Standard (AS) 29**

Provisions, Contingent Liabilities and Contingent Assets

(This Accounting Standard includes paragraphs paragraphs set in bold italic type and plain type, which have equal authority. Paragraphs set in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)

Pursuant to this Accounting Standard coming into effect, all paragraphs of Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date, that deal with contingencies (viz., paragraphs 1 (a), 2, 3.1, 4 (4.1 to 4.4), 5 (5.1 to 5.6), 6, 7 (7.1 to 7.3), 9.1 (relevant portion), 9.2, 10, 11, 12 and 16), stand withdrawn except to the extent they deal with impairment of assets not covered by other Indian Accounting Standards.

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions

and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down appropriate accounting for contingent assets.

xxxx xxxx xxxx

7. This Standard defines provisions as liabilities which can be measured only by using a substantial degree of estimation. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

8. Other Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

xxxx xxxx xxxx

Definitions

10. The following terms are used in this Standard with the meanings specified:

10.1 A provision is a liability which can be measured only by using a substantial degree of estimation.

10.2 A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

10.3 An obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

10.4 A contingent liability is:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

> ***(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or***
>
> ***(ii) a reliable estimate of the amount of the obligation cannot be made.***

10.5 A contingent asset is a possible asset that arises from past events the existence of which will be confirmed only by the

occurrence or non occurrence of one or more uncertain future <u>events not wholly within the control of the enterprise.</u>

<u>10.7 Possible</u> obligation - an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

10.8 A <u>restructuring</u> is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an enterprise; or

(b) the manner in which that business is conducted.

11. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. Obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

12. Provisions can be distinguished from other liabilities such as trade payables and accruals because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. Although it is sometimes necessary to estimate the amount of accruals, the degree of estimation is generally much less than that for provisions.

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Recognition

Provisions

14. A provision should be recognised when:
(a) an enterprise has a present obligation as a result of a past event;
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) a reliable estimate can be made of the amount of the obligation.
If these conditions are not met, no provision should be recognised.

Present Obligation

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15. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the balance sheet date. On the basis of such evidence:
(a) where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and
(b) where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

Past Event

16. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

17. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.

18. It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation to the extent that the enterprise is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

xxxx **xxxx** **xxxx**

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Probable Outflow of Resources Embodying Economic Benefits
22. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

xxxx xxxx xxxx

Reliable Estimate of the Obligation
24. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature involve a greater degree of estimation than most other items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is reliable to use in recognising a provision.

xxxx xxxx xxxx

Contingent Liabilities
26. An enterprise should not recognise a contingent liability.

xxxx xxxx xxxx

28. Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made (see paragraph 14).

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Illustration A

Tables - Provisions, Contingent Liabilities and Reimbursements

The purpose of this illustration is to summarise the main requirements of the Accounting Standard. It does not form part of the Accounting Standard and should be read in the context of the full text of the Accounting Standard.

Provisions and Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of:

(a) a present obligation the one whose existence at the balance sheet date is considered probable; or (b) a possible obligation the existence of which at the balance sheet date is considered not probable.		
There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.	**There is a possible obligation or a present obligation that may, but probably will not require an outflow of resources.**	**There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote**
A provision is recognised (paragraph 14). Disclosures are required for the provision (paragraphs 66 and 67)	No provision is recognised (paragraph 26). Disclosures are required for the contingent liability (paragraph 68).	No provision is recognised (paragraph 26). No disclosure is required. (paragraph 68).

Reimbursements

Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party

The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.	**The obligation for the amount expected to be reimbursed remains with the enterprise and it is virtually certain that reimbursement will be received if the enterprise settles the provision.**	**The obligation for the amount expected to be reimbursed remains with the enterprise and the reimbursement is not virtually certain if the enterprise settles the provision.**
The enterprise has no liability for the amount to be reimbursed (paragraph 50).	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. The amount recognised for the expected	The expected reimbursement is not recognised as an asset (paragraph 46).

	reimbursement does not exceed the liability (paragraphs 46 and 47).	
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement (paragraph 67(c)).	The expected reimbursement is disclosed (paragraph 67(c))."

xxxx **xxxx** **xxxx**

Illustration 3: Offshore Oil field

An enterprise operates an offshore oil field where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event -The construction of the oil rig creates an obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion -A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it (see paragraph 14). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted."

14. Reverting then to the judgment in *Vedanta Limited*, Mr. Jolly invited our attention to the following passages of that decision: -

"**29.** Thus on the conspectus of the legal precedents discussed above, we are of the clear opinion that for the three Assessment Year in question, the provision made by the Assessee for 'Site Restoration cost' under the contractual obligations of the Assessee in the Product Sharing Contract, made on scientific basis was clearly an allowable expenditure in question should be laid out or expended wholly for the purpose of business of the Assessee. There is no dispute that the

> Provision on question was made wholly and exclusively for the purpose of business. The only dispute was that expenditure not actually incurred in there years and the amount was to be spent in future out of the Provision made during these Assessment years namely A.Y.1996-1997 to 1998-1999.
>
> **30.** We find no prohibition or negation for making a provision for meeting such a future obligation and such a provision being treated as a revenue expenditure under Section 37(1) of the Act. The Hon'ble Supreme Court in the case of ***Calcutta Company Limited*** clearly held that the words Lay (laid out) or Expend includes expendable in future also, which has been quoted by us above. The making of a Provision by an Assessee is a matter of good business or commercial prudence and it is to set apart a fund computed on scientific basis to meet the expenditure to be incurred in future. There is no time frame or limitation prescribed for the said provisions to be actually spent. Merely because in the context like the one involved in this case, the contract period was long viz., 25 years, which too now stands extended by period of ten years or more and therefore the actual work of site restoration may happen after 35 years depending upon the actual exploration of oil reserves and the Site restoration would be undertaken only if there is no longer some oil to be explored or drawn out and, therefore, it cannot be said that the provision made for the three Assessment Years presently at the beginning of the Contract period was irrational or an disallowable expenditure. The question of commercial expediency is a usual business and the economic decision to be taken by the Assessee and not by the Revenue Authorities and therefore the provision made on a reasonable bias, cannot be disallowed under section 37(1) of the Act, unless it can be said to be have no connection with the business of the Assessee. The words wholly and exclusively for the purpose of business is a sufficient safeguard and check and balance by the Revenue Authorities to test and verify the creation of provision for meeting a liability by the Assessee in future and its connectivity with the business of the Assessee. Assuming that such set apart provision is not actually spent in future, or something less is spent of Site Restoration, nothing prevents Revenue Authorities and Assessee himself to offer it back for taxation in such future year, the unspent Provision to be brought back to tax as per Section 41(1) of the Act."

It was in the aforesaid backdrop that learned senior counsel submitted that the Tribunal had committed a manifest error in failing to deal with this significant issue which was directly raised for its consideration.

15. Upon hearing learned counsels for respective sides, we deem it apposite to observe at the very outset that we do not propose to deal

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with the issue pertaining to '*actual cost*' as it appears in Section 32(1) since, upon a holistic examination of the rival submissions which were addressed, we for reasons which we propose to assign hereinafter would be of the opinion that it is the alternate plea based on Section 37 which alone would merit further consideration. This more so in light of the stand of the assessee as voiced by Mr. Jolly that they would be content if the Court were to answer that issue alone especially since the same would be more advantageous. As is manifest from a reading of Section 37, any expenditure, provided it is not capital in character, when laid out or expended wholly and exclusively for the purposes of business, is liable to be taken into consideration while computing income chargeable under the head profits and gains of business or profession. This provision thus focuses on expenditure 'laid out' or 'expended' as opposed to the identification of an actual cost and which constitutes the heart of Section 32.

16. This would constitute an appropriate juncture to also broadly capture the issues which emanate from Section 36(1)(iii) of the Act and the challenge which stood raised by the appellant assessee to the disallowance of interest paid in respect of capital borrowed for purposes of business. Insofar as this aspect is concerned, the Tribunal had taken note of the admitted fact of the appellant having declared **Capital Work-in-Progress**[9] amounting to INR 278.96 million in its Balance Sheet. The Tribunal records that the AO, however, had found that the above was in addition to Fixed Assets disclosed to be INR 12828 million as an item distinct from CWIP which was shown separately. It has then proceeded to hold that since CWIP would not qualify the requirement of "*extension of existing business*", as that

[9] CWIP

phrase existed in the Proviso to Section 36(1)(iii) at the relevant time, the interest was liable to be disallowed. It becomes pertinent to note that the expression "*extension of existing business*" as it stood in the Proviso to Section 36(1)(iii) ultimately come to be deleted by Finance Act, 2015 with effect from 01 April 2016. However, and since in the present appeal we are concerned with AY 2009-10, we would have to proceed on the basis of the Proviso existing and governing the applicability of Section 36(1)(iii) of the Act.

17. Insofar as the creation of assets is concerned, the Tribunal had taken note of the contention of the appellant in the following terms: -

> "**21**. After considering the rival submissions and perusing the relevant material on record, it is first necessary to understand the nature of the capital work-in-progress capitalised in the balance sheet at Rs.2789 million. On a pertinent query, the Id. A.R submitted that this amount represents the cost of installing new cell site towers to be used for providing a better network to its customers. It was stated that roughly a period of three months is spent in the setting up of a tower. During the currency of such period of three months, i.e., when a tower is being set up, the costs incurred on such installation of towers are booked under the head 'Capital work-in-progress'. When installation gets completed, the amount so capitalised is transferred from the 'capital work-in-progress' account to the 'fixed assets' in regular course. From the above narration of factual background, it is clear that a sum of Rs.2789.6 million represents the amounts incurred by the assessee up to the end of the year on installation of towers, whose process of installation was still on at the end of the year. In other words, this figure represents the value of assets which may still not been used by the assessee during the year for its business purpose. The AO invoked first proviso to section 36(1)(iii) which, at the material time, read as under:-
>
> > 'Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset/or extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.'"

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18. It proceeded to negate the contention that the interest burden would qualify the requirement of "extension of existing business" in the following terms: -

> "**24**. We are not convinced with the contention advanced by the Id. AR. The words 'for extension of the existing business' presuppose that there is already a business in existence and capital is borrowed for acquisition of assets for extension of such existing business. 'Extension' can be vertical as well as horizontal. Existing telecommunication business can be extended in different forms. One of such forms can be the one described by the Id. AR in which a Cellular mobile service provider (CMSP) expands its area of business to a different Circle which was not hitherto- in its reach. In the same breath, there can be an extension of existing business when CMSP increases its reach within the allotted Circle itself by means of setting up new towers. To put it simply a CMSP has license to operate in a particular state, it may initially set up cell towers catering to urban areas for meeting the requirements of population residing therein. With the passage of time, it may try to reach to rural areas and still more rural areas within the same State by establishing towers for providing connectivity in such areas as well. With new towers in areas, which were hitherto not having connectivity because of lack of the coverage of adequate existing towers, the service provider will, naturally, be going in 'for extension of existing business.' With such a setting up of new towers, the service provider will increase its customer base within the existing Circle, which is nothing but an extension of existing business.
>
> **25**. When we advert to the facts of the instant case, it emerges that the assessee was successful in increasing its customer base by setting up new towers, cost of which has been classified as capital work-in progress. It is evident from the assessee's Director's Report for the year under consideration which records that: "the company has also witnessed a good level of increase in the subscriber base in all the three Circles (UPE, Rajasthan and Haryana) in which it operates. *The company has further expanded its network to increase its coverage across all its Circles.* During the year the company added 5096 cell sites to enhance its network coverage closing with 14411 cell sites as at 31st March, 2009." It is evident from the assessee's Director's Report that the setting up of new cell sites has enhanced its network coverage within all the three existing Circles and the resultant customer base, which is nothing, but, an extension of existing business. We, therefore, hold that the argument advanced by the Id. AR that the setting up of new cell sites, the cost of which was capitalised in the balance sheet as Capital work in progress (CWIP), does not lead to extension of existing business, is sans merit and, hence, dismissed."

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19. Before we proceed to notice the elaborate submissions which were advanced by Mr. Jolly based on a perceived distinction between the words 'extension' and 'expansion' as well as how the phrase 'extension of business' itself should be understood, we note that the Tribunal had, while ruling on this question, also alluded to certain recitals appearing in the Director's Report for the year under consideration. It has essentially borne in consideration the following paragraph from the Director's Report:-

"**DIRECTORS' REPORT**

The Directors have pleasure in presenting the Annual Report and Audited Accounts for the year ended on 31st March 2009.

FINANCIAL PERFORMANCE

Set out below is the summary of the financial performance of the Company during the year under review:

(Rs. Million)

Particulars	Year ended 31 Mar 2009	Period ended 31 Mar 2008
Revenue from operations	31,301.5	27,501.90
PBIDTA	7,344.1	8,811.20
Depreciation and Amortisation	5,315.4	3,855.50
Finance charges	1,709.4	1,537.60
Profit Before Tax	319.3	3,418.10
Profit After Tax	317.1	3,497.80

The Earning Per Share for the year has substantially declined to Rs. 3.1 per share from Rs. 34.6per share in the previous period which can be attributed primarily due to increased rates in depreciation resulting in higher depreciation and amortisation costs coupled with higher finance and fuel costs.

DIVIDEND

With a view to augment resources, your Directors do not recommend any Dividend.

OPERATIONS

2008-09 was a challenging year for all Telecom Operators. The year witnesses launch of several new operators coupled with regulatory driven tariff cuts, drop in International Inroaming traffic due to global economic slowdown. The end of the year finally saw the

impact of the global slowdown hitting India visibly in statistical terms.

During the year under review, the Company has further widened its innovative and user friendly services. Keeping in line with the latest global technology, the company introduced a variety of Value Added Services ("VAS"), and expanded its data business on blackberry & Vodafone Live. The Company has also witnessed a good level of increase in the subscriber base in all the circles in which it operates. The Company, in line with its group's initiatives launched the "happy to help" customer service initiative and many Value Added Services like Voice mail, election pack, Amar Chitra Katha, full song downloads, portfolio tracker and various 'Alert' services which was met with overwhelming response.

<u>The Company has also witnessed a good level of increase in the subscriber base in all the three circles (UPE, Rajasthan and Haryana) in which it operates. The Company has further expanded its network to increase its coverage across all its circles. During the year the Company added 5096 cell sites to enhance its network coverage, closing with 14,411 cell sites as at 31 March 2009.</u> The Company has outsourced some of its major functions i.e IT, Cell Site passive infrastructure maintenance to IBM and Indus respectively during the year, which will bring cost efficiencies in the coming years."

20. Mr. Jolly submitted that if the finding of the Tribunal which flows from a perceived reading of the extracts appearing in the Director's Report were to be accepted, the appellant would clearly not fall within the mischief of the Proviso since those extracts had spoken of a network already established and put to use. It was in the aforesaid context that Mr. Jolly submitted that the ultimate conclusions rendered by the Tribunal are clearly contradictory and the order impugned before us is thus liable to be set aside on this score alone.

21. An ancillary issue which appears to have arisen was whether the investment in CWIP was made out of interest free funds available with the appellant itself and thus not entirely on the basis of capital borrowed for the purposes of making such an investment. This issue came to be answered by the Tribunal as under: -

"**27**. Before dealing with this contention it is worthwhile to mention that the assessee made investment of Rs. 2789.6 Million in its CWIP, which is the centre of dispute. On having a glimpse at the balance sheet of the assessee, it becomes evident that it has paid up Share capital to the tune of Rs.1011.0 Million and Reserves and Surplus for a sum of Rs.4571.8 Million. Thus, it is palpable that as against the investment of Rs. 2789.6 Million in CWIP, the assessee has its own shareholders fund for a sum of Rs. 5582.9 Million, which is roughly double the amount of Capital work in progress.

28. Section 36(1)(iii) provides for deduction of interest of the amount of interest paid in respect of capital borrowed for the purpose of business or profession. The essence of this provision is that the interest should be allowed so long as the capital borrowed, on which such interest is paid, is used for the purpose of business or profession. If, however, an assessee is having its own interest free surplus funds and such funds are utilised as interest free advances even for a non business purpose, there cannot be any disallowance of interest paid on interest bearing loans. The Hon'ble Bombay High Court in CIT vs. Reliance Utilities and Power Ltd. (2009) **313 ITR 340 (Bom),** has held that where an assessee possessed sufficient interest free funds of its own which were generated in the course of relevant financial year, apart from substantial shareholder's funds, presumption stands established that the investments in sister concerns were made by the assessee out of interest free funds and, therefore, no part of interest on borrowings can be disallowed on the basis that the investments were made out of interest bearing funds. In that case, the AO recorded a finding that a sum of Rs.213 crore was invested by the assessee out of its own funds and Rs. 1.74 crore out of borrowed funds. Accordingly, disallowance of interest was made to the tune of Rs.2.40 crore. The assessee argued that no part of interest bearing funds had gone into investment in those two companies in respect of which the AO made disallowance of interest. It was also argued that income from operations of the company was Rs.418.04 crore and the assessee had also raised capital of Rs. 7 .90 crore, apart from receiving interest free deposit of Rs.10.03 crore. The assessee submitted before the first appellate authority that the balance-sheet of the assessee adequately depicted that there were enough interest free funds at its disposal for making investment. The ld. CIT(A) got convinced with the assessee's submissions and deleted the addition. Before the Tribunal, it was contended on behalf of the revenue that the shareholder's fund was utilized for the purchase of its assets and hence the assessee was left with no reserve or own funds for making investment in the sister concern. Thus, it was argued that the borrowed funds had been utilized for the purpose of making investment in the sister concern and the disallowance of interest was rightly called for. The Tribunal, on appreciation of facts, recorded a finding that the assessee had sufficient (funds of its own for making investment without using the

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interest bearing funds. Accordingly, the order of CIT(A) was upheld. When the matter came up before the Hon'ble High Court, it was contended by the Department that the shareholders' funds stood utilized in the purchase of fixed assets and hence could not be construed as available for investment in sister concern. Repelling this contention, the Hon'ble High Court observed that : "*In our opinion, the very basis on which the Revenue had sought to contend or argue their case that the shareholders' fund to the tune of over Rs.172 crore was utilized for the purpose of fixed assets in terms of the balance- sheet as on March 31, 1999, is fallacious.”* In upholding the order of the Tribunal, the Hon’ble High Court held that, “*if there be interest free funds available to an assessee sufficient to meet its investment and at the same time the assessee had raised a loan, it can be presumed that the investments were from the interest free funds available".* Thereafter, the judgment of the Hon'ble Supreme Court in the case of East India Pharmaceutical Works Ltd. Vs. CIT (1997) 224 ITR 627 (SC) and also the judgment of the Hon'ble Calcutta High Court in Woolcombers of India Ltd. Vs. CIT (1981) 134 ITR 219 (Cal) were considered. It was finally concluded that *"The principle, therefore, would be that if there are funds available both interest free and overdraft and/or loans taken, then a presumption would arise that the investments would be out of interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investment".* Consequently the interest was held to be deductible in full.

29. From the above judgment, it is manifest that there can be no presumption that the shareholders' fund of a company was utilized for purchase of fixed assets. If an assessee has interest free funds as well as interest bearing funds at its disposal, then the presumption would be that investment were made from interest free funds at its disposal. Similar view has been taken by the Hon’ble Delhi High Court in CIT vs. Tin Box Company (2003) 260 JTR 637 (Del), holding that when the capital and interest free unsecured loan with the assessee far exceeded the interest free loan advanced to the sister concern, disallowance of part of interest out of total interest paid by the assessee to the bank was not justified.

30. The legal position set out in the preceding para is applicable if an assessee has a common pool of funds and some part is investment in the disputed amount. This proposition does not hold water, if a specific borrowing is made for making such an investment. When we turn to the facts of the instant case, we find that even though the shareholders' fund is more than the investment in CWIP, but no detail of secured loan is available. In the absence of such specific information, it is difficult to decide the issue at our end. The impugned order is set aside to this extent and the AO is directed to decide this issue afresh in consonance with our foregoing observations. It is made clear that if there is some direct borrowing for investing in CWIP, then interest paid on such borrowing has to

> be disallowed. If, on the other hand there is no specific borrowing, the financing of CWIP has to be treated as out of interest- free shareholder's fund. In such a scenario, no disallowance of interest can be made as the interest-free shareholders' fund would be higher than the amount of investment in CWIP."

The Tribunal has thus, and as is evident from the above, ultimately left it open for the AO to examine the extent to which borrowings may have been utilized in connection with CWIP and the interest free funds that may have been used in the course thereof.

22. We propose to take up the issues pertaining to the question of depreciation and of whether a provision could have been made by the assessee insofar as ARC was concerned. From a reading of the order of the Tribunal we note that an amount of INR 510,79,752 had come to be disallowed by the AO and which was claimed as being part of the cost likely to be incurred on account of ARC. The stand of the assessee in this respect came to be rejected with the AO taking the position that the provision made was not in the nature of an ascertained liability and which was also affirmed by the Tribunal. It is this stand which was reiterated by Mr. Rai and who had principally argued that ARC was clearly a contingent liability as explained by AS-29 and, therefore, no provision could have been made in respect thereof.

23. According to Mr. Rai, the Lease Agreement itself had used the expression 'if any' and thus clearly being indicative of there being no present obligation that could be acknowledged in law. Mr. Rai had in this respect also sought to draw sustenance from a judgment rendered by a Division Bench of the Court in **Seagram Distilleries Pvt. Ltd. (Now Pernod Ricard India Pvt. Ltd.) v. Commissioner of Income Tax**[10] and where the Court had an occasion to review some of the

[10] 2015 SCC OnLine Del 12586

provisions comprised in AS-29. It, however, becomes pertinent to note that *Seagram Distilleries* arose in the context of a provision which the assessee had made in respect of transit breakages. The Court was thus called upon to consider whether breakage of bottles during transit and a provision made in respect thereof was liable to be viewed as a liability and whether it could be said to have been estimated on a scientific basis. While dealing with that question and on a review of the various provisions contained in AS-29, the Court held as follows: -

> "**11.** AS 29 further states that 'provisions' are distinguishable from other liabilities such as trade payables and accruals "because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement." However a 'provision' is recognised only where:
>
> "(a) an enterprise has a present obligation as a result of a past event:
>
> (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
>
> (c) a reliable estimate can be made of the amount of the obligation.
>
> **12.** If these conditions are not met, no provision should be recognised."
>
> **13.** Appendix A to AS-29 sets out in a tabular the summary of the AS. The provisions which are recognised and those that are not are set out in separate columns. What is not recognised is a provision for a liability which arises from 'a possible obligation' that may, but probably will not, require an outflow of resources.
>
> **14.** It is not in dispute that as and when transit breakages do occur the resultant losses are allowable as revenue expenditure, given the nature of the business of the Assessees. The decision in *Commissioner of Income Tax* v. *Balaji Distilleries Ltd.* (supra) and *Commissioner of Income Tax* v. *Brindavan Beverages (P) Ltd.* (supra) recognised this. In fact, for AYs 2002-03 to 2004-05 the AO has allowed transit breakages as revenue expenditure in the year in which the breakages occurred.
>
> **15.** The issue, however, is the justification for creating a provision for such breakages anticipating them in advance of the occurrence of the actual breakages. If such transit breakages cannot be estimated with a reasonable degree of certainty then the liability

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on that score would be considered 'contingent' in terms of the definition of that expression in AS 29 i.e. "a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise". AS 29 itself makes it explicit that no provision for a contingent liability would be recognised.

16. As regards the judicial decisions on the point, the Court proposes to first discuss the decision in *Bharat Earth Movers* (supra). There the Assessee had floated a beneficial scheme for its employees for encashment of leaves. The Assessee made a provision for meeting the liability to the extent of the entitlement of the officers and staff to accumulated earned leaves in terms of the scheme and claimed that provision as a deduction. The ITAT held in favour of the Assessee but the High Court reversed it on the ground that the provision for the accrued leaves was a contingent liability. The Supreme Court, however, disagreed with the High Court and held as under:

> "The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is *in prasenti* though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."

xxxx **xxxx** **xxxx**

18. On facts, in *Bharat Earth Movers* (supra), the Supreme Court was satisfied that the provision made by the Assessee for meeting the liability "incurred by it under leave encashment scheme proportionate with the entitlement earned by the employees of the company… is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability" and that "the liability is not a contingent liability." The decision acknowledged that where a scheme for leave encashment is floated by a company, the number of employees and their entitlements to leave encashment can be estimated with a reasonable degree of certainty. It would be a case of a 'known' liability.

19. In *Commissioner of Income Tax* v. *Vinitec Corporation P. Ltd.* (supra) the question for consideration was whether a provision for future warranty expenditure is a contingent liability. On facts, it was not in dispute that the warranty clause was part of the sale

> document and imposed a liability on the Assessee to discharge an obligation under the clause for the period of warranty. "It was a liability which was capable of being construed in definite terms which had arisen in the accounting year even though the actual quantification and discharge was deferred to a future date." In terms of the accepted principles of commercial practice and accountancy, it was held that a liability accrued, though discharged at a future date would be a proper deduction."

24. After having examined some of the decisions pertinent to the question which stood posed, the Court ultimately negated the stand of the assessee upon forming the opinion that no uniform or scientific method could be discerned so as to justify the creation of a provision. This becomes evident from a reading of Paras 24 and 27 of the report and which are extracted hereinbelow: -

> "**24.** The Court is unable to discern any uniform scientific method followed by the Appellant in making provision for the breakages. As noticed by the ITAT in its order dated 16th March 2009, the explanation offered by the Appellant was that on an ad hoc basis it fixed a rate per case of bottles. In the case of Andhra Pradesh, the rate was Rs. 10 per case, for Goa and Karnataka it was Rs. 15 per case. Also the breakages are known within a period of 15 to 30 days after despatch of the goods. The Court also concurs with the view of the ITAT that with the first Assessee having entered the line of business only from AY 2001-02, it cannot be said to have gathered sufficient experience to have reasonably estimated such breakages for the AYs in question. In the circumstances, the 'liability' on that score could at best be described as a 'contingent liability' as defined in AS-29
>
> **xxxx xxxx xxxx**
>
> **27.** To summarise the legal position as far as the Assessees are concerned:
>
> (a) There is no reasonable scientific method adopted by the Assessees to estimate the transit breakages so as to justify creating of provision for such breakages.
>
> (b) The provision would, in the circumstances, be a provision for a contingent liability and, therefore, in terms of the AS 29 ought not be recognised.
>
> (c) The actual transit breakages as and when they occur are allowable as revenue expenditure in the accounting year in which such breakages occur."

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25. Mr. Rai had also cited for our consideration the judgment of the Supreme Court in **Rotork Controls India (P) Ltd. v. CIT**[11]. In *Rotork*, the Supreme Court was called upon to examine whether a provision made with respect to possible warranty claims connected with the sale of goods, could be said to be an actual, accrued or contingent liability. It appears to have been urged by the Revenue in that case that since in the relevant year no claim for replacement had been received, the assessee could not have made any provision in its books of accounts.

26. The Supreme Court in *Rotork* proceeded to lucidly explain the concept of a provision as understood in accounting practise and the distinction which one must recognise between a positive obligation and a contingent liability. We thus deem it apposite to extract the following passages from that decision: -

> "**22.** What is a provision? This is the question which needs to be answered. A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognised when: (*a*) an enterprise has a present obligation as a result of a past event; (*b*) it is probable that an outflow of resources will be required to settle the obligation; and (*c*) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognised.
>
> **23.** Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognised as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole.

[11] 2009 SCC OnLine SC 1119

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> **25.** In the present case, the appellant has been manufacturing and selling valve actuators. They are in the business from Assessment Year 1983-1984 onwards. Valve actuators are sophisticated goods. Over the years the appellant has been manufacturing valve actuators in large numbers. The statistical data indicates that every year some of these manufactured actuators are found to be defective. The statistical data over the years also indicates that being sophisticated item no customer is prepared to buy valve actuator without a warranty. Therefore, warranty became integral part of the sale price of the valve actuator(s). In other words, warranty stood attached to the sale price of the product. These aspects are important. As stated above, obligations arising from past events have to be recognised as provisions. These past events are known as obligating events."

27. The enunciation of the legal position with respect to provisioning was thus succinctly explained by the Supreme Court as relating to the accepted and recognised practise of an amount being set aside to cover the expected cost of a probable liability which an assessee may incur and factor in, provided it can be measured by a reasonable degree of estimation and subject to it being found that the assessee was burdened by a present obligation flowing from a past event coupled with the probability of an outflow of resources for purposes of settling such an obligation. The Supreme Court in *Rotork,* in light of the aforenoted basic precepts, upheld the provision which the assessee had made upon noticing that the statistical data was indicative of return of defective parts and it was on the basis of the said historical data that the assessee had made a provision. It thus found the action of the assessee, in the facts of that case to be justified.

28. As we view AS-29, we find that the said standard defines a provision to be a liability which can be measured by using a substantial degree of estimation. A 'liability' is defined by AS-29 as a present obligation arising from past events and the settlement of which is expected to result in an outflow of resources from the enterprise.

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Similarly, an 'obligating event' is defined to mean one which creates an obligation and which leaves the enterprise with no realistic alternative except to settle that obligation. Of significance, is the meaning ascribed to the expressions 'present' and 'possible' obligations with AS-29 defining the former to be an obligation which is considered probable i.e. more likely than not while a possible obligation is to be understood as meaning an eventuality which is considered not probable.

29. Proceeding further to expound upon the concept of a present obligation, AS-29 in Para 15 stipulates that an enterprise would be justified in creating a provision where it is more likely than not that the present obligation exists at the Balance Sheet date. It explains a converse situation and where the enterprise would only disclose a contingent liability and where no present obligation exists or where the possibility of an outflow of resources is remote. In Para 22, AS-29 explains that in order for a liability to qualify for recognition it must satisfy the twin conditions of there existing a present obligation as also the probability of an outflow of resources. It proceeds further to expand upon those basic postulates by observing that an outflow of resources would be regarded as probable if the event is more likely than not to occur, i.e. the probability of the event occurring being greater than a probability that it would not. It was thus explained that where the probability of a present obligation is found not to exist, the enterprise would only disclose a contingent liability.

30. Para 26 on the other hand proscribes the recognition of a contingent liability. It thus only contemplates the making of appropriate disclosures in that respect in accordance with Para 68. In contrast to the meaning assigned to a present obligation, obligating event, liability and

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a provision, AS-29 defines a contingent liability to be a possible obligation, the existence of which would be confirmed only upon the occurrence or non- occurrence of one or more uncertain future events, and which may or may not be wholly within the control of the enterprise. A contingent liability is further defined to mean that though flowing from a present obligation arising from past events, it is not liable to be recognized since it is not probable that it would lead to an outflow of resources or where a reliable estimate of the expense involved cannot be made.

31. The key takeaways from AS-29, is of an enterprise being entitled to create a provision if a liability is found to exist. A liability is explained to mean a present obligation arising from past events and the settlement of which is expected to result in an outflow of resources. The past event insofar as the assessee is concerned, is the lease agreement and under which it came to be placed under the obligation to expend an asset restoration cost and which would undoubtedly result in an outflow of resources. A present obligation is defined by AS-29 as being one whose existence is considered probable on the Balance Sheet date. A possible obligation, on the other hand, is defined to be one which is not considered probable. Thus, as long as one is able to discern a positive obligation being placed upon an enterprise and its existence is considered as probable as distinguished from a certainty and in respect of which a reliable estimate can be made, it would permit the creation of a provision. Thus, as long as the probability of the obligation being liable to be discharged is found to exist, the requirements of AS-29 would stand attracted. This position comes even more to the fore when one views Para 15 and which while elaborating upon the concept of a present obligation speaks of the enterprise, upon the available evidence,

being of the opinion that it is more likely than not, that a present obligation exists.

32. A contingent liability on the other hand is defined to mean a possible obligation that may or may not arise and the existence of which in any case would be confirmed only upon the occurrence or non-occurrence of one or more uncertain future events. AS-29 also brings within the fold of a contingent liability, cases which although qualifying the test of a present obligation, do not stand coupled with a probability of an outflow of resources or one in respect of which no reliable estimate can be made. Thus, a contingent liability contemplates the uncertainty of the existence of both an obligation as well as the occurrence of unpredictable future events. It also brings within its fold those cases where it is not probable that the liability may lead to an outflow of resources as well as a situation where the liability itself cannot be quantified on the basis of the principles of reasonable estimation. Thus, the provisions of AS-29 bar the creation of a provision only in the case of a contingent liability and which, as a concept, stands explained in the manner indicated above.

33. Of equal significance are the Illustrations which form part of AS-29 and which while explaining when a provision could be made or recognized lay down the primordial tests to be the existence of a present obligation coupled with the probability of an outflow of resources subject to it being possible to reliably estimate the monetary liability that may come to be created if such an obligation were to be discharged. AS-29 prohibits the recognition of a provision where although a possible or present obligation is found to exist, but it would probably not entail an outflow of resources or where the outflow is

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considered to be remote. Illustration 3, which forms part of AS-29, explains a situation where an enterprise which was operating an offshore oil field is contractually obliged to remove the apparatus at the end of production and restore the seabed to its original condition. The answer which AS-29 provides in respect of that query, lends credence to the case set forth by the assessee herein as would become clearer from the discussion which follows.

34. One cannot possibly doubt the imperative requirement of civil works being undertaken on premises in order to erect cell towers. This would necessarily be liable to be removed upon the end of the license term in light of the contractual obligation which stands imposed upon the assessee. Since this would necessarily entail dismantling as well as restoration of the site to its original condition, the assessee appears to have estimated the cost likely to be incurred based on past experience and the inevitability or, to put it differently, the evident probability of such a cost being incurred. The contractual covenant cast a duty upon the assessee to remove the BTS equipment in such a manner that the aesthetics/structural design/architecture of the building is not disturbed. It was also placed under a positive obligation to restore the premises to its original state at its own cost. The respondents, however, would contend that the aforesaid liability was contingent upon damage 'if any' that may be caused. In our considered opinion, the view so taken is clearly untenable for the following reasons.

35. We are of the firm view that the usage of the phrase 'if any damage is caused' in the lease agreement cannot be construed as detracting from the right of the assessee to provision for a liability which flowed from an existing obligation and the occurrence of which

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was not liable to be viewed as an improbability. In our opinion, the phrase 'if any damage is caused' as it occurs in the agreement would only be germane to the issue of actual computation of the expenditure that would be incurred in the course of restoration. The qualificatory language as adopted in the agreement is thus liable to be viewed as merely being pertinent to identification of actual damage at the end of the lease term and the true or concrete expense to be incurred in repair and restoration. The said qualification would, in any case, have to be read in conjunction with the primary obligation to restore the premises to its original condition. The obligation to repair and restore forms the core of the contractual obligation which stood placed upon the assessee. It was therefore entitled to provision for such an expense provided it was considered probable and could be quantified on the basis of a reasonable estimation. The usage of the phrase 'if any damage is caused' did not transform that obligation into a contingent liability. We thus find ourselves unable to countenance the view expressed by the AO and the Tribunal in this respect.

36. A provision can be validly made, provided it be in line with the prescriptions set out in AS-29. That accounting standard is not concerned with events of certainty or an ascertained liability as the AO and the Tribunal understood. In our considered view, the stand taken by the respondents firstly proceeds on the incorrect premise of the liability being one which already exists and in respect of which there cannot possibly be a doubt. It is while proceeding on this fundamental postulate which has led to the Tribunal seeking to discern the existence of an ascertained liability. This clearly runs contrary to the express language of AS 29 when it defines a liability to be one whose settlement is expected to result in an outflow. AS 29 while explaining

when a provision may be justifiably made speaks of the probability of an outflow. The usage of the expression 'probable' is equated to 'more likely than not'. Thus, it is the reasonable likelihood of the outflow as opposed to a remote or uncertain possibility which is deemed to be germane and relevant. It thus has to be viewed as distinct from unforeseen liabilities and obligations. As we view the contract term, we have no hesitation in recognising the same as being the manifestation of a positive commitment to repair and restore. The duty to repair and restore stands attached to the removal of equipment as well as the liability to restore the premises to its original condition. The contract thus constitutes the past event and which in turn creates an obligation in praesenti pertaining to a liability which is probable and ascertainable. Thus, the only facets which are left to conjecture are the exact timing and the amount of outflow that may occur.

37. A contingent liability on the other hand is concerned with a possible obligation and which may or may not arise since it would be dependent upon the occurrence or non-occurrence of an uncertain future event. These are liabilities which are neither considered probable nor can they be reasonably estimated. The obligation and outflow which is spoken of in connection with contingent liabilities are prefaced by the words 'possible', 'one or more uncertain future events' and where the occurrence or non-occurrence of those events is itself unclear and uncertain. A contingent liability is one where both the obligation as well as the occurrence of the event which would trigger the same are to be found in the realm of conjecture. It is the facet of such liabilities neither being probable, more likely not to occur and being immeasurable which distinguishes these liabilities from those in respect of which a provision may be legitimately made.

38. The provision as made thus, clearly appears to follow lines similar to the site restoration situation which the Madras High Court had an occasion to review in *Vedanta Ltd*. As was held by that High Court, the words 'laid out' or 'expended' are not confined to an immediate expenditure but would also comprehend an expenditure which may arise in the future. Their Lordships noted that the assessee in that case was placed under the contractual obligation to expend monies on site restoration and the creation of the provision itself being based on empirical principles. It thus held that all that Section 37(1) requires is that the expenditure should be "laid out" or "expended" for the purposes of business.

39. The Madras High Court also had an occasion to notice a whole body of precedent which had, while speaking of provisions for liabilities being made, clearly interpreted the words 'laid out' or 'expended' as including an expenditure likely to be incurred in the future. It was thus held that the provision so made, on the basis of and informed by commercial prudence would clearly qualify the prescriptions of Section 37.

40. We are thus of the considered opinion that the provisioning for ARC qualified the prescriptions of AS 29 and the assessee was thus justified in accounting for the same. The ARC obligation clearly met the test of a positive obligation flowing from a past event, being a conceivable probability as well as being measurable. In any event, both the AO as well as the Tribunal appear to have proceeded on the basis that only an ascertained liability could have been provisioned for. That view is not only erroneous but also unsustainable in law.

41. We are also of the view that the Tribunal in any case failed to notice or engage with the contention of the assessee in the alternative and which was based on Section 37 of the Act. By placing its case within the ambit of Section 37, the assessee stood relieved of getting into the quagmire of 'actual cost' and other related issues. All that it was left to establish was that the expenditure had been laid out. As the Madras High Court correctly explains in *Vedanta*, the usage of the expression 'laid out' and 'expended' in Section 37 are indicative of that section not being confined to immediate expenditure but also factoring for situations where an amount may be set apart for a determined or specified objective. The appellant was thus clearly entitled to succeed on this point.

42. That then takes us to the issue of Section 36(1)(iii) and whether the interest burden borne by the assessee in respect of the capital borrowed was liable to be permitted as a deduction in computing its income. According to the respondents, since the capital borrowed was for the purposes of extension of an existing business or profession, the interest borne on borrowed capital would not be deductable during the period when the capital was initially borrowed and till such time and date as the asset is first put to use.

43. The aforenoted submission proceeds on the basis of the Proviso, as it stood at the relevant time and prior to the amendments which came to be made therein by virtue of Finance Act, 2015. It is pertinent to note that the Proviso in its original form had come to be inserted by Finance Act, 2003. In order to highlight the modifications which came to be made therein, we place below a table which captures how that provision stood pre and post its amendment by Finance Act, 2015:

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SECTION 36 AS AMENDED BY THE FINANCE ACT, 2003	SECTION 36 AS AMENDED BY THE FINANCE ACT, 2015
Other deductions.	**Other deductions.**
36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—	**36.** (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—
(*i*) the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;	The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;
[(*ia*) the amount of any premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society;]	(ia) the amount of any premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society;]
[(*ib*) the amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by the General Insurance Corporation of India formed under section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) and approved by the Central Government;] (*ii*) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or	(ib) the amount of any premium [paid by any mode of payment other than cash] by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by— the General Insurance Corporation of India formed under section 9 of the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) and approved by the Central Government; or any other insurer and approved by the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance

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commission; (*iia*) [*Omitted by the Finance Act, 1999, w.e.f. 1-4-2000.*] (*iii*) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession. **Provided** *that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.* *Explanation.*—Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;	Regulatory and Development Authority Act, 1999 (41 of 1999);] any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission; the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession : **Provided** that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction. *Explanation.*—Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause

44. As we view Section 36(1)(iii) it becomes manifest that an assessee would be liable to claim deductions in respect of the amount of interest paid in respect of capital borrowed for the purposes of business. On a reading of the principal part of Section 36(1)(iii), it becomes evident that such a deduction could be validly claimed as long as

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capital has been borrowed and interest burden has been shouldered coupled with the capital itself having been obtained for the purposes of business.

45. Reverting then to the principal contention of Mr. Jolly pertaining to Section 36(1)(iii) and which revolved upon the meaning to be ascribed to ‘extension of business’, it was vociferously argued that the Tribunal had clearly erred in holding that the investments which was made was for the purposes of extension of an existing business. It was in the aforesaid context that learned counsel had also sought to draw sustenance from certain other provisions comprised in the Act and which define the word “expansion” as well as “substantial expansion” as distinct from ‘extension’.

46. However, in our considered opinion, the distinction which was sought to be canvassed for our consideration and the arguments based thereon would clearly distract us from discerning the true intent and purpose underlying the insertion of the Proviso to Section 36(1)(iii). We express our hesitation in founding our judgment on the perceived distinction between the words ‘extension’ and ‘expansion’ especially since etymologically both appear to have been employed interchangeably and on many occasions, deemed to be synonyms of each other.

47. The **Black’s Law Dictionary** defines the word ‘**Extension**’ as a part constituting an addition, enlargement or enlargement of existing facilities. This becomes evident from the following extract of that work:-

> “**Extension-** “An increase in length of time specified in contract (e.g. of expiration date of lease, or due date of note). See also Grace period.

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> A part constituting an addition or enlargement, as an annex to a building or an extension to a house. Addition of something smaller than that to which it is attached; to cause to reach or continue as from point to point; to lengthen or prolong. That property of a body by which it occupies a portion of space. Network Stove Co. v. Gray & Dudley., D.C.Tenn., 39 F. Supp.992, 993."

48. The **Advanced Law Lexicon** of **P. Ramanatha Aiyar** explains the meaning of the word "**Extension**" as follows: -

> "**Extension-** "the act of extending or stretching out; enlargement in any direction, in length, breadth, or circumference the continuous of an existing thing (as); extension of the term of Parliament."

While the principal meaning accorded to that word flows on lines similar to those found in *Black's*, it also equates the word "extension" with "expansion" basis a decision rendered by the Allahabad High Court.

49. The **Oxford English Dictionary** defines the word "extend" as meaning to stretch out, to prolong in duration, to carry to a further point of completeness. Relevant extracts from that lexicon are reproduced hereinbelow:-

> "**Extend-**
>
> I. To stretch out
>
> II. To stretch or pull out (anything) to its full size; to strain (nerves); to hold or maintain in a stretched condition. Also to train (a vine)"

50. **Words and Phrases** in its Permanent Edition renders the following illuminating explanation to the meaning of the word 'extend':

> **"Extend** - "The word extend is used in a statute providing that motion for a new trial shall be filed within four days after return of verdict, provided that on application of defendant court may extend time for filing motion for 30 days, means time added to basic four days, unless extension order discloses, or contrary intention, so that time as extended makes a total of 34 days.
>
> Mo. 1994 the word "extend", as used in statue, providing that motion for new trial shall we filed within four days after return of verdict, provided that on application of defendant court may extend

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time for filing motion for 30 days, means time added to basic 4 days, unless extension order discloses a contrary intention so the time as extended makes a total of 34 days. The word "extension" ordinarily implies the existence of something to be extended, state vs graves.

Mo 1932. Word "extend" is defined as to enlarge in any sense; to make more comprehensive or capacious to broaden the application or action of its synonyms being increase, enlarge, expand and widen." - Meyering v. Miller, 51 S.W.2d 65, 330 Mo. 885.

Mont. 1936. To "extend" means to make more comprehensive; enlarge the scope of; give wider range. "Reference statutes," which by reference wholly or partly adopt pre-existing statutes, are not strictly "amendatory" or "revisory" in character, and hence are not obnoxious to constitutional provision that no law should be revised or amended, or extended by reference to its title only. State ex rel. Berthot v. Gallatin County High School Dist., 58 P.2d 264, 102 Mont. 356.

N.J.Err. & App. 1930. Word "extend" lends itself to great variety of meanings, which must in each case be gathered from context.- Blouch v. Stevens, 150 A. 581, 106 N.J.L. 488.

N.J. Sup.1903. The word "extend," both by etymology and by common usage, is an exceedingly flexible term, lending itself to a great variety of meanings, which must in each case be gathered from the context, which is owing to the fact that it is essentially a relative term, referring to something already begun; hence, in a concrete sense, it has no persistent meaning, although abstractly it always implies increase or amplification as distinguished from inception; as, for instance, "the extension of a man's business," or "of his line of credit," or "of the due time of his debts." Extension in space may be in any direction. It is not confined to mere linear prolongation. Middlesex & S. Traction Co. v. Metlar, 56 A. 142, 70 N.J.L. 98, 41 Vroom 98, reversed Metlar v. Middlesex & Somerset Traction Co., 63 A. 497, 72 N.J.L. 524, 43 Vroom 524.

N.M. 1924. "Extend," means to make more comprehensive; enlarge the scope of; give a wider range to.- State v. Armstrong, 243 P. 333, 31 N.M. 220.

51. As is evident from the above, the aforenoted authoritative work explains that the word 'extend' is clearly flexible, lending itself to a variety of meanings dependent upon the context in which it may be used. While so explaining the meaning of the word 'extend', it also significantly states that it would also imply increase, amplify as well as

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any action which would be in tune with its well-known synonyms such as expand including the 'extension of business'.

52. Some of the major lexicons and dictionaries, while explaining the meaning of the word "expansion" have stated that it would derive colour from the word "expand" and which essentially means to become greater or bigger in size. The **Oxford English Dictionary** ascribes the following meaning to that word:-

> "**Expansion-**"The action of expanding the fact or state of being expanded.
>
> I. Spreading out, Unfolding, opening out.
>
> II. The action or process of spreading out or unfolding; the state of being spread out or unfolded; the opening of a bud, flower, etc. Also a spreading out to view a display.
>
> > 1646 SIR T. BROWNE Pseud. Ep. IV. V. 191 The.. distance betwixt the extremity of the fingers of either hand upon expansion. 1656 tr. Hobbes' Elem. Philos. (1839) 458 Whereupon there will follow a great expansion of light, with vehement flame. 1664 POWER Exp. Exp. Philos. 11. 101 The Spring of a Watch.. if the String be broke.. flyes out into its fullest expansion. 1701 GREW Cosm. Sacra 1. v. 28 The easie expansion of the wing of a bird. 1731 POPE Ep. Burlington 145 The gilded clouds in fair expansion lie. 1847 DE QUINCEY Sp. Mil. Nun §8 (1853) 18 A mob orator, whose brawling mouth open to its widest expansion, [etc.]. 1867
> >
> > The detailed expression of what is implicitly contained in a statement; the writing out in full the meaning of graphical contractions. Also in Alg. the process of working out a contracted expression (cf. EXPAND I b.) and stating the result in full; the result or statement thus obtained.
> >
> > 1858 TODHUNTER Algebra xxxvi. §519 The subject of the expansion of expressions is.. properly a portion Differential Calculus. Ibid. xxxvi. §524 To find the number of terms in the expansion of any multinomial. 1886 J. EDWARDS Diff. Calc. 96 96 Now assuming the possibility of such an expansion, let, etc.
> >
> > 1869 E. J. REED Shipbuilding 186 Either a model of one side of the ship or an expansion drawing is prepared, on which to

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set off the edges and butts of the plates. Ibid. 439 An expansion batten is applied to the line on the floor representing the moulding edge of the frame. 1877 THEARLE Theor. Naval Archit. 1. 163 When an expansion drawing is made, the several strakes of plating can be shown upon it, also their thicknesses... It is obviously impossible to calculate the position of the centre of gravity from an expansion.

2. *concr.* Anything that is spread out; an expanse; esp. the expanse of heaven, the firmament.

1611 BIBLE Gen. i. 6 Let there be a firmament [*marg*. expansion) in the midst of the waters. 1659 PEARSON Creed (1839) 70 This house of God..is not all of the same materials.. there is a vast difference between the heavenly expansions. 1760 BEATTIE Lucretius 1. 6 All that lies Beneath the starr'd expansion of the skies. 1833 LAMB Elia Ser. 1. xxvi. (1865) 211 Less time. than it took to cover the expansion of his broad moony face.. with expression. a 1845 Hood Kilmansegg cxl, Venus and Mars Are rolling along in their golden cars Through the sky's serene expansion. 1863 ANSTED Channel Isl. 1. iv. (ed. 2) 64 Sorne.. flat expansions of hard.. rock, afford a kind of irregular pavement.

fig. 1662 R. MATHEW Unl. Alch. 557. 61 That ocean or expansion of wrath.

3. a. Extent; space to which anything is extended. b. Pure space (see quot. from Locke).

1690 LOCKE Hum. Und. 11. vii. §10 The capacious Mind of Man..extends its thoughts often, even beyond the utmost expansion of Matter. Joid. 11. xv. §1 Distance or Space, in its simple abstract conception. I call Expansion to distinguish it from Extension, which by some is used to express this distance only as it is in the solid parts of Matter. 1712 BLACKMORE Creation IV. (1718) 121 Lost in expansion, void and infinite. 1755 in JOHNSON.

4. a. The action or process of causing something to occupy or contain a larger space, or of acquiring greater volume or capacity; dilatation; an instance of this.

1664 Phil. Trans. I. 29 To prove the expansion of glass by heat. 1665 Ibid. 1. 49 What Bodies are expanded by being frozen, and how that expansion is evinced. 1692 BENTLEY Boyle Lect. viii. (1693) 27 The condensation and expansion of any portion of the Air is always proportional to the weight and pressure incumbent upon it. 178a Specif. Watt's Patent No. 1321. 5 The piston continues to descend by virtue of the

expansion of the steam. 1830 R. KNOX Béclard's Anat. 235 They are furnished with tensor muscles, whether proper, or simply by expansion of their tendons. 1875 URE Dict. Arts II. 319 s.v., Some remarkable examples of expansion are furnished by the influence of sunshine on the Britannia Tubular Bridge. 1882 VINES Sachs Bot. 874 These movements depend not upon alternate expansion and contraction of the tissue.. but, etc.

b. of immaterial things.

1682 SIR T. BROWNE Chr. Mor. 19 Spread not into boundless expansions either of designs or desires. 1856 SIR B. BRODIE Psychol. Ing. I. i. 31 A high education may.. have the effect of preventing the full expansion of genius. 1864 D. G. MITCHELL Sev. Stor. 69, I felt.. an unusual expansion. 1879 M. ARNOLD Mixed Ess. Pref. 7 The love of liberty is simply the instinct in man for expansion.

c. Comm. and Finance. (a) An extension (of business transactions). (b) An increase in the amount of the circulating medium. More fully expansion of the currency.

1847 CRAIG, Expansion, in commerce, commerce an increase of issue issues of bank notes. 1864 in WEBSTER. 1891 Pall Mall G. 10 Nov. In some directions there has been expansion, so that the 7/1 In losses have been partially neutralized.

d. Extension of the territorial rule or sway of a country.

1882 J. R. SEELEY in Macm. Mag. XLVI. 456 (title) The Expansion of England in the Eighteenth Century. 1903 Sun (N.Y.) 1 Dec. 2 When he indorsed the doctrine of expansion "the cheers were pronounced.

5. The amount or degree of dilatation.

1790 BLAGDEN in Phil. Trans. LXXX. 322 The whole expansion of pure spirit from 30° to 100% of Fahrenheit's thermometer, is not less than th of its whole bulk at 30°. 1816 J. SMITH Panorama Sc. Art II. 32 Taking a proportional part of the difference of the two expansions. 1875 URE Dict. Arts II. 391 8.v., The expansion of the solid corresponding to two degrees of the thermometer, is twice the expansion which corresponds to one degree.

6. concr. a. An expanded or dilated portion. b. A product of expansion; what (a thing) is expanded into.

1860 TYNDALL Glac. 11. vii. 261 This lake [Geneva] is simply an expansion of the river Rhone. 1865 RUSKI Sesame 178 A man has a personal work.. and a public work .. which is the expansion of the other. 1866 HUXLEY Phys."

53. Thus, a review of the aforesaid works leads us to the inevitable conclusion of both "expand" and "extend", essentially seeking to convey enlargement or expanding over and above what may have originally existed. We also contemplate both words envisaging the spread of or addition to what may exist, both in its vertical as well as horizontal forms. It is this synonymous and similar meaning ascribed to the words 'extend' and 'expand' which weighs upon us and convinces us to desist from toeing this line of reasoning.

54. More fundamentally, and in our considered opinion, the objective of the Proviso does not really revolve or pivot upon the use of the word 'extension' as it appears. This would become evident from the discussion which ensues. The phrase "*extension of existing business*" came to be introduced in the statute on the basis of Finance Bill, 2003. The Explanatory Memorandum seeks to shed light on the underlying objective of its insertion in the following words :-

> "**Clarificatory amendments in respect of deduction for interest on borrowed capital**
>
> Under the existing provisions contained in clause (iii) of sub-section (1) of section 36, deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "profits and gains of business or profession".
>
> The existing provisions have been prone to litigation. It is, therefore, proposed to provide that no deduction will be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalized in the books of account or not) for the period beginning from the date on which the capital was borrowed for the acquisition of the asset till the date on which such asset was first put to use. The proposed amendment will take effect from the 1st day of April, 2004 and will, accordingly apply in relation to assessment year 2004-2005 and subsequent years."

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55. The Explanatory Notes to the provisions of the Finance Act, 2015 provide the following insight underlying the deletion of that phrase from the Proviso itself: -

> "**16. Alignment of provisions relating to capitalisation of interest and claim of deduction of bad debts with the provisions of the Income Computation and Disclosure Standards (ICDS)**
>
> 16.1 The Income Computation and Disclosure Standards (ICDS)-IX relating to borrowing costs provides for capitalisation of borrowing costs incurred for acquisition of assets up to the date the asset is put to use. The proviso to clause (iii) of sub-section (1) of section 36 of the Income-tax Act provided for capitalisation of borrowing costs incurred for acquisition of assets for extension of existing business up to the date the asset is put to use. However, the provisions of ICDS-IX do not make any distinction between the asset acquired for extension of business or otherwise.
>
> 16.2 Therefore, there was an inconsistency between the provisions of proviso to clause (iii) of sub-section (1) of section 36 of the Income-tax Act and the provisions of ICDS-IX. The general principles for capitalisation of borrowing cost requires capitalisation of borrowing cost incurred for acquisition of an asset up to the date the asset is put to use without making any distinction whether the asset is acquired for extension of existing business or not. The Accounting Standard Committee, which drafted the ICDS, also recommended that there is a need to carry out suitable amendments to provisions of the proviso to clause (iii) of sub-section (1) of section 36 of the Income-tax Act for aligning the same with the general capitalisation principles.
>
> 16.3 In view of the above, the provisions of proviso to clause (iii) of sub-section (1) of section 36 of the Income-tax Act have been amended so as to provide that the borrowing cost incurred for acquisition of an asset shall be capitalised up to the date the asset is put to use without making any distinction as to whether an asset is acquired for extension of existing business or not.
>
> 16.4 The provisions of the ICDS are applicable for computation of income and not for the purposes of maintenance of books of account. There may be cases where the income is recognised for computation of taxable income in accordance with the provisions of ICDS without recording the same in the books of account and such income may be required to be reversed in accordance with the provisions of the ICDS. For claiming bad debt, the provisions of section 36(1)(vii) of the Income-tax Act, inter alia, require that the amount should be written off in the accounts of the assessee.
>
> 16.5 Therefore, the reversal of income in accordance with the provisions of the ICDS may not be allowable on the ground that

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same has not been written off in the accounts as per the provisions of section 36(1)(vii) of the Income-tax Act. In view of this, a proviso has been inserted in section 36(1)(vii) of the Income-tax Act so as to provide that for claiming deduction under section 36(1)(vii) of the Income-tax Act, the income which have been recognised as per the provisions of ICDS without recording in the accounts and is required to be written off as irrecoverable as per the provisions of ICDS, it shall be deemed to be written off as irrecoverable in the accounts.

16.6 Applicability: - These amendments take effect from 1st April, 2016 and would accordingly apply to assessment year 2016-17 and subsequent assessment years"

56. The words 'extend', 'extension' and 'expansion' have arisen for interpretation in various judgments, including some of which were cited by Mr. Rai for our consideration. For instance, in **United India Insurance Co. Ltd. v. Great Eastern Shipping Co. Ltd**[12] the issue arose in the context of the extension of an existing insurance policy and whether the extended coverage would cover goods in transit. While dealing with this question, the Supreme Court observed: -

> "**17.** Learned counsel also referred to *Law Lexicon*, to give dictionary meaning to the word, "extend", which reads as follows:
>
> "*Extend*.—This term has a wide variety of meanings and has been defined as follows: To prolong, to continue or continue in any direction: stretch out; to stretch out of reach; to expand; to enlarge or lengthen the bounds or dimensions or; lengthen. And it is sometimes used as equivalent to the word 'exceed' (as) to extend the bounds of jurisdiction."
>
> Learned counsel also referred to *K.J. Aiyar's Judicial Dictionary* wherein the word "extend" has been defined as follows:
>
> > "*Extend*.—The word 'extend' in an enactment is not quite analogous to 'shall come into force'. Where it is laid down in an Act that it extends to a certain area it does not necessarily mean that it is also in that area, particularly when there is an express provision that before it can come into force, something further, such as a notification, is necessary."
>
> **18.** Learned counsel also invited our attention to *Black's Law Dictionary* (5th Edn.) which defines the word, "extend" as follows:

[12] (2007) 7 SCC 101

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> "*Extend*.—Term lends itself to great variety of meanings, which must in each case be gathered from context. It may mean to expand, enlarge, prolong, lengthen, widen, carry or draw out further than the original limit; e.g. to extend the time for filing an answer, to extend a lease, term of office, charter, railroad track, etc.

xxxx **xxxx** **xxxx**

> **25.** The contention of Mr Mehra that the extended coverage does not cover the goods in transit till they reach any part of the country is not correct because the transit infers storage also till it reaches its destination. The damage on the rail or road would also include that in transit the goods are to be kept in transit shed, the policy would cover that also. If this interpretation is not given then the extended coverage would be of no use. Looking to the expression used in the background of the intention of the parties, it clearly transpires that once the goods were insured, then till they reach any part of the country they shall be covered by the extended coverage. Therefore, the contention of Mr Mehra cannot be accepted."

57. Our view with respect to the soundness of the submission based on a perceived distinction between the words 'extend' and 'expand' also finds resonance in the judgment handed down by the Punjab and Haryana High Court in **Nahar Poly Films Ltd. vs. Commissioner of Income- Tax, Ludhiana**[13] and where while dealing with the provisions of Section 36(1)(iii) itself and the issue of when a borrowing could be said to be for extension or expansion of a business, the High Court pertinently observed as follows:-

> **"**11. The effect of proviso to section 36(1)(iii) inserted by the Finance Act, 2003 w.e.f. 1-4-2004 relating to assessment year 2004-05 and subsequent years <u>is to disallow interest on moneys borrowed for acquiring a capital asset till the date on which the asset was brought to use even if it is for extension of existing business</u>.
>
> 12. After considering the issue, we do not find any substance in the contention of the learned counsel. It would at the first place be quite apt to have a glimpse of the dictionary meanings of the two words. <u>According to Chambers 21st Century Dictionary, the meaning of word Extension, inter alia, is the process of extending something or the state of being extended, an added part that makes the original larger or longer whereas the meaning of the word "expansion" is the</u>

[13] [2011] 201 Taxman 304 (Punjab & Haryana)

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act or state of expanding. The distinction between "Extension" and "Expansion" as has been sought to be projected by the assessee does not carry any persuasion as there is no real distinction between the two as suggested by the counsel. Even if the distinction as professed by the learned counsel in the terms "Extension" and "Expansion" is taken to exist still the plea of the assessee does not inspire acceptance as "Expansion" would be wider and embrace "Extension" within it. The Tribunal had recorded a finding of fact that there was extension of the assessee's business as it had purchased the assets for the same by borrowing capital from the banks and, therefore, it was not entitled to deduction under section 36(1)(iii) of the Act. The relevant observations of the Tribunal, in para Nos. 20 and 21 of the order are as under:

> "20. The facts of the present case before us are that the assessee was running a unit with spindle capacity 153664 spindles which was increased to 201664 spindles by putting up new machinery. This exercise of increasing the capacity amounts to the process of enlarging and/or extending the existing capacity and hence is a case of extension of existing business. It can by no stretch be called as acquisition of assets for the existing business as even in the director's report, the managing director talks about the changing global textile scenario, and the role of capacities and up-gradation of technology in the success of business which was the instrument for increasing the spindle capacity which, in turn, was to be financed by the term loan raised by the assessee-company during the year. In the facts before the Hon'ble Delhi High Court in Modi Industries Ltd.'s case (supra) relied upon by the assessee, person was engaged in the business of manufacture of diverse items and a new item was added to its manufacturing business, whereas there was complete unity or control and utilisation of common funds and it was held that the business of manufacturing of new items was an extension of the business and not a new business. In the facts before us, though the same line of business is being carried on but scope of production has been enlarged by increasing the spindle capacity and the same is extension of business by the assessee. Consequently, the provisions of proviso to section 36(1)(iii) are applicable in the case.
>
> 21. The plea of the assessee before us was that the increased capacity amounts to expansion of business, and is not extension of business envisaged in the proviso to section 36(1)(iii). The dictionary meaning of the word 'expand' or as per the Concise Oxford English Dictionary is 'to make or become larger or more extensive' and the meaning of the word 'expansion' is 'the action or an instance of expanding'. In view thereof the two words

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'expansion' and 'extension' are synonymous and even if it be taken as expansion, as contended by the assessee, it is not different from extension of business and consequently the application of the proviso to section 36(1)(iii) of the Act is justified. In the entirety of facts and circumstances and in view of the machinery not being put to use, the interest expenditure on the utilisation of borrowed funds for the acquisition of new assets, from the date of its acquisition till the date when machinery is put to use, is disallowable. Accordingly, we uphold the order of CIT(A) and dismiss the ground No. 3 raised by the assessee."

13. In view of the above well reasoned observations of the Tribunal and the fact that the judgments relied upon by the learned counsel do not support the case of the assessee being based on individual factual situation involved therein, no substantial question of law arises in this appeal. Accordingly, finding no merit in the appeal the same is dismissed.**”**

58. We are thus of the considered opinion that the question which stands posited would have to answered on an independent evaluation of the scheme of Section 36(1)(iii) read along with the Proviso and the legislative intendment underlying the insertion of that amendment in the Act. We are thus of the firm view that it would be imprudent and unwise to base our answer solely on the purported difference which Mr. Jolly sought to advocate based on the usage of word ‘extension’ in Section 36(1)(iii) as contrasted with ‘expansion’ as appearing in other parts of the statute.

59. It was in connection with the aforesaid issue that learned counsels for respective sides had also cited various judgments in the context of Section 10(2) of the Income Tax Act, 1922 and which also imbibed the expression ‘actual cost’ as that phrase appears in Section 32 of the present Act. In **Challapalli Sugar Ltd. v. CIT**[14], one of the questions which arose was with respect to the meaning to be accorded to ‘actual cost’ for the purposes of computing written down value.

[14] 1974 SCC OnLine SC 332

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While ruling on the aforesaid question, the judgment in *Challapalli Sugar* carried the following observations: -

> "**12.** It has not been disputed that so far as the question before us is concerned the legal position for determining the actual cost for the purpose of development rebate is the same as for the purpose of depreciation.
>
> **13.** It would appear from the above that while considering the question of deduction on account of depreciation and development rebate, we have to take into account the written down value. Written down value in its turn depends upon the actual cost of the assets to the assessee. The expression "actual cost" has not been defined in the Act, and the question which engages our attention is whether the interest paid before the commencement of production on the amount borrowed for the acquisition and installation of the plant and machinery can be considered to be part of the actual cost of the assets to the assessee. So far as the interest after the commencement of production in respect of capital borrowed for the purposes of business is concerned, the same can be deducted under clause (*iii*) of sub-section (2) of Section 10 of the Act.
>
> **14.** In finding the answer to the question mentioned above, we have to bear in mind that it arises in the context of profits or gains of business and the permissible deductions on account of depreciation and development rebate relating to the machinery and plant of the assessee. As the expression "actual cost" has not been defined, it should, in our opinion, be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the above expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The word "cost", as observed on p. 424 of Simon's *Taxes D* Third Edition, is not synonymous with "price". Other items of expenditure, such for instance as freight or warehouse charges or insurance, must in certain cases be added to the price. The matter has been dealt with in *Accountancy by Pickles,* 1955 Ed. on p. 944 under the head "Payment of interest on Construction Capital" as under:
>
> **xxxx xxxx xxxx**
>
> **15.** It would appear from the above that the accepted accountancy rule for determining the cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in working condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets which have been created as a result of such expenditure. The above rule of accountancy should, in our

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view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.

16. We have already referred to Section 208 of the Companies Act which makes provision for payment of interest on share capital in certain contingencies. Clause (*b*) of sub-section (1) of that section provides that in case interest is paid on share capital issued for the purpose of raising money to defray the expenses of constructing any work or building or the provision of any plant in contingencies mentioned in that section, the sum so paid by way of interest may be charged to capital as part of the cost of construction of the work or building or the provision of the plant. The above provision thus gives statutory recognition to the principle of capitalising the interest in case the interest is paid on money raised to defray expenses of the construction of any work or building or the provision of any plant in contingencies mentioned in that section even though such money constitutes share capital. The same principle, in our opinion, should hold good if interest is paid on money not raised by way of share capital but taken on loan for the purpose of defraying the expenses of the construction of any work or building or the provision of any plant. The reason indeed would be stronger in case such interest is paid on money taken on loan for meeting the above expenses.

xxxx xxxx xxxx

21. It may be mentioned that as against the view taken by the Andhra Pradesh High Court in the judgment which is the subject-matter of the appeal, three other High Courts have taken the contrary view and have held that interest paid in such circumstances can be capitalised and included in the actual cost of the machinery and plant. The decision of the Calcutta High Court in which the contrary view has been taken is the subject-matter of appeal before us. The view of Calcutta High Court has been followed by the Madras High Court and the Allahabad High Court. The decision of the Madras High Court is in the case of *CIT* v. *L.G. Balakrishnan and Bros.* (*P*) *Ltd.* [(1974) 95 ITR 284 (Mad)] , while that of the Allahabad High Court is in the case of *CIT* v. *J.K. Cotton Spinning & Wvg. Mills* [IT reference No. 234 of 1972 decided on May 13, 1974] . After giving the matter our consideration, we are unable to subscribe to the view taken by the Andhra Pradesh High Court. The correct view in the matter, in our opinion, has been taken by the Calcutta High Court and we affirm the same."

60. Much before the judgment in *Challapalli Sugar*, the Supreme Court in **India Cements Ltd. vs. CIT**[15] was called upon to answer the question as to when the expenditure incurred by the assessee in

[15] (1996) 2 SCR 944

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obtaining a loan was allowable. The question itself arose in the context of a loan obtained by the assessee from a financial institution and which was secured by a charge on its fixed assets. It appears to have been urged before the Supreme Court that the expenditure would clearly be admissible as a deduction under Section 10(2) of the Act. *India Cements,* as would be evident from the recordal of facts which obtained therein, was concerned with a loan taken for an existing business and thus distinct from what prevailed in *Challapalli Sugar.* The latter was called upon to answer the question in light of a business which was yet to be commenced.

61. It was the aforesaid distinguishing feature which had led the Supreme Court in *Challapalli Sugar,* to observe that where money is borrowed by a company which is yet to commence operations, the interest burden which accrues thereon in the pre-commencement of production stage would be liable to be capitalized and added to the cost of the fixed asset. It is this underlying distinction which appears to weighed upon the Supreme Court to distinguish its earlier judgment in *India Cements* as would be evident from Para 20 of the report and where it noted that the aforementioned decision was rendered in the context of a company which was a running concern unlike the assessee in *Challapalli Sugar.*

62. Reverting then to the decision in *India Cements,* the principal question which arose was the nature of expenditure connected with an interest liability and when it would qualify for deduction under Section 10(2)(xv). The Supreme Court summarised its conclusions in Para 16 in the following terms: -

> "**16.** To summarise this part of the case, we are of the opinion that (*a*) the loan obtained is not an asset or advantage of an enduring

nature; (*b*) that the expenditure was made for securing the use of money for a certain period; and (*c*) that it is irrelevant to consider the object with which the loan was obtained. Consequently, in the circumstances of the case, the expenditure was revenue expenditure within Section 10(2)(*xv*)."

63. In our considered opinion, the true import of the judgments of the Supreme Court in *Challapalli Sugar* and *India Cements* were correctly explained by the Gujarat High Court in **CIT vs. Alembic Glass Industries** [16] as well as by our Court in **CIT vs. Monnet Industries Ltd**[17]. In *Alembic Glass,* the principal issue which arose was whether the borrowing obtained by the assessee was liable to be viewed as an extension of an existing business or for the purposes of establishment of a separate undertaking. It was while dealing with the principal issue of commonality of purpose, interlacing of businesses that the Gujarat High Court held as under: -

"**14.** We shall first analyse the facts of the Bombay case because these facts are found to be quite apposite to the facts of the present case. In the Bombay case the assessee-firm which carried on business of bleaching, dyeing and printing cloth, borrowed money in the year of account in order to expand its business, purchase land and erect additional plant and machinery and paid interest on borrowed capital. In its assessment to income-tax in the relevant assessment year the claim of the assessee to deduction of interest so paid under section 10(2)(iii) of the Indian Income-tax Act, 1922, was rejected on the ground that the plant and machinery were not used for business in the year of account. The High Court held that the assessee was entitled to deduction claimed even though the plant and machinery were not used in the year of account. While coming to this conclusion, the High Court observed that where the assessee claims deduction of interest paid on capital borrowed under section 10(2)(iii) of the Indian Income-tax Act, 1922, all that the assessee has to show is that the capital which was borrowed was used for the purpose of the business of the assessee in the relevant year of account. The High Court further observed that it did not matter that the capital was borrowed in order to acquire a revenue asset or a capital asset. Following are the pertinent observations which are made in that judgment:

[16] 1975 SCC OnLine Guj 55
[17] [2008 SCC OnLine Del 1506]

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"Before we look at the authorities, it would perhaps be best to turn to the section itself, and the deduction which is permissible under section 10(2)(iii) is 'in respect of capital borrowed for the purposes of the business, profession or vocation, the amount of the interest paid'. Now it will be noticed that the sub-section makes no distinction between capital borrowed in order to acquire a revenue asset and capital borrowed to acquire a capital asset. All that the section requires is that the assessee must borrow the capital and the purpose of the borrowing must be for the business which is carried on by the assessee in the year of account. The capital must be borrowed for the purpose of no other business except the business which is being assessed. Now, when we look at the other sub-clauses of section 10(2), it is clear that the underlying idea of these sub-clauses is that the particular deduction claimed must be in relation to the business which is referred to in sub-section (1) of section 10, that is, the business in respect of which tax is payable by an assessee…… We are prepared to agree with Mr. Joshi that, looking to the whole scheme of subsection (2), the capital which is borrowed must be used in the year of account. If the capital is used in the year of account and the use is for the purpose of the business, then it is immaterial whether the user of capital actually yields profit or not. What sub-clause (iii) emphasises is the user of the capital and not the user of the asset which comes into existence as a result of the borrowed capital…… Unlike section 10(2)(xv) which expressly excludes an expense of a capital nature, the legislature has made no distinction in section 10(2)(iii) between capital borrowed for a revenue purpose and a capital purpose. An assessee is entitled to claim interest paid on borrowed capital provided it is for the purpose of the business irrespective of what may be the result of using the capital which he has borrowed."

15. These observations show that when for the purpose of a running business an assessee borrows some amount then it is immaterial for the purpose of section 10(2)(iii) of the Act of 1922 to consider whether the borrowed amount was invested for the purpose of obtaining an asset of enduring nature or was spent for revenue. The facts of the present case are exactly similar to the facts of the Bombay case, because here also the assessee's business was a going concern at Baroda and what the assessee has done is to expand its business by establishing a new separate unit at Bangalore. Thereafter, whatever borrowing was made by the assessee for the purpose of establishing a separate unit at Bangalore, the interest paid on such borrowing would, on the ratio of the above judgment of the Bombay High Court be covered by the provisions of section

10(2)(iii) for the simple reason that the said borrowing was for the purpose of the business which the assessee carried on, as section 36(1)(iii) of the Act 1961, with which we are concerned in this reference is equivalent to section 10(2)(iii) of the Act of 1922.

xxxx **xxxx** **xxxx**

18. This decision of the Supreme Court makes it clear that where for the purpose of a running business a borrowing is made, then the loan obtained by the said borrowing is not to be considered as an advantage of an enduring nature and that the consideration of the object with which the loan was obtained is irrelevant. If that be so, in this case also it can be said that even if the disputed borrowings were made by the respondent-assessee with the object of establishing a new industrial unit at Bangalore, the interest paid by it on those borrowings cannot be treated as the capital expenditure if it is found that the borrowings in question were for the purpose of its running business. Now, it cannot be disputed that the borrowings were for the purpose of business which the assessee was already running at Baroda, when it decided to establish a new industrial unit at Bangalore, because, though the unit at Bangalore was to be newly established, it was merely the expansion of the existing business, which was carried on by the assessee at Baroda.

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20. The question which still remains to be considered is whether, in spite of the above referred two decisions, any difference in the legal situation is made by the recent decision of the Supreme Court in *Challapalli Sugars Ltd.* v. *Commissioner of Income-tax* [[1975] 98 ITR 167 (SC).] . In order to understand the ratio of the decision in *Challapalli Sugars Ltd.'s case* [[1975] 98 ITR 167 (SC).] , and with a view to see how far the said ratio is in harmony with the ratio of the above referred decision of the Supreme Court in *India Cements Ltd.'s case* [[1966] 60 ITR 52 (SC).] , it would be necessary to state shortly the facts relating to that decision. There the assessee was a public limited company engaged in the manufacture and sale of sugar. The company went into production on January 22, 1958. It had borrowed considerable sums of moneys from the Industrial Finance Corporation of India for the installation of machinery and plant. During the accounting period, the company paid Rs. 2,38,614 as interest and claimed that the said payment should be treated as part of the cost of the machinery and plant installed by it, and the depreciation should be calculated accordingly. The Income-tax Officer rejected this claim of the company and held that the interest paid by the company from year to year was revenue expenditure. The matter eventually went to the Andhra Pradesh High Court which held that where a plant is constructed out of borrowed money, the interest on loan up to the date of the commencement of the business could not be capitalised or treated as part of the actual cost of the plant. The Supreme Court rejected this view of the High Court on

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consideration of the question as to what was the "actual cost" for the purpose of determining "written down value" of a plant. The Supreme Court considered the principles of accountancy and held that the cost of fixed assets should include all expenditure necessary to bring such assets into existence and to put them in working condition and, therefore, in case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of fixed assets which have been created as a result of such expenditure.

22. It is no doubt true that in the case of *Challapalli Sugars Ltd.* [[1975] 98 ITR 167 (SC).] the Supreme Court has unequivocally observed that interest paid on the borrowing utilised to bring into existence a fixed asset which has not gone into production goes to add to the cost of installation of that asset. But these observations have been made with reference to a situation wherein it was not possible to contend that the borrowing on which interest was paid was made for the purpose of any business. The company which had made the borrowing in that case had not yet started production, and hence had not commenced any business when it borrowed the amount in question. Therefore, it was not possible to say in that case that the borrowing was made "for the purposes of the business" to bring the case within the ambit of section 10(2)(iii) of the Indian Income-tax Act, 1922 (which is equivalent to section 36(1)(iii) of the Act of 1961). If the said borrowing was not "for the purpose of business" inasmuch as no business had come into existence, it must follow that it was made for the purpose of acquiring an asset which could be put to use for doing business, and hence interest paid on such borrowing would go to add to the cost of the assets so acquired.

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24. The High Court of Bombay has unequivocally stated in *Calico Dyeing and Printing Works* [[1958] 34 ITR 265 (Bom).] that in order to attract the provisions of section 10(2)(iii) it does not matter whether the capital is borrowed in order to acquire a revenue asset or a capital asset, because all that the section requires is that the assessee must borrow the capital for the purpose of his business. This dichotomy between the borrowing of a loan and actual application thereof in the purchase of a capital asset, seems to be on the ground that a mere transaction of borrowing does not, by itself, bring any new asset of enduring nature into existence, and that it is the transaction of the investment of the borrowed capital in the purchase of the new asset which brings that asset into existence. Since the transaction of borrowing is not the same as the transaction of investment, the Supreme Court has observed in *India Cements Ltd.* v. *Commissioner of Income-tax* [[1966] 60 ITR 52 (SC).] that, for considering whether payment of interest on a borrowing is

revenue expenditure or not, the purpose for which the borrowing is made is irrelevant. Thus, the decisions of the Bombay High Court in *Calico Dyeing & Printing Works* [[1958] 34 ITR 265 (Bom).] and of the Supreme Court in *India Cements Ltd.* [[1966] 60 ITR 52 (SC).] were given with reference to the borrowings made for the purposes of running businesses, while the decision of the Supreme Court in *Challapalli Sugars Ltd.* [[1975] 98 ITR 167, 178 (SC).] was given with reference to the borrowings which could not be treated as made for the purposes of business, as no business had yet been commenced. Thus, there is no incompatibility between these decisions. The Supreme Court itself has distinguished its earlier decision in *India Cements Ltd.* [[1966] 60 ITR 52 (SC).] in the following terms in *Challapalli Sugars Ltd.* [[1975] 98 ITR 167, 178 (SC).] :

> "This case too is of no assistance to the revenue. The appellant-company in that case at the time it raised the loan was a running concern. Unlike the assessees in the present appeals, the loan raised by the appellant-company in the cited case was not before the commencement of production but at a later stage. The question of including the interest paid on the loan before the commencement of business in???*he* actual cost of the plant did not arise in that case."

64. As is evident from the aforesaid extracts, in *Alembic* the High Court found that the decision of the Supreme Court in *Challapalli Sugar* would have to be appreciated bearing in mind the indubitable fact that the same had been rendered in the context of a business which was yet to commence. It thus held that since the business had yet to commence activities of production, it could not be said that the borrowing was made for the purposes of business as that expression appeared in Section 10(2)(iii) of the erstwhile income tax legislation. The High Court had then proceeded to notice certain other decisions including that rendered by the Bombay High Court to elucidate the legal position as being that Section 10(2)(iii) was clearly not concerned with whether the capital borrowed was to acquire a revenue or a capital asset. The High Court thus held that the aforenoted provision would be triggered immediately upon capital being borrowed for the purposes of

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business. It thus pertinently observed that the Revenue had clearly appeared to have misconstrued the provisions of the statute by construing its applicability as being dependent upon the investment of borrowed capital as opposed to the act of borrowing itself. It thus proceeded to record its conclusions in the following words: -

> "**25.** In view of this, we conclude that the decisions of the Bombay High Court in *Calico Dyeing & Printing Works* [[1958] 34 ITR 265 (Bom).] and of the Supreme Court in *India Cements Ltd.* [[1966] 60 ITR 52 (SC).] , hold the field with equal force, even after the decision in *Challapalli Sugars Ltd.* [[1975] 98 ITR 167, 178 (SC).] We can state the ratio of all these three decisions as under:
>
> (1) Where a borrowing is made for the purposes of a business, the interest paid on such a borrowing becomes eligible to deduction contemplated by section 10(2)(iii) of the Act of 1922 or section 36(1)(iii) of the Act of 1961.
>
> (2) This would be so, even if the capital is invested in order to acquire a revenue asset or a capital asset, because the act of borrowing capital is distinct from the act of investment of that capital to acquire an asset.
>
> (3) However, the business for which an asset of enduring nature is purchased with the borrowed capital should not be separate or distinct from the business for the purposes of which the capital is borrowed if deduction under section 10(2)(iii) is to be allowed.
>
> (4) If there is no existing business with reference to which the capital is borrowed and the borrowed capital is invested to purchase a new asset of enduring nature, then the interest paid on such borrowing till the asset so purchased goes into production, increases the cost of the installation of the said asset, and hence should be treated as capital expenditure not covered by section 10(2)(iii) of the Act of 1922 or section 36(1)(iii) of the Act of 1961."

65. Of significance is the High Court, in *Alembic* observing that in the case of a business which is yet to commence production, capital borrowed and the interest burden which accrues thereon would not be liable to be reckoned till such time as the asset which is so created or acquired gets utilized in production. This it held bearing in mind not

only the language in which Section 10(2)(iii) of the erstwhile income tax legislation stood couched but also Section 36(1)(iii) with which we are concerned. This decision, thus, assumes significance in light of it having propounded the principle of interest costs on borrowing not being liable to be countenanced till such time as the asset is put to use.

66. Insofar as the judgment in *Monnet Industries* is concerned, suffice it to note that the primary question which arose for consideration was whether the establishment of a sugar project could be construed as being part of the same business fold of the assessee. Although the provisions of Section 36(1)(iii) were duly noticed, the Court in *Monnet Industries* was principally called upon to examine aspects such as unity of business, commonality of control and interlacing. This becomes apparent from a reading of the following passages of that decision: -

> "**19.** Section 36(1)(iii) of the Act permits an assessee to claim interest paid, as expenditure in respect of, borrowed capital in computing its income under section 28 of the Act in the event the loan taken i.e., "capital borrowed" and the interest paid thereon is for the purposes of business. It is important to note that we are not concerned with the proviso in the present case which was inserted in section 36(1)(iii) of the Act by the Finance Act, 2003, with effect from April 1, 2004. The year under consideration in this appeal, is the assessment year 1996-97.
>
> **20.** In ascertaining whether interest on borrowed capital is paid for the purpose of businesses where an assessee has two lines of businesses, the following well settled tests have been evolved over the years by the courts in India.
>
> **21.** In Scales (H.M. Inspector of Taxes) v. George Thompson and Co. Ltd. (1927) 13 TC 83, 89 (KB), Rowlatt J. formulated the following test:
>
> > "I think the real question is was there any inter-connection any interlacing any inter-dependence any unity at all embracing those two businesses ;"
>
> **22.** In ascertaining whether there was unity of business and unity of control and management, the Supreme Court in the cases of

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Setabganj Sugar Mills Ltd. v. CIT (1961) 41 ITR 272 and L. M. Chhabda and Sons v. CIT (1967) 65 ITR 638, laid down the tests that the following will have to be borne in mind, the inter-relation of the businesses, the employment of same capital, the maintenance of common books of account, employment of same staff to run the business, the nature of the different transactions, the possibility of one being closed without affecting the texture of other.

23. This test was further refined by the Supreme Court in the case of CIT v. Prithvi Insurance Co. Ltd. (1967) 63 ITR 632. In this case, while holding that life insurance business and general insurance business were the "same business", it observed that in determining whether two or more lines of businesses may be regarded as "same business" or "different business", what has to be looked at is, the nature of businesses, the nature of their organization, management, source of capital fund utilized, method of book keeping used and other related circumstances which stamp the businesses as the same or distinct. The Supreme Court concluded that both life insurance and general insurance came within the fold of "same business". It took into account the fact that both businesses were attended by the branch managers and agents without any distinction and there was one common administrative organization, and the expenses incurred in connection with the business, both for administration and for heads of expenditure such as salary of the staff, postage, staff welfare fund and general charges, were common.

xxxx **xxxx** **xxxx**

27. Based on the aforesaid tests, let us examine the findings returned by the Tribunal in coming to the conclusion that there is unity of control and management, interlacing and dovetailing of finances. The Tribunal in the instant case found as a fact in paragraphs 30 and 31 of the impugned judgment that there was a common board of directors controlling the ferro alloys plant as well as the sugar plant which operated from the head office located at Delhi, funds for the two plants were common and hence, there was inter-mingling and interlacing of funds, as also the fact, that even though the two divisions were geographically located at different sites, marketing of the final products was carried out under the supervision and control of the same set of executives at the head office. Applying the tests discussed hereinabove to the facts as determined by the Tribunal, we have no difficulty in holding that the sugar plant and the ferro alloys plant were in the same fold of business.

28. This brings us to the other issue, which is, whether financial charges, i.e, interest paid on borrowed capital for the "purposes of business", in the instant case, is allowable as a deduction in the circumstances that the borrowed capital brought into existence a capital asset. To our mind the fact that the loan or capital borrowed has been used for purchase or in connection with bringing into existence a capital asset or not, has no impact in determining

whether the interest paid on borrowed capital ought to be allowed under section 36(1)(iii) of the Act (see observation in India Cements Ltd. v. CIT (1966) 60 ITR 52 at pages 62 and 63). The determining factor is whether interest paid on borrowed capital was used to set up a new business or was used to expand the existing business or, as in the instant, case to set up a new division within the same business fold. In the case of CIT v. Alembic Glass Industries Ltd. (1976) 103 ITR 715, the Gujarat High Court dealt with a similar situation wherein the assessee- company had an existing unit for manufacture of glass at Baroda since 1947. During the relevant assessment years 1965-66 and 1966-67, the assessee-company incurred expenditure for establishing a new glass unit at Bangalore. The unit at Bangalore did not go into production during the aforesaid two assessment years in question and, therefore, during the course of assessment, the Income-tax Officer disallowed the payment of interest on borrowings in respect of the aforesaid two assessment years. The Income-tax Officer was also of the view that the Bangalore unit was not a branch of the assessee factory at Baroda and was, therefore, a new business and since this new business had not started production, the payment of interest could not be taken as revenue expenditure. The Gujarat High Court was called upon to answer the following questions (page 719):

> "(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the Whitefield factory at Bangalore did not constitute a separate undertaking but was only an establishment of a new unit of the existing factory at Baroda ?
>
> (2) Whether, on the facts and in the circumstances of the case, the interest, miscellaneous expenses, and travelling expenses incurred by the assessee referable to the Bangalore unit are wholly and exclusively for the purpose of the assessee's business?"

67. The Court in *Monnet* proceeded then to record the following conclusions:-

"**31.** The upshot of the aforesaid decisions as applied by the Tribunal in the instant case is that:

(i) <u>a loan taken or capital borrowed is, by itself, not a capital asset, nor does it give an advantage of an enduring nature;</u>

<u>(ii) as long as a loan was taken or capital was borrowed for the purposes of business, the assessee is entitled to claim interest paid thereon as deduction under section 36(1)(iii) of the Act</u>;

(iii) interest may have to be capitalized after the borrowed capital or loan taken is utilized in bringing into existence an asset at the

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stage of commencement of business. In other words, after the assessee's business had already commenced then the interest paid on capital borrowed or loan taken can be claimed as deduction under section 36(1)(iii) of the Act.

(iv) in coming to the conclusion whether the interest paid on capital borrowed or loan taken in setting up a new line of business ought to be capitalized or treated as revenue expenditure, the test as laid down by the Supreme Court in the cases of Produce Exchange Corporation (supra) and Prithvi Insurance Company (supra) would be relevant; and

(v) lastly, as long as interest is paid on capital borrowed or loan taken in respect of new line of business which is in the same business fold for the purposes of ascertaining income under section 28 of the Act, it can be claimed as a deduction under section 36(1)(iii) of the Act.

32. In the instant case, the Tribunal has returned the finding that there is a unity of control and management, in respect of the ferro alloys plant as well as the sugar plant and there is also intermingling of funds and dovetailing of businesses. In these circumstances it cannot be said that the respondent/assessee had not commenced its business and hence, interest would have to be capitalized in terms of the ratio of the judgment in the case of Challapalli Sugars Ltd. (supra). If that is not so then, the only other conclusion that is possible on these facts, is that, the interest was paid by the respondent/assessee on borrowed capital for the purposes of business. That being the case, in our view, the Tribunal correctly allowed the financial charges i.e., interest paid to the extent of Rs. 3,50,83,472 as deduction under section 36(1)(iii) of the Act".

68. As is apparent from the conclusions which came to be drawn by our Court in *Monnet Industries,* as long as a loan is taken for purposes of business, the assessee would be entitled to claim interest as a deduction under Section 36(1)(iii) of the Act. It however drew a distinction between a business which had already commenced as opposed to a new line of business which was yet to be operationalized. It was in that context that *Monnet Industries* had spoken of unity of control and management and other similar precepts that Courts have enunciated. However, in the facts of the present appeals, we are really not called upon to examine issues akin to commonality of control and

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management since, and undisputedly, the assessee was engaged in an existing business.

69. We then proceed to examine the decision in *Core Healthcare* and which appears to be more apt insofar as this set of appeals is concerned. In *Core Healthcare* the primary question which stood posited was whether interest paid on borrowings taken in relation to capital assets which had not been put to use in the year under consideration could be permitted as an allowable deduction under Section 36(1)(iii). The Revenue appears to have contended that it would be the provisions of Section 43(1) as well as Explanation 8 embodied therein which should be taken into consideration for the purposes of answering that question. This submission came to be stoutly rejected with the Supreme Court in unequivocal terms holding that Section 36(1)(iii) clearly does not envisage a distinction existing between money borrowed to acquire a capital or a revenue asset. It was pertinently observed that all that the provision requires is the assessee having borrowed capital for the purposes of business. It thus held that sub-section (3) is concerned with the user of capital and not the use of the asset which may come into existence.

70. The Supreme Court consequently while interpreting Section 36(1)(iii), held that the Legislature clearly did not contemplate a distinction being carved out between capital borrowed for a revenue or a capital purpose. It also pertinently held that it would wholly be erroneous to impute the provisions of Section 43(1) since Section 36(1)(iii) did not employ the word 'actual cost' at all. In our considered opinion, the soul of *Core Healthcare* is paragraph 16 and where the Supreme Court held that it would be wholly incorrect to base the

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applicability of Section 36(1)(iii) on an actual application of borrowing and the acquisition of a capital asset. It thus held that Section 36(1)(iii) constitutes a self-contained code which would get triggered by the transaction of borrowing itself. It was in the aforesaid backdrop that it explained Section 36(1)(iii) as being a provision which would become applicable as soon as capital is borrowed and is not dependent on a transaction of investment. In *Core Healthcare,* the Supreme Court also brushed aside the argument of there being an apparent conflict between *India Cements* and *Challapalli Sugar* recognizing that while the former was concerned with the borrowings obtained for a running business, the latter had been called upon to deal with the applicability of Section 10(2) of the erstwhile legislation in respect of a business which was yet to commence production. If one were to bear the aforesaid precepts in mind and Section 36(1)(iii) is understood as being applicable merely upon capital being borrowed, it is evident that all other aspects as were sought to be urged by learned counsels for respective sides pale into insignificance.

71. We are, however, in these appeals concerned more with the scope of the Proviso to Section 36(1)(iii) as opposed to divergent lines of business, managerial control or commonality of interest. This, since we are primarily called upon to ascertain its true intent bearing in mind the undisputed fact of the interest liability being concerned with CWIP. As we bear the legislative history preceding the insertion of the Proviso and the various judgments rendered in the context of Section 36(1)(iii) or its avatar in the erstwhile regime, it clearly appears to have been prompted by the felt need to overcome a contingency where although capital comes to be borrowed, the asset which is sought to be created with its assistance is yet to be utilised or put to use. It was in order to

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make appropriate provisions with respect to such an eventuality that Parliament stepped in and clarified that the interest burden borne, although for the purpose of business, would not be liable to be factored in till such time as the asset is actually put to use. This becomes apparent from a plain reading of the explanatory notes as well as the plain language in which the Proviso itself ultimately came to be cast and inserted in the statute.

72. A Proviso, as is well settled, is intended to carve out and make an exception for a contingency which may otherwise be subject completely to or subsumed in the principal provision. As *Core Healthcare* explained, the principal part of Section 36(1)(iii) was not dependent on the character of the asset which was sought to be created or acquired be it revenue or capital. As the Supreme Court pertinently observed, the provision is triggered by the borrowing and not the investment. The Legislature also appears to have borne in consideration the decisions which had been rendered in the context of existing businesses as distinct from those which were yet to commence.

73. Regard must also be had to the ICDS norms which were taken into consideration by Finance Act, 2015 and which recognised the requirement of borrowing costs being capitalised up to the date when the asset is put to use without making any distinction between an extension or expansion of business. The Proviso is thus clearly intended to carve out from the ambit of Section 36(1)(iii), the borrowing cost of capital between the period when the loan is originally taken till such time as the asset comes to be actually utilised in the course of business. It thus makes an exception for such a contingency and which would

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have otherwise fallen within the ken of the principal part of Section 36(1)(iii) irrespective of whether the asset had been put to use or not.

74. In order to underline the core and essence of that provision, suffice it to note that Section 36(1)(iii) enables an assessee to claim a deduction on interest paid in respect of capital borrowed for purposes of business. Judicial precedents have consistently held that the said provision is clearly not concerned with whether the intendment of borrowing is for the creation of a capital or a revenue asset. As was noticed above, those decisions have clearly explained the scope of Section 36(1)(iii) as being with reference to the factum of borrowing and the interest paid thereon. The Proviso, however, seeks to carve out an exception in respect of the acquisition of an asset which may be utilized for or in the course of extension of an existing business and thus disables the assessee from deducting interest paid on that borrowing during the period when the capital was first borrowed and till such time as the asset is put to use. Thus, the interest borne on borrowed capital during this period alone is sought to be removed from the ambit of Section 36(1)(iii).

75. We thus recognize the principal purpose of the Proviso as being merely to exclude a claim of interest paid on borrowed capital as a deduction and borne during the period identified above. The submissions, therefore, based on a conceived difference between ‘extension’ or ‘expansion’ of an existing business are of little relevance or import.

76. However, and the additional issue which must be necessarily borne in mind is the factual position in these appeals and where the identifiable line between borrowed capital and the utilisation of interest

free funds which were available in the hands of the assessee became blurred and with the Tribunal itself noting that the material as existing was insufficient to enable it to render a conclusive finding on this score. It is in the aforesaid backdrop that the Tribunal ultimately held that in order to ascertain the true character of the "common pool of funds" and the extent to which secured loans formed part thereof, the matter would be liable to be remitted for the consideration of the AO.

77. Indelibly connected with the above would be the issue of whether the assessee could have been extended the benefit of Section 36(1)(iii) in light of the Tribunal having found that a sum of INR 2789.6 million represented the expenditure incurred by it on installation of towers up to the end of the year and that the process of installation was *"…still on at the end of the year"*. This issue would have to be examined in light of the stated stand of the appellant itself that it is only when installation is complete that the amount is capitalised and transferred from CWIP account to fixed assets in regular course.

78. It appears to have been contended on behalf of the appellant that the expenditure in question was in connection with CWIP and thus leaving one to draw the impression that the assets were yet to be put to use. However, the Tribunal, unfortunately has confounded the issue by thereafter alluding to the recitals appearing in the Directors Report relating to the enhancement of the appellant's network on account of the addition of 5096 cell sites during the year in question. The findings of the Tribunal rendered in this regard are not only contradictory but also clearly convoluted. This since the cell sites could have either been works in progress or completely constructed. While at one place it holds that they had not been put to use, it does a complete turnaround

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by resting its decision on the Directors Report and which clearly refers to completed and operationalised cell sites. These observations are thus clearly incompatible.

79. Therefore and in our considered opinion, the scope of the remand would necessarily entail the AO not only examining the aspects pertaining to a common pool of funds as framed by the Tribunal but also whether the cell sites had been actually brought into use. The exercise which the AO would thus be obliged to undertake would have to cover the twin issues that we have identified above bearing in mind the construction that we have placed on Section 36(1)(iii) of the Act.

80. We would thus answer Question A in the affirmative and in favour of the assessee. Insofar as Question B is concerned, we direct the AO to re-examine the issues emanating from Section 36(1)(iii) bearing in mind the enunciation of the scope of that provision as explained by us in terms of this judgment. We also expand the scope of the remand in light of the observations which appear hereinabove and to thus include the twin issues of a common pool of funds as well as cell sites having been put to use. Question C concededly stands concluded by the decision of the Supreme Court in *Bharti Cellular* and thus needs no further elaboration.

81. ITA 660/2018 shall stand disposed of on the aforesaid terms. The appeal of the Revenue to be called again as per the separate order passed.

YASHWANT VARMA, J.

HARISH VAIDYANATHAN SHANKAR, J.

MARCH 11, 2025/kk/neha/DR