

**IN THE INCOME TAX APPELLATE TRIBUNAL  
BANGALORE BENCHES "B", BANGALORE**

**Before Shri Chandra Poojari, AM & Smt. Beena Pillai, JM**

ITA No.1892/Bang/2016 : Asst.Year 2010-2011  
IT(TP)A No.685/Bang/2016 : Asst.Year 2011-2012

M/s.Walvoil Fluid Power India Private Limited 23 & 25, Behind Graphite India, Mahadevpura Post Doddanakundi Industrial Estate, Bangalore-560 048. <b>PAN : AAACW5954E.</b>	Vs.	The Dy.Commissioner of Income-tax, Circle 7(1)(2) Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.R.E.Balasubramaniam, CA  
Respondent by : Sri.Muzaffar Hussain, CIT-DR&  
Smt.Swapna Das, JCIT-DR

<b>Date of Hearing : 29.01.2020</b>	<b>Date of Pronouncement : 18.02.2020</b>
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**ORDER**

**Per Chandra Poojari, AM :**

The assessee has filed these appeals, i.e., for assessment year 2011-2012, challenging the assessment order passed for the assessment year 2011-2012 by the Assessing Officer u/s 143(3) r.w.s. 144C of the I.T.Act, in pursuance of the directions given by the learned Dispute Resolution Panel (DRP); and for assessment year 2010-2011, directed against the order passed by the CIT(A) dated 23.08.2016.

2. First, we take the Revised grounds of appeal filed by the assessee in ITA No.685/Bang/2016, with regard to Transfer Pricing issue, which read as follows:-

**In respect of Transfer Pricing Adjustments:**

- (a) That in the calculation of ALP the Ld.AO erred in including entities such as M/s.DHP India Ltd and Sundaram Bleistahl Limited which are functionally incomparable with the Assessee.
- (b) That the Ld AO erred in including Sundaram Bleistahl Limited as a comparable entity even though the Related party transactions of the said company exceeds the accepted limits for reasonable comparison for ascertaining the ALP.
- (c) That the Operating Margin of Assessee computed by the Ld.AO is erroneous inasmuch as he has not made the same adjustments to the financial results of the Assessee as he has made for the comparable entities.
- (d) That in the Computation of the ALP, Ld AO erred in not considering the adjustments to the respective Working Capital position of the Assessee and the Comparable Entities.
- (e) That in the computation of ALP the Ld AO erred in not including the interest paid in arriving at the operating profits of the Comparable entities.

**In respect of Other Additions:**

- (a) That the Ld AO erred in holding that the tools and spares written off during the year were capital items when in reality they were merely consumable items used in normal manufacturing activity that have limited life due to the stringent quality

requirements of the products manufactured by the assessee.

3. The assessee has raised these issues by way of ground No.(b) to (e) before the DRP as follows:-

- (b) That in the calculation of ALP the Ld TPO erred by including entities such as M/s DHP India Ltd which are functionally incomparable with the assessee.
- (c) That the Ld.TPO erred in including entities such as Sundaram Bleistahl as a comparable even though the Related party transactions of the said company exceeds the accepted limits for reasonable comparison for ascertaining the ALP.
- (d) That in the Computation of the ALP, the Ld TPO erred in not considering Adjustments to the respective Working Capital position of the Assessee and the Comparable Entities.
- (e) That the Operating Margin of Assessee computed by Ld TPO is erroneous inasmuch as the Ld TPO has not made the same adjustments to the financial results of the assessee as he has made for the comparable entities.

4. These grounds were adjudicated by the DRP in para 1.2 to 1.4, as under:-

“1.2 As regards objection of assessee in ground b & c for including comparables, the TPO has given his reason

and justification in Para 8, 8.1 & 8.3 of his order. The reason given by the TPO is justified and the objection of the assessee on this ground is rejected.

1.3 As regards objection for not allowing working capital adjustment, the TPO has discussed his views and justification in para 9 of his order. The TPO has observed that the assessee does sales & purchase transactions with both AE & Non-AEs. Assessee is not a captive unit but a full-fledged entrepreneur engaged in manufacturing activity. Hence, the claim of working capital adjustment by the assessee is not justified. He has also further held that assessee has failed to demonstrate that it gets working capital advantage over comparables owing to advances from its AEs. Assessee's Non-AE business partner (Debtors & Creditors) are in majority. Hence, TPO has not allowed WCA to the assessee. Considering the cogent reasons and justifications advanced by TPO, the objection of the assessee is rejected.

1.4 As regards objections at ground 3, it was submitted during hearing that the same ground is not pressed. Hence, this ground is rejected.”

5. We have heard the rival parties and perused the material on record. The main plea of the learned AR is that the direction of the DRP is cryptic and not adjudicated the issues in a proper perspective. On the other hand, the learned Departmental Representative submitted that the direction of

the DRP to be read along with the TPO's order and the assessment order and there is no infirmity in the direction of the DRP. It has considered the whole issue and given finding on the issues raised by the assessee and the same to be sustained. In this case the matter was referred to the DRP u/s 144C of the IT Act. Under sub-section (1) of Section 144C, the Assessing Officer is under an obligation to forward a draft of the proposed order of assessment to the assessee if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee. Under sub-section (2) of Section 144, the assessee within 30 days of the receipt of such draft order can accept the variation made by the Assessing Officer or he can file objections either to Dispute Resolution Panel or to the Assessing Officer. Since the assessee had filed his objections with DRP, then, under sub-section (5) the DRP, upon receipt of objection is under obligation to issue directions as it thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment and under subsection (6) such directions which are put up under sub-section (5) would be further considering the following documents:

- (a) Draft order;
- (b) The objection filed by the assessee;
- (c) The evidence furnished by the assessee;
- (d) Report, if any, of the Assessing Officer, valuation officer, or TPO or any other authority;
- (e) Records relating to the draft order;
- (f) Evidence collected by, or caused to be collected by, it; and

(g) Result of any inquiry made by, or caused to be made by it.

5.1 Under sub-section (7), DRP is also authorized before issuing of direction under sub-section (5) to make such further inquiry, as it think fit or cause any further inquiry to be made by any income-tax authority and report the result of the same to it. Under sub-section (8), the DRP has power to confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further inquiry and passing of the assessment order. Under sub-section (11), no direction u/s sub section (5) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue respectively. Under sub-section (12), directions under sub-section (5) cannot be passed after nine months from the end of the month in which draft order is forwarded to the eligible assessee. Under sub-section (13), on receipt of directions issued under subsection (5), the Assessing Officer has to pass the assessment order in conformity with the directions without providing any further opportunity of being heard to the assessee within one month from the end of the month in which such directions are received.

5.2 The directions passed by DRP u/s 144C (5), as it can be seen in the present case, are not speaking about what objections were raised by the assessee and how they have been found to be not acceptable. The DRP has simply

observed that the TPO has given reasons for rejecting the comparables and by the Assessing Officer in the draft order. Therefore, the order passed by the DRP is a non-speaking order on the issues raised by the assessee, not stating the objections raised by the assessee and the reasons have also not been given as simply the order of TPO and Assessing Officer are referred. We find that similar issue was considered by the Hon'ble Delhi High Court in the aforementioned case of Vodafone Essar Ltd. (340 ITR 352) against the order passed by the DRP. 4.9.1 In view of the above, we find that it is a fit case where this issue should be restored back to the file of DRP to pass a detailed order stating all the objections of the assessee and disposing them by giving a cogent and germane reason for adjudication of the objections of the assessee. We direct accordingly. After receiving the order from DRP, the Assessing Officer will again pass order u/s 144C(13) and the present assessment passed by the Assessing Officer is set aside as the DRP is directed to readjudicate the objections raised by the assessee as per directions give above. We direct accordingly. This ground of appeal of the assessee is allowed for statistical purposes.

6. The next common ground in both the appeals is against the holding of tools and spares written off during the year were capital items when in reality they were merely consumable items used in normal manufacturing activity that have limited life due to the stringent quality requirements of the products manufactured by the assessee.

7. Since the facts are similar in both the years, we consider the facts for assessment year 2011-2012 in ITA No.685/Bang/2016. The assessee has debited Rs. 1,53,15,391 in the profit-and loss account as purchase of consumable tools and claimed the same as revenue expenditure. The A.O. noted that the assessee in the earlier assessment years, except in A.Y. 2009-2010, capitalised the purchase of tools and claimed depreciation in accordance with the provisions of section 32 of the Act and the same was allowed. However, in the assessment year 2009-10 and 2010-11, the assessee claimed the expenditure towards the tools as revenue expenditure. In the Assessment order for A.Y. 2009-10, the claim of the assessee was not accepted and only depreciation was allowed after detailed discussion of the facts. The brief reasons for not accepting the claim of the assessee were as under:

- The assessee had changed the method of treating the tools as capital to revenue for the first time in assessment year 2009-10 which is against the method consistently followed by the assessee.
- The assessee has considered the tools as capital expenditure in the books of account prepared in accordance with the provisions of companies Act; but, considered the same as revenue expenditure for the purpose of Income tax Act.
- Even for Income Tax purpose, the assessee has considered the same as capital expenditure in the earlier

assessment years. The nature of business activities carried on by the assessee is same as that of earlier assessment years. There is no change in the nature of use and lifetime of the tools used in earlier years and assessment year 2009-10.

- Amended provisions of the Act allow depreciation u/ s 32 on a block of assets till the block continues to exist. Therefore, even if a small portion of assets is used up in the process of conduct of business, the closing written down value of the asset continues to be eligible for depreciation till the block continues to exist. Therefore, the assessee's argument of life of some of the tools being less than 1 year will not bar the assessee from claiming depreciation on the same.

7.1 The Dispute Resolution Panel issued certain directions on this issue for AY. 2009-10 as under.

"The assessing officer is directed to verify the nature and the functions of tools replaced by the assessee as per the test laid down by the Hon'ble Supreme Court in the case of Saravana Spinning Mills (P) Ltd (2007) 163 TAXMAN 201 (SC). If it is found by the assessing officer that tools replaced are not independent machineries but part of the big machinery, the same should be allowed as current repairs admissible as deductible revenue expenditure. In that case, depreciation already granted by the A.O. on such replacement tools will have to be withdrawn. However it must be verified by the assessing officer that by replacing the set tools, no new asset came in to existence but they maintained the already existing machines".

7.2 The nature and functions of tools replaced by the assessee were verified accordance with the directions of DRP and in view of decision Hon'ble Supreme Court the case of Saraoana Spinning Mills (P) Ltd (2007) 163 TAXMAN 201 (SC). It was observed that the tools were having independent functions and were not part of any big machinery. The major tools replaced were: complete fixture SD6 Doosan VC 500, Display temperature controller, Thickness gauge, Special thread plug, Pressure transducer, Pattern tools, Tirafascettethomas and Bett ERG 50, Laptor S Gross DIA M25, Cavity gauge, Flow meters, Balancing equipment etc. These tools were used for drilling cavity on castings and machining; fixing/ placing castings on it to perform machine jobs; to measure the flow of oil; for performing milling operation on castings; enlarging the inner diameter of a hole; for checking the size of holes and threads on castings; to check the internal structure of the part etc., Thus all the tools were found to be having independent functions and do not form part of any big machinery.

7.3 Considering the nature of tools, their functions, life span and the method of accounting regularly followed by the assessee the replacement of the tools were considered as not allowable as "current repairs" u/ s 31(i) of the Act. The reliance was placed on the decision of Hon'ble Supreme Court the case of Saravana Spinning Mills (P) Ltd (2007) 163 TAXMAN 201 (SC). Once the expenditure is not allowable u/ s 31(i) of the Act then the same cannot be allowed even u/ s 37 of the Act as per the ratio of the above judicial

pronouncement. Therefore the claim of the assessee to write off entire value of tools in the year contrary to the method followed in the earlier years was rejected. Instead the assessee was allowed to capitalize the same and claim depreciation.

7.4 During the Assessment Year 2011-12, the assessee has claimed Rs.1,53,15,391 as revenue expenditure towards Tools. During the course of hearing the assessee made a submission as under:

"A detailed description of Nature of use and life of tool is enclosed herewith. As could be observed therein, the objective of expenditure is to facilitate manufacture of finished products. The tools are generally used for drilling cavity on castings and machining.

The materials are in the nature of consumables, which does not have a useful life of beyond single / limited usage. Further, these are to be frequently replaced due to usage requirements. These tools does not bring any new asset into existence.

As evident from the enclosed Annexure, the value of each item is insignificant clearly highlighting the fact that these are not capital in nature and accordingly expensed in the Profit and Loss account.

Further, tools of capital nature worth Rs. 24.34 Lakhs purchased during FY 2009-10 have been capitalised in the books of accounts. Refer the attached Schedule-5 for Fixed Assets forming part of Financial Statements for the year ended 31-03-2010".

7.5 The Assessing Officer further stated that the submissions made by the assessee are not acceptable in view of the decision taken by the department in the AY. 2009-10 discussed above. The facts of the case for AY. 2009-10 and 2010-11 are same. The assessee has not produced any details

or evidence to differentiate the facts of the case between AY. 2009-10 and 2010-11. Only explanation of the assessee was with regard to the values of the items involved. However, the amount of expenditure cannot determine the nature of expenditure. Whether an item of expenditure is capital or revenue depends on various factors such as nature of business, purpose of expenditure, result of such expenditure, longevity of benefit derived, etc. However, as discussed in the above paragraphs, the purchase of tools in the present case is not amounting to Current repairs as provided in section 31 (i) of the Act.

7.6 In view of the above, the A.O. held that the assessee is considered to be eligible to claim the depreciation on the tools u/ s 32 of the Act instead of allowance u/ s 31(i)/37 of the Act. Accordingly, the claim Rs. 1,53,15,391/- as revenue expenditure towards Tools is disallowed and added back to the taxable income of the assessee after allowing depreciation for the A.Y. 2011-12.

8. Against this the assessee is in appeal before the Tribunal. The learned AR submitted that these tools are consumables and business expenditure incurred for day to day manufacture of the assessee and no stretch of imagination could be considered it as capital in nature so as to give enduring benefit to the assessee. This expenditures are debited to the profit and loss account in the relevant assessment year, whose value is very less and insignificant in relation to the turnover and size of the assessee and life of these items are less than 6 to 8 years and it is revenue in

nature and debited to the profit and loss account in these two assessment years.

9. The learned Departmental Representative, on the other hand, submitted that the expenditure incurred for acquisition of tools and they were having independent functions and were not part of any big machinery. The major tools replaced were complete fixture SD6 Doosan VC 500, Display temperature controller, Thickness guage, Special thread plug, Pressure transducer, Pattern tools, Tirafascette Thomas and Bett ERG 50, Laptor S Gross DIA M25, Cavity guage, Flow meters, Balancing equipment etc. These tools were used for drilling cavity on castings and machinery; fixing /placing castings on it to perform machine jobs; to measure the flow of oil; for performing milling operations on castings; enlarging the inner diameter of a hole; for checking the size of toles and threads on castings; to check the internal structure of the part etc. Thus all the tools were found to be having independent functions and do not form part of any big machinery. The learned DR further submitted that considering the nature of tools, their functions, life span and the method of accounting regularly followed by the assessee the replacement of the tools were considered as not allowable as "current repairs" u/ s 31(i) of the Act. The reliance was placed on the decision of Hon'ble Supreme Court the case of Saravana Spinning Mills (P) Ltd (2007) 163 TAXMAN 201 (SC). Once the expenditure is not allowable u/ s 31(i) of the Act then the same cannot be allowed even u/ s 37 of the Act as per the ratio of the above judicial pronouncement. Therefore, the claim of the assessee

to write off entire value of tools in the year contrary to the method followed in the earlier years was rejected. Instead the assessee was allowed to capitalize the same and claim depreciation. According to the learned DR, these items are to be capitalized and depreciation at eligible rate would be allowed to the assessee.

10. We have heard the rival parties and perused the material on record. The learned AR submitted that the Assessing Officer followed his findings for assessment year 2009-2010 in assessment year 2010-2011 so as to treat the tools and consumables as capital expenditure. He submitted that whenever the expenditure is resulted in enduring benefit have been duly accepted by the assessee as capital in nature and only the expenditure which is not having enduring benefit was treated as revenue expenditure and debited to the profit and loss account, and there is no material brought by the A.O. to show that the assessee got any enduring benefit to these small tools and consumables purchased by the assessee. He also relied on the judgment of the House of Lord in *Atherton v. British Indulated & Helsby Ltd.* [10 TC 155 (HL)], wherein it was held that a payment made not only once and for all but also to bring into existence an asset or advantage of enduring nature during the lifetime of the company may be treated as Capital expenditure, otherwise it would be revenue. Another one of the earliest decisions, which serves to indicate a broad area of distinction between capital and revenue expenditure is the ruling of Bowen L. J. in the case of *City of London Contract Corporation v. Styles*,

where he remarked that an outlay on the "acquisition of the concern" would be capital while an outlay in "carrying on the concern" is revenue. The Supreme Court in the case of *CIT v. Travancore Titanium Products Ltd, Appeal (Civil) No.3825 of 1999 dated 7<sup>th</sup> December, 2000*, held that to determine the deductibility of an item, the nature of the outgo must be viewed in the light of commercial practices and normal business requirements. It should be one that is normal and incidental to the nature of the assessee's business and must be necessitated and justified by commercial expediency. What the Act purports to tax is the business profits, and therefore, in determining the deduction, the Assessing Officer cannot ignore the normal rules of accountancy and business principles. All these views were considered by the Court in the *CIT V Ashok Leyland Ltd (1969) 72 ITR 137* wherein it was observed as follows:

*“A clear cut dichotomy cannot be laid down in the absence of a statutory definition of 'capital and revenue expenditure'. Invariably, it has to be considered from the point of view of the payer. In the ultimate analysis, the conclusion of the admissibility of an allowance claimed is one of law, if not a mixed question of law and fact. The word 'capital' connotes permanency and capital expenditure is, therefore, closely akin to the concept of securing something tangible or intangible, property, corporeal or incorporeal rights, so they could be of a lasting or enduring benefit to the enterprise in issue. Revenue expenditure on the other hand, is operational in perspective and solely intended for the furtherance of the enterprise.”*

10.1 In the case of the Assessee, the consumable tools do not form part of the final product, but are used in the process of manufacturing of the final product and are of lower value. Also, these tools do not satisfy the criteria for capital expenditure as mentioned herein. The tools have a short working life and have absolutely no realisable or resale value.

10.2 In the present case, the DRP followed the order relevant to the assessment year 2009-2010 in two assessment years. The assessee pleaded before us that the Assessing Officer also narrated the facts of assessment year 201-02011 and 2011-2012 as in assessment year 2009-2010 though it was entirely different. The facts are relating to the acquisition of various instruments like SD6Doosan VC 500, Display temperature controller, Thickness gauge, Special thread plug, Pressuretransducer, Pattern tools, Tirafascettethomas and Bett ERG 50, Laptor S Gross DIA M25, Cavity gauge, Flow meters, Balancing equipment etc. These tools were used for drilling cavity on castings and machining; fixing/ placing castings on it to perform machine jobs; to measure the flow of oil; for performing milling operations on castings; enlarging the inner diameter of a hole; for checking the size of holes and threads on castings; to check the internal structure of the part etc., Thus all the tools were found to be having independent functions and do not form part of any big machinery. The learned AR also explained to us that these are not tools consumables acquired in the assessment year under consideration. In the assessment years under consideration, the assessee acquired consumable tools for day to day

manufacture operation of the assessee and nothing to do with these machineries mentioned by the Assessing Officer and confirmed by the DRP in their respective orders. In our opinion, the Assessing Officer is required to examine the details relating to the incurring of expenses for tools and consumables, if they are not relating to acquisition of above independent machinery, then the Assessing Officer shall treat the same as revenue expenditure and to be allowed in toto. With these observations, we restore the entire issue relating to allowability of expenditure relating tools and consumables to the file of the Assessing Officer for fresh consideration.

11. In the result, the appeals filed by the assessee are partly allowed for statistical purposes.

Order pronounced on this 18<sup>th</sup> day of February, 2020.

Sd/-  
**(Smt.Beena Pillai)**  
**JUDICIAL MEMBER**

Sd/-  
**(Chandra Poojari)**  
**ACCOUNTANT MEMBER**

Bangalore ; Dated : 18<sup>th</sup> February, 2020.  
Devadas G\*

Copy to :

1. The Appellant.
2. The Respondent.
3. The DRP-2, Bengaluru.
4. The Pr.CIT-7, Bengaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore