

आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'B' अहमदाबाद  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**"B" BENCH, AHMEDABAD**

**BEFORE SMT.ANNAPURNA GUPTA, ACCOUNTANT MEMBER**  
**AND**  
**T.R. SENTHIL KUMAR, JUDICIAL MEMBER**

**ITA No.1747/Ahd/2009**

**AND**

**ITA No.1657/Ahd/2015**

**Asstt.Year: 2005-06**

Gujarat Mineral Development Corporation Ltd. "Khanji Bhavan" 132ft Ring Road University Ground, Ahmedabad.	Vs	DCIT/JCIT, Cir.4 Ahmedabad.
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**ITA No.1471/Ahd/2015**

**Asstt.Year: 2005-06**

DCIT/JCIT, Cir.4 Ahmedabad.	Vs	Gujarat Mineral Development Corporation Ltd. "Khanji Bhavan" 132ft Ring Road University Ground, Ahmedabad.
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<b>(Applicant)</b>		<b>(Responent)</b>
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Assessee by :	Shri S.N. Soparkar, with Shri Bandish Soparkar, AR, and Shri Parin Shah, AR
Revenue by :	Shri James Kurian, CIT-DR

सुनवाई की तारीख/Date of Hearing : 30/08/2022

घोषणा की तारीख /Date of Pronouncement: 30/11/2022

**आदेश/O R D E R**

**PER ANNAPURNA GUPTA, ACCOUNTANT MEMBER**

The present appeals relate to the same assessee, pertain to the same assessment year and are against orders passed by the

ld.CIT(A) under section 250(6) of the Income Tax Act, 1961 ("the Act" for short ) in quantum proceedings under section 143(3) and in penalty proceedings under section 271(1)(c) of the Act for the Asst.Year 2005-06.

2. While the assessee has come up in appeal against order of the ld.CIT(A) passed in quantum proceedings, both the assessee and the Revenue have filed appeal against order passed by the ld.CIT(A) in penalty proceedings, wherein the ld.CIT(A) had deleted penalty levied on certain additions confirmed in quantum proceedings while he had confirmed the levy of penalty on certain other issues. Since the fate of the penalty appeal is dependent on the order passed in the quantum appeal of the assessee, all the appeals were taken up together for hearing.

3. We shall first deal with **assessee's appeal** in quantum proceedings in **ITA No.1747/Ahd/2009 - A.Y 2005-06**

4. The original grounds raised by the assessee being argumentative, the assessee subsequently filed concise grounds of appeal before us on 24-12-13 to which no objection was raised by the Revenue. We shall therefore be dealing with the grounds raised therein.

**5. Ground No 1-3**, it was contended related to the disallowance of project expenses, depreciation and on account of addition made of interest and misc income earned from the certain projects undertaken by the assessee which the AO found had not commenced operations. Ld.Counsel for the assessee contended that his arguments with respect to all the grounds were identical. Therefore, all the above grounds are being dealt with together.

6. Ld.counsel for the assessee stated that the assessee being in the business of exploration of minerals was undertaking the said activity at various sites; as lignite being excavated at various places in Kutch, Bharuch and Surat districts of Gujarat; fluorspar being excavated at Baroda; Bauxite calcinations project at Gadhsisa, Jamnagar and multi-metal project at Banaskantha. The assessee, it was contended, was also undertaking power project in Kutch district. In this regard, he drew our attention to the Annual Report of the assessee-company for the impugned assessment year placed before us at PB Page No.1 to 33 mentioning various projects, as above, being undertaken by the assessee in the Annual Report at page no.3. The ld.counsel for the assessee stated that all these projects were undertaken as part of the business of the assessee, but the Revenue authorities had disallowed claim of expenses with respect to certain projects on the ground that the said project had not commenced during the year, and could not be said to be part of the business of the assessee, but were in fact separate undertakings of the assessee. The ld.counsel for the assessee pointed out that Revenue had held the expenses incurred with respect to the following projects as disallowable for the above reasons:

- i) Akri Mota Power Project
- ii) Lignite Projects at Bhavnagar & Tadkeshwar

21. The ld.counsel for the assessee then contended that with respect to the said projects, depreciation on asset used in implementation of the project was also disallowed. Further he pointed out that interest and miscellaneous income earned from the project was treated as income from other sources. The detail of the projects and expenses relating to them disallowed for the reasons that these projects had not been commenced and were separate undertaking of the assessee are as under:

Sr.No.	Name of Projects	Amount of disallowance of exps.
i)	Akri Mota Power Projects	Rs.32,60,51,123/-
ii)	Lignite Project Bhavnagar.	Rs.14,21,350/-
ii)	Lignite Project at Tadkeshwar	Rs.5,57,07,769/-

Depreciation on the assets used in the implementation of the projects disallowed.

Sr.No.	Name of Projects	Amount of Depreciation
i)	Akrimota Power project	Rs.122,67,81,665/- plus Rs.38,26,54,024/- additional depreciation
ii)	Lignite Project, Bhavnagar	Rs.6,134/-
iii)	Lignite Project, Tadkeshwar	Rs.3,59,224/-

Other misc. and interest treated as income from other sources with respect to –

- i) Akrimota Power Project at Rs.5,55,24,208/-
- ii) Lignite Project, Bhavnagar at Rs.12,305/-
- iii) Lignite Project, Tadkeshwar Rs.33,01,301/-

7. The ld.counsel for the assessee stated that all these issues have been raised in Ground No.1, 2 and 3 as under:

*“a) In facts and circumstances of the case, Your Appellant most respectfully submits that the learned Assessing Officer has erred in rejecting claim of project expenses of Rs. 32,60,51,123/- in respect of lignite based AKRI MOTA POWER PROJECT which was a step further for forward integration of existing business, and Ld. CIT (A) has further erred in Confirming this disallowance.*

b) *In facts and circumstances of the case, Your Appellant further submits that Ld. A.O, erred in making an addition of Rs. 555,24,208/~ being Interest and Misc income of the said Power Project, Particularly when the payment of interest in respect of said Power Project was Capitalized, and Ld. CIT(A) has further erred in confirming this addition.*

2. *In facts and circumstances of the case, Your Appellant most respectfully submits that learned A.O. erred in making addition of project expenses in respect of two Lignite Projects at Bhavnagar and Tadkeshwar Which were basically an expansion of its Existing business in Lignite and the Ld. CIT(A) further erred in confirming the additions of both the Projects as detailed below*

Sr.No.	Name of Project	Project Expense	Depreciation on Assets used implementation of the Projects.
1.	Lignite Project, Bhavnagar.	Rs.1421.305/-	Rs.6,134/-
2.	Liginite Projects, Tadkeshwar	Rs.557,07,769/-	Rs.359,244/-

*Your Appellant further respectfully submits that both the lower Authorities, have further erred in taxing Misc. Income of Rs.12.305/- and Rs.33,01,301/- in respect of both the above Lignite Projects resp.*

3. *In facts and circumstances of the case, Your Appellant further submits that both the Lower Authorities have further erred in rejecting the claim of Depreciation and Additional Depreciation of Rs.122,67,81665/- and Rs.38,26,54,024/- resp on the assets of AKRI MOTA POWER PROJECT, which commenced production on 31/03/2005, on the plea that commercial production had not started and in respect of claim of Additional depreciation by holding that generation of power does not amount to manufacture or production of an article or thing and also that generation of power had not commenced. Both the lower Authorities failed to appreciate legal position that the depreciation has to be allowed even in a case where trial runs have commenced. Even the legal position is that even in case of passive use of assets, the depreciation has to be allowed.”*

8. His contention before us was that these projects were being run under sole management and control as other existing projects, utilizing common funds, and therefore, could not be said to be a separate undertaking so as to disallow expenditure incurred prior to commencement of business. In this regard, he referred to the decision of Hon’ble Apex Court in the case of CIT Vs. Monnet Industries Ltd., 350 ITR 305 (SC) laying down the criteria on which it is to be determined whether the business is to be referred to as

extension of same business or a different business for the purposes of allowance of claim of expenses on setting up the said new business.

9. Further, in the case of power projects, the ld.counsel for the assessee contended that it was a vertical integration of the existing business of the assessee, since it was into business of extraction of minerals, which was an important and major material required for production of power. Therefore, power project was nothing but vertical integration of existing business of the assessee only, and could not be treated as new business carried out by the assessee. The ld.counsel for the assessee reiterated his contention that considering the fact that management, control and funds and entire work was being carried out under a common business system only, merely because the projects were situated in different geographical locations it could not be said to be new business.

10. The ld.DR relied on the orders of the Revenue authorities.

11. We have gone through order of authorities below, and we have noted that with respect to Akri Mota power project, which was dealt at para-5 of the CIT(A)'s order, the entire project expenses of Rs.33,60,51,123/- were disallowed for the reason that it was entirely new project set up by the assessee; process of construction was going on, and had not commenced production or generation of electricity. Further it was held not to be an expansion of the existing business of the assessee, but an entirely new project totally different and distinct from the existing industrial undertaking. The ld.CIT(A), we have noted, has confirmed, disallowance of project expense, as made by the AO in this regard, rejecting the assessee's contentions that it was a vertical integration of the existing business of the

assessee, stating that generation of electricity requires various other machineries and equipments which are admittedly not manufactured by the assessee, and therefore, the power project cannot be said to be expansion of the assessee's existing business. The relevant findings of the Ld.CIT(A) at para 5.2 of his order is as under:

*"5.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. It is seen that the Akrimota Power Project is entirely a new project which is being set up by the appellant. During the relevant period it was in the process of construction and had not started the generation of electricity. The Ld.A.R's claim that the project is an expansion of appellant's existing business is bereft of reasoning. The appellant is engaged in excavation of Lignite which is one of the various inputs used for generation of electricity. Further, the generation of electricity requires various other machineries and equipments and admittedly these are not manufactured by the appellant. Therefore, the project under reference cannot be held as expansion of appellant's existing business. As already held that this project has not started functioning during the relevant period, therefore, the claim of interest on borrowed funds cannot be allowed under the provisions of sec.36(1)(iii) of the Act. Besides, the other expenses incurred on this project are also not deductible from the income of the appellant. In this regard reliance is placed on the decision of Hon'ble Supreme Court in the case of Chellapalli Sugar Ltd 98 ITR 167 and Bokaro Steel Ltd 236 ITR 315. In view of the above, the ground taken by the appellant against the same are hereby dismissed."*

12. With regard to the lignite project at Bhavnagar, which has been dealt with by the Id.CIT(A) at para-6 of his order, the same was disallowed and upheld as capital expenditure, since the AO noted that the project had not commenced its production during the relevant year, and it was entirely new project set up by the assessee, different and distinct from the existing industrial undertaking. The finding of the AO was upheld by the Id.CIT(A) at para 6.4 of his order as under:

*"6.4 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. The LdAR. has not contradicted the findings of the A.O. that the project under reference was entirely a new project the construction thereof was not completed during the relevant period. Further the Ld.A.R. has not brought on record supporting facts to show that the project was an expansion of appellant's existing business. It is a well settled position of law that the expenditure incurred on interest for the money borrowed for setting up a new industrial undertaking is not deductible before its completion. In these circumstances, the A.O. has rightly rejected the appellant's claim for deduction under the provisions of sec.36(1)(iii) of the Act"*

13. With respect to Tadkeshwar project, for the same reason, as in the case of Bhavnagar project, the claim of project expenses was disallowed. The findings of the Ld.CIT(A) upholding the order of the AO at para 7.2 of his order is as under:

*“7.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. The Ld.A.R. has not contradicted the findings of the A.O. that the project under reference was entirely a new project and the construction thereof was not completed during the relevant period. Further the Ld.A.R. has not brought on record supporting facts to show that the project was an expansion of appellant's existing business. It is a well settled position of law that the expenditure incurred on interest for the money borrowed for setting up a new industrial undertaking is not deductible before its completion. In these circumstances, the A.O. has rightly rejected the appellant's claim for deduction under the provisions of sec.36(1)(iii) of the Act.”*

The claim of depreciation was also disallowed with respect to machineries employed in setting up these projects for identical reason.

14. We shall first deal with the project expenses disallowed vis-à-vis power projects and two lignite projects and also claim of depreciation on assets vis-à-vis these projects, all of which are disallowed for the same reasons, that were all treated as new undertaking of the assessee and not an expansion of existing business, since these projects had not commenced operations.

15. The proposition of law with regard to identifying whether the business set up by an assessee is an expansion of its existing business or totally new business undertaken, has been laid down by the Hon'ble Apex Court in the case of Monnet Industries Ltd. (supra) wherein order of the Hon'ble High Court in this regard was upheld by the Hon'ble Supreme Court. Hon'ble High Court while dealing with the issue had held that the decisive test for

determining whether two lines of business constitute the same business, is the unity of control and not nature of two businesses. As long as there is a unity of control and management in respect of two business, and there is intermingling of funds and dove tailing of the business, it cannot be said that a new business had been commenced by the assessee. But on the contrary, only conclusion that can be drawn was that it was extension of the existing business of the assessee only. The Hon'ble Court confirmed the findings of the Tribunal in this regard while holding so at para 7-9 of its order as under:

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

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

*(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;*

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

*8. 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 dove-tailing 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.*

*9. These being the findings of fact, we do not consider it fit to interfere with the impugned judgment of the Tribunal. Accordingly, we hold that there is no question of law, much less a substantial question, which arises for consideration. In the result, the appeal is dismissed.”*

16. Now, having said so, we find in the facts of the present, the issue has been decided against the assessee not based on these parameters, but on parameters which have been categorically rejected by the Hon'ble Supreme Court for determining, whether business is new venture or continuation of existing business of the assessee only, as noted above. The only reason for holding Akri Mota Power project and lignite project as new undertaking is the fact that in the case of lignite projects they were being undertaken in new geographical area and in that case of the power project because it has no link with the existing projects of the assessee. It is clear from the proposition of law laid down by the Hon'ble Apex Court that merely because new projects are in different geographical area it necessarily does not make it a new business of the assessee and that cannot be criterion for holding so.

17. As for power project is concerned, we agree with the ld.counsel for the assessee that it could be said to be a vertical integration of the existing business of mining of the assessee , since it was lignite based project, where lignite is a major material for the projects for the purpose of generation of power. The Ld.CIT(A) does not dispute this fact. On the contrary he relies on the fact that machineries also were required for producing power which has not been

manufactured by the assessee and therefore the power project could not be said to be vertical integration of the business of the assessee . This we find is of no consequence. As long as it is not disputed that lignite is the major raw material from which power is been generated and lignite being extracted by the assessee itself in its mining business, setting up power project is nothing but a vertical integration of the business of the assessee only. For this reason alone, setting up of the power project cannot be said to be a new business of the assessee. Even otherwise, based on the parameter laid down by the Hon'ble Apex Court in Monnet Industries (supra) also it cannot be said to be new business undertaking merely because it is a completely different project which has been set up by the assessee. In the case of Monnet Industries Ltd. (supra) the facts of the case was that the assessee was in the business of ferro-alloys and had set up sugar manufacturing plants at different place s which were treated as new business of the assessee and all expenditure incurred prior to the commencement of the business were treated as not allowable. In these facts and circumstances, the decision was rendered by the Hon'ble Apex Court holding that the different nature of the business was not a determinative factor for the purpose of deriving whether it is a new business or expansion of exiting business only. On the contrary, it is the unity of management and control and handling of funds which would determine the same. In the case of these projects, the issue has certainly not been examined from this angle.

18. We have also noted that the impugned appeal before us relates to Asst.Year 2005-06 which is more than 17 years old. No purpose, we find, will be achieved by restoring back to the file of the Revenue authorities for deciding this issue on this parameter. On

the contrary, interest of justice could be well served by examining the facts from audited annual accounts of the impugned year, which have been placed before us in the paper book which clearly reveal the fact that all these projects were being undertaken under the same management with common control and funds, and there is nothing in the audited balance sheet disclosing any fact to the effect that they were different undertakings with separate funds for each projects.

19. In view of the above, we hold that all three projects i.e. Akrimota Power Projects, Lignite projects at Bhavnagar and Tadkeshwar are nothing but the continuation of existing projects of the assessee only, and all its expenses incurred therefore in the setting up of these, prior to the commencement of the business in these projects, are to be treated as revenue expenses. Accordingly, the claim of project expenses vis-à-vis all three projects along with claim of depreciation on assets in the Tadkeshwar and Bhavnagar lignite projects are directed to be allowed.

20. Having held so, we find that the Revenue authorities have also treated the income generated from these projects as income from other sources. Since, we have held these projects to be continuation of existing projects only, therefore income generated from these projects are to be considered as business income of the assessee .

21. Now we take up the issue denial of claim of depreciation in all the projects.

Depreciation on assets used in implementation of the project of Lignite extraction at Bhavnagar and Tadkeshwar, having also been denied finding the projects to be new and in which business activity

was yet to commence, we delete the disallowance of depreciation with respect to these projects since we have held these projects to be in continuation of the business of the assessee and not new undertakings set up ,above in our order.

22. As for denial of depreciation of machinery used in AKRI MOTA Project,it transpires from order of the authorities below that claim was denied for the reasons that the assets were not shown to have been used as at the end of the year. The assessee's claim of having conducted trial production or trial run was rejected by the Revenue. The reasons for rejecting the claim, as emanates from orders of the ld.CIT(A), is that apparently after conducting the trial run the assessee had actually put to use its machinery after seven months and gave no explanation for this long gap between conducting trial run and commencing actual user of the assets, from which the Revenue concluded that trial run conducted by the assessee was a mere sham and only for the purpose of claiming huge depreciation.

23. Before us, the ld.counsel for the assessee contended that the fact that it had conducted trial run had been evidenced by the fact that the power generated by virtue of trial run was to GEB; copy of the invoice raised on GEB was submitted to the Revenue authorities, report of meter reading duly signed by GEB Officials, confirmation of generation of power was also provided to the Revenue officers, as also newspaper cuttings covering the news on synchronization of power project with GEB Grid was also submitted to the Revenue officers. It was also pointed out that the reasons for non-commencement of actual production, thereafter was pointed out to be due to technical reasons, and since the assessee has demonstrated the fact of actual production of power in the trial run

conducted, this explanation of the assessee could not have been simply brushed aside, that too, ignoring all the evidences filed by the assessee and making adverse observation solely for the reasons that there was huge time gap between the trial run and actual production trial which were also duly explained by the assessee. The ld.counsel for the assessee further relied on the decision of Hon'ble Madras High Court in the case of Lakshmi General Finance Ltd., [433 ITR 94 (Madras)] for the proposition that where even on trial production, machineries can be said to be ready for use and depreciation thereon allowed.

24. The ld.DR relied on the order of the authorities below.

25. We have heard both the parties and we find that the assessee's case for claiming depreciation rests entirely on the fact that it had conducted trial run of its machinery during the impugned year. The Revenue does not dispute the allowability of claim of depreciation on the machinery on the basis of trial run conducted. The contention/basis for denying depreciation is refuting the claim of any trial run conducted by the assessee.

We have noted from the arguments and submissions made before us, and even from the order of the ld.CIT(A) that the assessee had substantiated carrying on trial run, by pointing out that the power generated during the trial run had been sold to GEB which was evidenced by copy of invoices issued by the GEB, meter reading confirmed by the GEB and fact that power generation from the plant being reported in the newspaper. All these evidences filed by the assessee having been dealt with by the authorities below, they have clearly chosen to ignore all these very valid evidences. On the contrary, they have arrived at a finding of no trial run for generation

of power according to their own whims and fancies ,that there is a huge gap between trial run and production of power, being seven months, for which no reasonable explanation was apparently given by the assessee. Considering the fact that the assessee had demonstrated carrying on trial runs with valid evidences, which have not been controverted by the Revenue despite being placed before both the authorities below, we cannot agree with the finding of the Revenue authorities that no trial run was conducted by the assessee. In view of the same, we hold that the assessee had rightly claimed deprecation at Rs122,67,81,665 & Rs 38,26,54,024/-. Assessee's claim of depreciation is accordingly allowed.

Ground of appeal No. 1-3 are allowed.

26. Ground No.4 raised by the assessee is against order of the ld.CIT(A) upholding rejection of claim of prior period expenses amounting to Rs.67,37,949/-. The ground reads as under:

*4. In facts and circumstances of the case, Your Appellant most respectfully submits that the Ld. A.O. erred in rejecting claim of Rs. 67,37,949/- being the amount of prior period expenses even through the said expenditure had, materialized and Crestaished during this Financial Year and Ld, CIT (A) further erred in rejecting the claim by sending / restoring the matter back on the file of Id. A.O. Your Appellant further submits that both the authorities have failed to follow Hon. ITAT's Judgment in appellant's own case in prior years, in appeals for A.Y. 1989-90 & A. Y. 1995-96.*

27. As transpires from orders of authorities below the assessee's claim of prior period expenses had been disallowed by the Assessing Officer (AO) since the assessee could not justify his claim to the said expenses during the impugned year by demonstrating with necessary evidences that the liability relating to the prior period expenses had crystalised during the relevant period. The ld.CIT(A), however noted that the assessee had produced vouchers relating to

these expenses before the AO but the AO had failed to analyse the claim of the assessee that the expenditure had crystallised during the year. He therefore restored the issue back to the AO allow all the prior period expenses which crystallised during the relevant year. His findings at page no. 27 para 13.2 of the order are as under:

*“13.2I have considered the facts of the case and the submissions of the ld.AR carefully. It is seen that the AO without analyzing the same of the appellant in detail has made the disallowance under reference. I have gone through the submissions made by the ld.AR before the AO during the assessment proceedings wherein he has provided all the vouchers pertaining to such expenses in the form of a paper book. Therefore, under these circumstances, it would be appropriate that the AO allow those expenses under this head which crystallized during the relevant period. The AO while giving effect to this order will pass the speaking order on this issue while allowing or otherwise the appellant’s claim and the nature of expenses since the details thereof are with him. The ground therefore stands disposed of accordingly.*

28. The ld.counsel for the assessee fairly admitted that for the Asst.Year 2003-04 also, the ITAT had restored this issue of claim of prior period expenses back to the AO with identical direction to examine which expenses had crystallised during the year and allow claim of the expenses accordingly. He drew our attention to the order passed in the Asst.Year 2003-04 in the case of the assessee in ITA No.1185 and 1246/Ahd/2007 dated 29.1.2015, copy of which placed before us at page no.1 to 36. Our attention was drawn to para-4 to 4.3 of the order containing the said directions of the ITAT. In view of this, the ld.counsel for the assessee fairly admitted that he had no grievance against the direction of the ld.CIT(A) on the impugned issue.

29. In view of the above, We see no reason to interfere in the order of the Id.CIT(A) in this regard. This ground of appeal raised by the assessee is therefore dismissed.

30. Ground No.5, 6 and 10 relate to different additions/disallowances made on account of lease and buy-back arrangement entered into by the assessee with Gujarat State Road Transport Corporation (GSRTC).

31. The Id.counsel for the assessee pointed out that the assessee had bought buses from GSRTC which were leased back to be sold to it ultimately in a lease and buy-back arrangement. Accordingly, the assessee had claimed depreciation on these buses, being owner of these buses and had also shown lease rental income and interest income on delayed rent received. Further, since the assessee was unable to recover the lease rental income from GSRTC it had accounted for the lease rental and interest income on receipt basis. Also considering inability of GSRTC to pay the lease rental incomes by way of lease rent and interest income, taken into account in earlier years by the assessee, the same was written off as bad debts during the impugned year. The Id.counsel for the assessee pointed out that the Revenue authorities held the lease and buy-back arrangement to be a colourable device and according the assessee's claim of depreciation on the buses was denied. Thereafter, he pointed out that the Revenue also held that since the assessee was following mercantile system of accounting, therefore, entire lease income and interest income on delayed rentals was treated as income of the impugned year, rejecting the cash system followed by the assessee in this regard. Further, the assessee's claim of bad debts of the unrecoverable lease rentals booked as income in earlier

years was denied for the reason that the assessee unable to demonstrate that the debt had turned bad. The ld.counsel for the assessee contended that these are three issues, which the assessee has raised in ground no.5, 6 and 10 are as under:

“5. In facts and circumstances of the case, the Ld. A.O. has erred in rejecting the claim of depreciation of Rs. 72,30,369/- in respect of Leased Buses to GSRTC and Ld. CIT (A) has further erred in confirming the action of Ld. A.O of rejecting such claim of depreciation.

6. In facts and circumstances of the case, the Ld. A.O. has erred in making addition of Rs. 11,75,96,450/- by rejecting the claim, of Bad-Debts u/s 36(i) (vii) of the Act, which was written off and which was in respect of long outstanding due from, Gujarat State Road Transport Corporation, and Ld. CIT (A) further erred in Confirming the disallowance of said Bad- Debts.

10. in facts and circumstances of the case, Your Appellant most respectfully submits that Ld. A.O, erred in making addition of Rs.8,93,10,033/- on account of Lease Rentals and interest in respect of the following items.

Sr. No.	Amount Rs.	Particulars
a.	268.63.080/ -	Lease Rental for the period up to 30/09/2004 to the Lease period with Gujarat State Transport Corporation Ltd.
V,	268,63,080/ -	Lease Rentals from October, 2004 to Mach 2005 for the period beyond Lease period which expired on 30.9.2004.
c.	327,89,873/ -	Interest Calculated by ld.AO for delayed payments of Lease due from Gujarat State Road Transport Corporation Ltd.
3.	27,94,000/-	
Total Rs.	8,93,10,033 /-	

32. Taking up first denial of depreciation on buses which were leased out by the assessee to GSRTC, the Ld. Counsel for the assessee's contention was that the Revenue had relied on the decision of Special Bench of the ITAT in the case of Indus Ind Bank

Vs. ACIT in (2012) 135 ITD 165 while holding so. The ld.counsel for the assessee contended that since then much water had flown and these lease and buyback issues had been accepted to be genuine by Supreme Court in the case of ICDS Ltd.Vs. CIT, 29 taxmann.com 129 (SC). Copy of the order was placed before us.

33. With respect to claim of bad debt, contention of the ld.counsel for the assessee was that this claim had been made in the P&L account by the assessee and it had been explained to the authorities below that it pertained to the lease rental and interest income from GSRTC which had remained unrecovered. He contended that even Directors' resolution in this regard, in writing, approving write off of bad debts had been filed. The ld.counsel for the assessee further contended that the Revenue's contention that the assessee had renewed lease and buy-back arrangement in the year showed that there was no problem in recovery of lease rental so incurred was wrong on account of the fact that the earlier agreement had expired and the assessee had entered into fresh terms for recovery of the lease rental on the buses which was leased out to GSRTC; that this agreement in no way demonstrated that earlier debt had not become bad for recovery. As for the department's contention that lease rental and interest income ought not to have been accounted for on cash basis since the assessee was in fact following mercantile system of account, it was contended that even going by the mercantile system of accounting only those income which were certain for recovery could have been accounted for as income and considering the fact that the assessee had repeatedly demonstrated that recovery from GSRTC was very poor therefore the lease rental which was not capable of being collected could not have been said to

have accrued to the assessee even going by the mercantile system of accounting.

34. The Ld DR on the other hand relied on the order of the Ld.CIT(A). He drew our attention to para 14-14.2 with respect to denial of claim of depreciation on assets leased holding the arrangement to be colorable device as under:

*"14. The grounds No.7.1 to 7.8 of appeal are directed against the A.O's action for making an addition of Rs.72,30,3697- by rejecting the claim of depreciation of the appellant on the assets leased out to G.S.R.T.C. The A.O. has discussed this issue in para-7 of the assessment order. While disallowing the claim the A.O. observed that in the earlier assessment years, it was held that the transaction of sale and leased back of buses entered into between the G.S.R.T.C and the appellant were not genuine. The impugned transactions were made as a device intended to avoid taxation by claiming depreciation on such sale and leased back assets i.e. buses, which the appellant had never owned or possessed.*

14.1 During the appellate proceedings, the Ld.A.R. of the appellant objected to the said disallowance and submitted as under:

*"8.1 Your Appellant is carrying on mining activities in the State of Gujarat Since 1964. It is engaged in tapping major mineral resources and developing mineral based industrial products which includes energy mineral like lignite, basis commodity like base metals and industrial minerals like Bauxite and Flourspar. Your Appellant is further engaged in the business of leasing since A. Y. 1994-95 relevant to accounting year 1993-94.*

*8.2 Your Appellant entered into first leasing transaction with Gujarat State Road Transport Corporation under lease Agreement in F. Y 1993-94 relevant to A. Y. 1994-95 for giving Buses on lease to Gujarat State Road Transport Corporation which were purchased under valid sale invoices of Gujarat State Road Transport Corporation Dt. 24/03/94. The full consideration was paid by A/c. payee cheques. Due Sales Tax payable to State Government by the Vendors viz. Gujarat State Road Transport Corporation was also paid. The lease rentals also received periodically by A/c. payee cheques.*

*8.3 In respect of first leasing transactions entered into A.Y. 1994-95 with Gujarat State Road Transport Corporation, the same has been accepted as genuine lease transaction by the Learned Assessing Officer being Dy. Comm. Of Income, SR-9, Ahmedabad in order passed u/s. 143(3) of the Act Dt. 21/03/1997 and taxed the lease rentals and accepted the claim of depreciation since your Appellant fulfilled both the conditions laid down for grant of depreciation u/s.*

32 of the Act in original scrutiny assessment made u/s.143(3) for A.Y. 1995-96, A.Y. 1996-97 and subsequent assessment years.

8.4 During F.Y. 1999-00 relevant to A. Y. 2000-01, your Appellant had entered into another lease agreement with Gujarat State Road Transport Corporation in respect of 254 Buses of value of Rs. 20.03 Crores.

It was for the first time in reassessment proceeding for A. Y. 1996-97, in an order dt. 26/03/03 passed u/s. 143(3)/147 of the Act, that the Learned Assessing Officer rejected claim of depreciation on Buses Leased to GSRTC, Learned Assessing Officer had initiated of proceedings u/s. 147 of the Act, in respect of A.Y. 1998-99, A.Y. 2000-01 etc. & disallowed claim of depreciation on assets Leased to GEB & GSRTC. However, in respect of completed assessments for A.Y. 1997-98 & A.Y. 1999-00, the Learned Assessing Officer has accepted the claim of depreciation on Leased Assets since he has not disturbed the completed assessments in respect of both the years of A.Y. 1997-98 & A.Y. 1999-00.

8.5 The Learned Assessing Officer in this respect relied on the earlier years assessments and disallowed the claim of depreciation of Rs.72,30,369/ in respect of Leased Assets to GSRTC. Without prejudice to the forgoing, the Learned Assessing Officer also did not consider the alternative plea made by the appellant regarding taxing only the interest component out of total lease rental received. In other words if depreciation is disallowed, the principal component out of total lease rentals should be reduced from the total income.

The Appellant also submitted detailed break-up of lease rental received during the year into principal and interest components vide letter dt.24/12/07. As per the said working out of total lease rentals of Rs. 2,68,63,0807-, the principal components works out to be Rs. 2,59,31,898/-."

14.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. It is seen that the facts and the circumstances surrounding the issue are similar to A.Yrs. 1999-2000 to 2002-03. My Ld. Predecessors on the identical facts have decided the issue against the appellant. Since, there is no change in the facts and legal position, the disallowance made by the A.O. is hereby confirmed. The Ld.A.R. has referred to the quashing of proceedings by the Hon'ble I.T.A.T. for the A.Yrs. 1995-96 & 1996-97 in support of his claim. However, that quashing does not , supports the appellant's claim for depreciation as the Hon'ble I.T.A.T. has not decided the issue on merits. Therefore, under these circumstances, the ground taken by the appellant against the disallowance is hereby dismissed."

35. He also drawn to para 15-15.5 of the order taxing lease rental and interest on delayed rentals on accrual basis rejecting assesses claim of accounting for on receipt basis as under:

*"15. The ground No.8 of appeal is regarding taxing of interest and lease rent receivable amounting to Rs.8,93,10,033/-. The A.O. from the perusal of Directors report found that the statutory auditors of the appellant had observed that "certain items of income are accounted on cash basis as stated in accounting policy No.1(A) in Schedule XVI which is not in accordance with Accounting Standard AS 9 "Revenue Recognition" ". In continuation of such note the A.O. found that the appellant had not accounted for lease rental amounting to Rs.5,37,26,160/- and delayed interest thereon amounting to Rs.3,27,89,873/- receivable from G.S.R.T.C. during the relevant period. He further found the appellant did not account for the interest accrued on loan to GIIC amounting to Rs.27,94,000/-. In response to queries raised by the A.O. in this regard, it was explained on behalf of the appellant that due to stringent financial position of G.S.R.T.C. and GIIC the appellant had not received lease rentals, interest on delayed payments during the relevant period. Therefore, under these circumstances these income were not accounted for and consequently not offered for tax.*

*15.1 The A.O. however, rejected the appellant's contention in this regard and held that it was following the mercantile system of accounting wherein accrued income on account of lease rental and interest thereon for delayed payment from G.S.R.T.C. was required to be accounted for by the appellant. Similarly, the appellant was required to show interest income from GIIC on accrual basis. In view of this, he made the addition of Rs.8,93,10,033/- in the income of the appellant.*

*15.2 During the appellate proceedings, the Ld.A.R. of the appellant objected to the said disallowance and submitted as under:*

*11.6 Your appellant had given Buses on Lease to GSRTC. The said lease agreement was in force till September 2004 only. The same was not renewed upon its expiry. Because of Stringent financial position, GSRTC was not in position to pay installments of lease rentals and therefore the corporation did not account for lease rentals due from GSRTC. On the contrary, it had written off the amount of Rs. 11.75 crores which was already accounted and was due from GSRTC. Your appellant had also put a clear note in the statement of total income disclosing these facts. Your appellant relied on the decisions of Hon'ble Supreme Court in the case of Godhra Electricity Co Ltd. V CIT 225 ITR 546 and Uco Bank v CIT 237 ITR 889 in this regard. The Learned assessing officer has not accepted the contention of the appellant has made the addition of Rs. 5,37,26,160/-. The addition made by the Learned Assessing officer also includes a sum of Rs. 2,68,63,080/- which pertains to the period beyond the period covered by the lease agreement.*

11.7 The said lease agreement provided for interest on delayed lease rentals. Since, the lease rentals itself were not recoverable, interest on delayed lease rental was also not provided for. The Learned assessing officer has made addition of Rs. 3,27,89,8737- being interest on delayed payment of lease rentals by GSRTC.

11.8 Your appellant had advanced certain sum to GIIC. Since the said sum itself was doubtful, interest in respect of the same was also not provided relying on the on the decision of Hon'ble Supreme Court in the case of *Uco Bank v CIT 237 ITR 889* . The Learned assessing officer has not accepted the contention of your appellant and has made the addition of Rs. 27,94,000/-."

15.3 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. It is an admitted fact that the appellant is following mercantile system of accounting. The provisions of sec. 145 of the Act are very clear in this regard after its amendment w.e.f. 1.4.1997, that an assessee has to follow either cash system of accounting or the mercantile system of accounting. The hybrid system of accounting is not permissible now. Under the mercantile system of accounting the income has to be recognized on accrual basis only. It may be pointed out that the appellant's main plea regarding non inclusion of impugned income is that M/s.G.S.R.T.C. was not in a position to pay its due. However, such plea is against the facts which emerged after close analysis of the affairs of the appellant company made by the A.O. The appellant in the F.Y.2005-06 itself debited the accounts of G.S.R.T.C. on 31.3.2006 with a amount of Rs.11.83 crore on account of lease rent receivable. It is an admitted fact that the appellant renewed the lease agreement with G.S.R.T.C. in the month of July, 2006. The appellant's claim that the earlier lease agreement became ineffective after September, 2004 breft of reasoning in sense the assets which were given by it to the G.S.R.T.C. remained with that company. Therefore, the lease agreement which was renewed by the appellant in the month of July, 2006 shall be seen in continuation of earlier lease agreement only. Therefore, under these circumstances, there was accrual of income to the appellant on account of lease rentals and the interest thereon due to late payments thereof.

15.4 It will not out of place to mention here that the auditors of the appellant in note No. 10 to the notes forming part of statement of total income have observed as under:

*"As per the consistent policy followed by the Corporation - interest on delayed lease rentals accounted on cash basis. The same will be offered for taxation as and when received by the Corporation".*

15.4.1 This note itself shows that the appellant recognizes the delayed interest as its income. Therefore, under these circumstances, the impugned income is required to be taxed in the hands of the appellant for the relevant period. In this regard reliance is placed on the decision of Hon'ble Delhi High Court in the case of *Saraswati Insurance Company Ltd Vs. CIT* reported in 252 ITR 430. The relevant extracts of the decision are as under:

*"The assessee-company had advanced certain loans to its subsidiary company on interest at the rate of 12 per cent, per annum. Interest income was included in the total income of the assessee. For the assessment years 1977-78 and 1978-79, the assessee claimed that it had not charged interest from the subsidiary company due to its financial condition. The Income-tax Officer found on verification that interest had actually accrued for both the assessment years on the basis of the method of accounting followed by the assessee and the interest was waived only after the accrual. The Commissioner of Income-tax (Appeals) affirmed the views of the Assessing Officer. The resolution forgoing interest was passed a few days before the close of the accounting year in respect of the assessment year 1977-78 and another resolution was passed after the close of the accounting year in respect of the assessment year 1978-79. The Tribunal held that what was waived by the assessee was income which had already accrued to it according to the method of accounting regularly employed by it. On a reference:*

*Held, that the taxability is attracted not only when income was actually received but also when it accrued. Income accrues when it falls due, that is to say when it becomes legally recoverable, irrespective of whether it is actually received or not and accrued income is that income which the assessee has a legal right to receive. Therefore, the income by way of interest, waived by the assessee, was includible in its total income for the assessment years 1977-78 and 1978-79."*

*15.5 The reliance placed by the Ld.A.R. on the decision of Hon'ble Supreme Court in the case of UCO Bank Ltd 237 ITR 887 is of no help to the appellant as same has been rendered in respect of the sticky advances in the banking business. Therefore, in view of the above, the ground taken by the appellant is hereby dismissed."*

He further drew our attention to para 18-18.3 of the order denying claim of bad debts on account of unrecoverable lease rentals as under:

*"18. The 11th ground of appeal is directed against disallowance of bad debt claimed at Rs.11,75,96,456/-. The A.O. disallowed the appellant's claim for writing off of bad debt amounting to Rs.11,75,96,456/- in respect of G.S.R.T.C. The A.O. found that though the appellant had written off the amount in its books of account during the relevant period, the G.S.R.T.C. had not given consequential effect to same in their books of account. He further found that in the subsequent year the appellant itself reversed the entries in its books of account and the impugned debts were again appearing in the appellants books of the subsequent years. The A.O. has discussed this issue in para -11 of the assessment order.*

*18.1 During the appellate proceedings, the Ld.A.R. of the appellant objected to the said addition and submitted as under:*

*"11.12 Your appellant had leased the Buses to GSRTC. The Lease rentals were accounted for on accrual basis till 31/03/2004. The*

*Income from lease was credited to the Profit & Loss account and was offered for taxation under the head Profits and Gain from Business or Profession*

*11.13 Lease Installments due from GSRTC amounting to Rs. 11,75,96,456/-were written off by your appellant in the Profit and Loss account as the same were considered to be Bad looking at the financial position of GSRTC.*

*11.14 Necessary resolution was passed at the meeting of the Board of Directors and the copy of the same was submitted during the course of assessment proceedings. Your appellant has failed all the requirements and law for allowing the claim of Bad Debts.*

*11.15 The Learned assessing officer has disallowed the claim of Bad Debt amounting to Rs. 11,75,96,456/- ignoring the provisions of law."*

*18.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. The close analysis of the submissions made by the appellant before the A.O. clearly reveal that he did not take legal action for recovery of impugned debt on his own volition. In other words, the effective steps were not taken by the appellant to recover the outstanding debt. There is no evidence of any correspondence which were made by the appellant with the defaulting party. The appellant reversed the entries in its books of accounts of subsequent year. Therefore, under these circumstances it can not be held that the debt under reference became bad during the relevant period. In this regard reliance is also placed on the decision of the Hon'ble Gujarat High Court in the case of Dhall Enterprise and Engineers Pvt. Ltd Vs. CIT 295 ITR 481 has held that "under clause (vii) of section 36(1) of the Income-tax Act, 1961, the requirement for allowing deduction on account of bad debt is that the bad debt should be written off as irrecoverable. Merely debiting the amount is not sufficient. The requirement is that the assesses should also prove that the debt has become bad in that particular year."(emphasis supplied).*

*18.3 Therefore, the appellant has to prove two vital points for claiming a deduction u/s.36(1)(vii) with regard to bad debt namely the debt has become bad, and it became bad during the relevant period. The debt claimed by the appellant in respect of G.S.R.T.C does not fulfill the conditions as laid down by the Hon'ble Gujarat High Court in the case of Dhall Enterprise and Engineers Pvt. Ltd. In view of this the appellant's claim of bad debt amounting to Rs.11,75,96,456/- is hereby Rejected. The disallowance made by the A.O. is therefore, hereby confirmed."*

36. We have heard the rival contentions and gone through the orders of the authorities below as also the case laws referred to before us.

After considering the entire facts relating to the issue, we are perplexed with the apparently contradictory stand taken by the Revenue on the impugned issue before us. As is evident, the Revenue had held the lease and buy back arrangement of the assessee with GSRTC to be ingenuine and colorable device while denying claiming of depreciation thereon of the assessee holding that the assessee was not the owner of buses allegedly leased to GSRTC. Having so found the lease and buy back arrangement to be ingenuine the Revenue has thereafter subjected to tax lease rent from the same arrangement on accrual basis as opposed to the assessee adopting the cash basis and has also denied write off of lease rentals of earlier years as bad debts holding that the assessee failed to establish that they had become bad. This tantamounts to the Revenue accepting the genuineness of the arrangement which is in stark contrast to its findings of the same being ingenuine while denying claim of depreciation.

37. Be that so we find that the denial of depreciation on leased assets was based on the decision of the ITAT Special Bench in the case of IndusInd Bank (supra), which the Ld. Counsel has pointed out has since then been reversed by the Hon'ble apex court in the case of ICDS Ltd (supra). In the case of Indus Ind Bank the lease and buy back arrangements were found to be colorable device and it was held that the assesses were merely financing purchase of vehicles by this arrangement, i.e it was a mere financing arrangement. That as a result the ownership of assets so allegedly leased out by virtue of these arrangements was not of the alleged lessor and thus claim of depreciation thereon by the lessor was held not allowable. The Hon'ble Apex court recognized the genuineness of such arrangements and held that by virtue of various clauses in the

agreement the ownership of the asses leased was that of the lessor. Claim of depreciation thereon by the lessors was accordingly held allowable by the Hon'ble apex court.

38. Since in the present case the assesees lease and buy back arrangement has been held to be a colorable device on the basis of the special bench decision of the ITAT in IndusInd Bank (supra) which blanket proposition vis a vis lease and buy back arrangements has since been reversed by the Hon'ble apex court and the Ld.DR has not distinguished the said case before us, applying the decision of the Hon'ble apex court ,we hold that the assessee is entitled to claim depreciation on leased assets .The order of the Ld.CIT(A) upholding the disallowance of depreciation amounting to Rs.72,30,369/- is set aside and the AO is directed to allow the same.

39. Having held so, we now proceed to deal with the issue of taxing the lease rentals; on accrual basis as held by the Revenue or on cash basis as claimed by the assessee.

40. We find that the solitary basis with the Revenue for taxing lease rentals on accrual basis is that the assessee was following mercantile system of accounting and even section 145 of the Act directs following of either cash or mercantile system and not hybrid system. But as rightly pointed out by the Ld.Counsel for the assessee, even as per the accrual basis only those amounts certain for recovery are to be accounted for. In the present case the contention of the assessee was that GSRTC being in stringent financial position was not paying lease rentals .This is evident from the fact that the assessee had written off lease rentals of earlier years unrecovered of Rs. 11.75 Crs. Therefore even as per the

accrual system of accounting the assessee was not required to account for lease rentals which were not certain of recovery and the method therefore adopted by the assessee of accounting for such income on cash basis was, we hold, justified .

The addition made of Rs. 8,93,10,033/- on account of lease rental income and interest on delayed rentals accordingly is directed to be deleted.

41. Taking up now the last aspect of claim of bad debts with respect to lease rentals written off amounting to Rs.11,75,96,450/-, we find that the same was denied for the reason that the assessee had failed to establish that the debts had become bad. The facts on record however we find are to the contrary. As discussed above the assessee in the impugned year had not accounted for lease rental income of approx. 5.36 Crs for the reason that its recovery was not possible as GSRTC was not paying up the said amount. Along with the same there was interest accrued on delayed lease rentals totaling 3.28 crs which again the assessee had not accounted for ,for the same reason. That these amounts pertaining to the impugned year were unrecovered is an admitted fact. Thus what derives from the same is that GSRTC was not paying up the amounts due from it to the assessee. And for this reason the assessee had resorted to accounting for lease rental income from GSRTC on cash basis which aspect we have dealt with above. Besides, the assessee had filed resolution of Board of directors approving the write off of debts. The facts on record themselves establish the fact of debts from GSRTC becoming bad. The assessee therefore, we hold, is entitled to claim bad debts of Rs.11,75,96,456/-.The finding of the Revenue that the assessee had renewed lease agreement with GSRTC which proved

that the debts were capable of recovery, has been duly explained by the assessee as being on account of expiry of earlier agreement which in no way effected the recovery of earlier lease rentals.

In view of the above Ground No.5,6 and 10 are allowed.

43. In Ground No.7, the assessee has challenged the order of the Id.CIT(A) in confirming the disallowance by the AO of the claim of contribution made by the assessee to the Office of Commissioner of Geology & Mining, Gandhinagar amounting to Rs.53,84,000/-. Ground No.7 reads as under:

*“7. Your Appellant further submits that the Ld, A.O. has erred in making addition of Rs.53,84,000/- in respect of contribution made to the Office of Commissioner of Geology & Mining, Gandhinagar on the plea that there was no legal or statutory obligation or liability of the Appellant to make such payment. Your Appellant further submits that for the purpose of allowance of any expenditure incurred by the Appellant as per the provisions of sect 37 of the IT Act, the expenditure should be for the purpose of business, and Ld. CIT (A) has further erred in confirming such addition.”*

44. As transpires from orders of the authorities below, the AO has disallowed the contribution made by the assessee to the Office of Commissioner of Geology & Mining, Gandhinagar amounting to Rs.53,84,000/-holding that there was no legal and statutory liability for the assessee to make such expenditure, and he further observed that the assessee did not bring on record the benefit derived from it during the relevant period out of such expenses.

45. Before the Id.CIT(A), the assessee contended that this contribution of Rs.53,84,000/- to the Office of Geology & Mining, Gandhinagar was made for the purpose of upgradation of their laboratory at Gandhinagar, which was set up for research and testing in the field of mining. It was contended by the assessee, that the laboratory being involved in the business of mining research

and testing its activities were very useful to the assessee which was in the business of mining and the expenditure therefore was purely on the principle of commercial expediency. The Id.CIT(A) however rejected the claim of the assessee holding that the assessee had not established what benefit it had derived from the such expenditure. The relevant findings of the Ld.CIT(A) at page 38-39 para 20.2 of his order is as under:

*“20.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. It is seen that the Ld.A.R. neither during the assessment proceedings nor during the appellate proceedings filed any details to establish that the impugned expenses were incurred for the purposes of the business of the appellant. It is also clear from the submissions that how such expenses have helped the appellant in its business of mining during the relevant period. Further it is also not clear the laboratory stated to be set up from the funds provided by the appellant were used by it for its business. If the said laboratory was used during the relevant period, then what kind of reports were obtained therefrom by the appellant. It has not come out in the submissions of the Ld.A.R, therefore, under these circumstances the A.O. has rightly disallowed the claim of the appellant for expenses amounting to Rs.53,84,000/-. In view of this I do not find any justification to interfere in the findings of the A.O. accordingly. As a result, the ground taken by the appellant is hereby rejected.”*

46. The Id.counsel for the assessee reiterated submissions made before the Id.CIT(A), while Id.DR relied on the order of the Id.CIT(A). He further relied on the decision of Hon'ble Apex Court in the case of Venkata Satyanarayana Rice Mill Contractors Co., (1996) 89 taxman 92 (SC) for the proposition that any contribution made by an assessee with a view to secure benefit to the assessee's business, whether voluntary or at the instance of the authorities concerned, were to be allowed.

47. We have heard contentions of both the parties. We find merit in the contentions of the Id.counsel for the assessee that the contribution made by the assessee to the Office of Commissioner of Geology & Mining, Gandhinagar was in furtherance of the business

of the assessee only. The fact that the contribution made to the Office of Commissioner of Geology & Mining, Gandhinagar was given for setting up of laboratory for research and testing in the field of mining, has not been controverted by the Revenue. It is also fact on record that the assessee is in the business of mining of minerals. Therefore the research carried out in the laboratory would benefit the assessee is a foregone conclusion. There is no doubt that the contribution made by the assessee to the Office of Commissioner of Geology & Mining, Gandhinagar was to assist and for the benefit of the business of mining only. The assessee need not demonstrate derivation of any direct/actual benefit on account of any expenditure claimed as long as intention for deriving benefit from the said expenditure is there. Intention to derive benefit is sufficient to treat the claim as allowable revenue expenditure on commercial principle itself. As rightly pointed out by the Ld.Counsel for the assessee, the Hon'ble apex court ,in the case of Sri Venkata Satyanarayana Rice Mill Contractors Co.(supra) settled the proposition with regard to claim of expenses for business, holding that the correct test for such claims is that of commercial expediency alone . That as long as payment is made *for the purpose of business and not for infraction of any law* ,the same would be allowed as deduction.

In view of the above, we hold that the assessee's claim of contribution to the Office of Commissioner of Geology & Mining, Gandhinagar amounting to Rs.53,84,000/-, being for the purpose of business, is allowable as expenditure under section 37(1) of the Act. Ground of appeal No.7 is allowed.

48. Ground No.8 raised by the assessee relates to disallowance of claim of expenditure incurred for excavation of river diversion

amounting to Rs.3,41,80,929/- which in turn was upheld to the extent of 80% by the ld.CIT(A). The ground raised reads as under:

*“8. In facts and circumstances of the case, Your Appellant most respectfully submits that Ld A.O, has further erred in disallowing claim of Rs. 3,41,80,929/- in respect of expenses incurred for Excavation of River Diversion holding that the expenditure was incurred giving benefit of enduring nature and hence treated as Capital Expenditure and rejected the claim and Hon. Ld. CIT (A) further erred in holding that the said expenditure was for a continuous benefit and thereby directing Ld. A.O. to allow only 20% of such expenditure in each of the five consecutive years.*

*Your Appellant further submits that both the lower Authorities have failed to appreciate the fact the said expenditure was incurred for removal of disadvantage or obstacle in its regular mining business. And have failed to appreciate the judgments in case of (a) Bikaner Gypsum Ltd. Vs CIT, 17 ITR 39 (S,C) (b) CIT Vs Ashok Leyland Ltd, (c) GMDC Vs. CIT 132 ITR 377 (Guj. High Court) (d) CIT Vs, GMDC 249 ITR 787 (S.C).”*

49. As transpires from the orders of authorities below the AO found that the assessee had claimed this expenditure as having been incurred to divert course of river so that mining could be done at the place. The AO accordingly held the expenditure to be enduring in nature since the assessee was not required to incur the same year to year and accordingly treated the same as capital expenditure.

50. The ld.CIT(A) upheld order of the AO relying on the decision of Hon’ble Apex Court in the case of Madras Industrial Investment Corpn. Vs. CIT, 225 ITR 802 from which he noted that the Hon’ble Apex Court had held that there was a continuous benefit to the business of the company over the entire period. He further relied on the decision of Hon’ble Bombay High Court in the case of Taparia Tools Ltd., 260 ITR 102 taking the same view. The relevant findings of the Ld.CIT(A) at page 40 para 21.2 – 21.5 of the order is as under;

*“21.2 I have considered the facts of the case and the submissions of the Ld.A.R. carefully. I find considerable force in the argument of the Ld.A.R. that the expenditure incurred for diverting the river does not result in*

*acquisition of a new capital asset by the appellant. Nonetheless, the nature of expenditure is such that the appellant will be having benefit therefrom for a longer period. Therefore, under these circumstances, having regard to the matching principle, entire expenses incurred for getting the benefit under reference cannot be allowed in the year under reference. In this regard, reliance is placed on the decisions of Hon'ble Supreme Court in the case of Madras Industrial Investment Corpn. Vs. CIT 225 ITR 802, wherein the apex court held that where there is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period.*

21.4 The Hon'ble Bombay High Court in the case of Taparia Tools Ltd reported in 260 ITR 102 has taken a similar view. Though the judgement relates to debenture issue expenses, yet it lays down a vital principle for the expenses having similar connotations. The Hon'ble court held that:

*"The assesses created an asset on the basis of interest for five years being paid in advance in the first year and, thereafter, the said asset was being written off over the period of debentures for five years. The assesses had received Rs. 595 lakhs for a period of five years. Therefore, it was a continuing benefit to the business of the assessee over the entire period and, therefore, the liability was to be spread over the period of debentures. Therefore, the entire amount of Rs. 55 per non-convertible debenture equal to the total amount of Rs. 2,72,25,000 could not be treated as expense in the first year. It would result in distortion. The premium payable by the assessee at the end of five years was Rs. 60 lakhs and each year twenty per cent, of Rs. 60 lakhs, that is, Rs. 12 lakhs, had been charged to the profit and loss account. In these circumstances, the Assessing Officer was right in spreading over the deduction over the period of five years which was the life of the debentures."*

21.5 In view of the above, keeping in view the nature of expenses, it would be appropriate that same is allowed @ 20% for the five consecutive years. Therefore, the A.O. is directed to allow 20% of such expenses out of the same while giving effect to this order. The remaining amount thereof is hereby confirmed."

51. The ld.counsel for the assessee contended before us that decision of Hon'ble Bombay High Court in the case of Taparia Tools Ltd. (supra) had been reversed by the Hon'ble Apex Court which was reported in (2015] 372 ITR 605 SC). Copy of the order was placed before us. He further contended that even as per the Ld.CIT(A) no asset had come into existence by virtue of incurring this expenditure therefore it is settled law that in the absence of any asset coming into existence the expenditure cannot be treated as capital in

nature. That even otherwise the sole purpose of incurring the expenditure was to facilitate carrying on business of mining by diverting the river from its course so as to enable mining in the area occupied by the River. The purpose was to remove an obstacle and therefore there was no question of the assessee deriving any enduring benefit from the same also. He drew our attention to submissions filed to the Ld.CIT(A) in this regard reproduced at para 21.1 of the order as under:

*“ 21.1 During the appellate proceedings, the Ld.A.R. of the appellant objected to the said addition and submitted as under:*

*11.24 Your Appellant is engaged in mining activities. Whenever mining is required to be done at a place where river is flowing, the same is required to be diverted to facilitate mining at such place. Your appellant incurred expenditure of Rs.3,41,80,929/- in this regard during the year under review.*

*11.25 The Learned assessing officer has wrongly considered this expenditure as Capital expenditure giving a benefit of enduring nature to your appellant. The Learned assessing officer has failed to appreciate the difference between the benefit and removal of disadvantage or obstacle. The said expenditure did not give any benefit to your appellant but it simply removed the disadvantage which was there.*

*11.26 Your appellant relied on the decisions of Hon'ble Supreme Court in the case of Bikaner Gypsum Ltd v CIT 187 ITR 39 and CIT V Ashok LeyLand , Ltd. 8 ITR 549. The Learned assessing officer while making the addition has not dealt with these decisions.”*

52. We have heard both the parties and have gone through the orders of the authorities below. We find merit in the contentions of the ld.counsel for the assessee that the expenses incurred for diverting the course of the river for enabling business of mining activities carried out by the assessee is allowable as revenue expenditure. The Hon'ble apex court in the case of Empire Jute Co. Ltd v CIT 124 ITR 1(SC) has settled the principle for determining capital expenditure holding that only when the advantage on

account of the expenditure is in capital field ,it would be treated as capital expenditure. That if the advantage consists merely in facilitating the assesses trading operations or enabling management and conduct of assesses business to be carried out more efficiently or more profitably, while having the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for indefinite future.

53. In the present case the sole reason for treating the expense incurred on diversion of a river as capital was that it gave rise to enduring benefit. The Ld.CIT(A) has given a finding of fact that the said expenditure has not resulted in any asset coming into existence. And as contended by the assessee and not controverted by the Revenue, the purpose of incurring the expenditure was to remove obstacle/ hindrance so as to enable carrying out its activity of mining smoothly.

54. It is amply clear therefore that the expense was incurred only for enabling conduct of the business of the assessee, admittedly without any expenditure being incurred on capital account. The ratio settled by the Hon'ble apex court in the case of Empire Jute(supra) will therefore squarely apply in the facts of the present case. Accordingly therefore, we hold, that the impugned expenditure is to be treated as revenue in nature.

55. The decision of the Hon'ble Bombay High court in the case of Taparia Tools (supra) relied upon by the Ld.CIT(A) while holding the claim of expenditure to be on capital account ,has been pointed out by the Ld.Counsel to have been reversed by the Hon'ble Supreme Court. The Ld.DR did not controvert the same. The Decision of the Hon'ble apex court in the case of Madras Industrial Investment

Corp.(supra) also relied upon by the Ld.CIT(A) is we find distinguishable on facts where the issue before the Hon'ble Apex Court was allowability of discount on issue of debentures, which it was held was to be allowed proportionately over the period of holding of the debentures. The issue therefore did not relate to capital/revenue expenditure. This issue was also there in Taparia Tools(supra) where the Hon'ble Bombay High Court held likewise but the said decision was reversed by the Hon'ble apex court subsequently .

In view of the above we hold, the assessee's claim of expenses incurred for excavation of river diversion amounting to Rs.3,4,80,929/- as allowable revenue expense.

Ground of appeal No.8 is allowed.

56. Ground No.9 raised by the assessee relates to disallowance of interest incurred for the purpose of earning exempt income, amounting to Rs.23,50,047/-,as per the provisions of section 14A of the Act, which was confirmed by the ld.CIT(A). The said ground reads as under:

*“9. In facts and circumstances of the case, Your Appellant most respectfully submits that Ld, A.O, has erred in making an addition of Rs. 23,50,047/- u/s 14A of the Act and Ld. CIT (A) further erred in directing the Ld. A.O. to make the disallowance u/s 14A as per rule 8D, and Particularly when the Rule 8D has come into existence by IT Rules 2008 Dated 24/03/2008.*

*Your Appellant further submits that both the lower authorities have failed to appreciate the facts that investments made in Tax Free Bonds, Equity Shares or Mutual Funds were out of own Capital & free .reserves and not out of borrowed funds.”*

57. As transpires from orders of the authorities below, the assessee during the impugned year had earned dividend income to

the tune of Rs.65,35,060/- and interest on tax free bonds of Ahmedabad Municipal Corporation of Rs.1,26,20,421/-. The assessee had shown investment of Rs.71,71,47,000/- as on 31.3.2005. In response to the query raised by the AO asking details of interest bearing funds utilized for investment in exempt income, the assessee filed reply stating that the investments were out of own interest free funds of the assessee. The AO however worked out disallowance of interest at Rs.77,487/- and administrative expenses of Rs.22,72,560/- accordingly disallowing of a sum of Rs.23,50,047/- under section 14A of the Act.

58. Before the Id.CIT(A), the assessee contended that it had deployed its own interest free funds for the purpose of making impugned investment which were more than sufficient for the said purpose, and further had incurred no administrative expenses to earn and collect impugned exempt income. He further pointed out that no such disallowance had been made in the preceding assessment year i.e. Asst.Year 2002-03. The Id.CIT(A) however held that since the assessee had not come forward with complete details to establish that it did not incur any expenditure to earn exempt income, it could not be held that nothing is attributable out of interest to the income from dividend income. Further reliance on the decision of Special Bench of the ITAT, Mumbai Bench in the case of ITO Vs. Daga Capital Management P.Ltd. which laid down that provision of Rule 8D inserted Income Tax Rules, 1962 is clarificatory for the purpose of computing disallowance under section 14A of the Act. The Id.CIT(A), accordingly, directed that disallowance be computed following the procedure laid down in Rule 8D of the Rules.

59. Before us, the ld.counsel for the assessee contended that the assessee had sufficient interest free funds for the purpose of making investment. He drew our attention to the audited financial accounts of the assessee before us placed at page no.1 to 105. He pointed out that the assessee had owned interest free funds of Rs.767.00 Crs while investment for earning exempt income amounted to only Rs.71 crores. He stated therefore that no disallowance under section 14A was warranted and relied upon the decision of Hon'ble Apex Court in the case of CIT(LTU) vs Reliance Industries Ltd. CA No. 37 of 2019 & others dated 23-03-2019. He further contended that direction of the ld.CIT(A) to follow Rule 8D for the purpose of computing disallowable expenses in the impugned year i.e. Asst.Year 2005-06 when such rules were not even notified was not in accordance with judgment of Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. CO. Vs. CIT, 328 ITR 81 wherein it had been categorically held that these rules were to be applied prospectively only w.e.f. Asst.Year 2007-08 onwards. He further pointed out that in the preceding year i.e. Asst.Year 2003-04, this issue had been decided by the ITAT in favour of the assessee. Our attention as drawn to page no.15 of the compilation of the orders wherein at para 6.3 the issue was dealt with by the ITAT deleting disallowance of interest expenses holding that in the case of CIT Vs. Gujarat Industrial Development Corpn 37 taxmann.com 254, the Hon'ble Gujarat High Court has held that department is expected to establish a nexus between interest bearing funds borrowed and those invested by the assessee respondent and only when it was shown that interest free funds were not available with the assessee, that question would arise of fastening tax liability on assessee.

60. The ld.DR, on the other hand, relied on the order of the ld.CIT(A).

61. We have heard both the sides. Vis-à-vis the issue of disallowance of expenses under section 14A of the Act, we agree with the ld.counsel for the assessee that invocation of Rule 8D is applicable for the purpose of computing the amount of expenditure to be disallowed only w.e.f. Asst.Year 2007-08, when said Rule were brought into force and section 14A of the Act also specifies the invocation of the said rules. This proposition was laid down by the Hon'ble High Court in the case of Godrej Boyce (supra) also. Further it is a settled law that where sufficient interest free funds are available the presumption is that the investments have been made out of such funds calling for no disallowance of interest under section 14A of the Act. Hon'ble Supreme Court in the case of Reliance Industries Ltd. (supra) has laid down the above law. In the present case, therefore, invocation of Rule 8D by the ld.CIT(A), we hold is not in accordance with law. Further, noting that the assessee had sufficient owned interest free funds for the purpose of making the impugned investment, as demonstrated both to the Ld.CIT(A) and also before us and which fact has remained uncontroverted by the Revenue, we hold no disallowance of interest under section 14A of the Act is warranted. Further noting that in identical facts and circumstances the ITAT in the case of the assessee in A.Y 2003-04 had deleted entire disallowance made u/s 14A of the Act, we hold that the disallowance of Rs.23,50,047/- under section 14A is unwarranted, not in accordance with law and direct the same to be deleted in entirety.

Ground of appeal No.9 of the assessee is allowed.

In effect the appeal of the assessee is partly allowed.

62. Now we take up both penalty appeals of the Revenue and the Assessee in ITA No.1471/Ahd/2015 and 1657/Ahd/2015 against the order of the Id.CIT(A) deleting/confirming imposition of penalty under section 271(1)(c) of the Act.

63. While dealing with assessee's appeal in ITA No.1747/Ahd/2009 hereinabove, we have deleted additions which were made by the AO and confirmed by the Id.CIT(A). Therefore, no additions exist in the case of assessee for the Asst.Year 2005-06. Additions on which the impugned penalties are challenged by both the Revenue and the assessee since are extinguished, the impugned penalties have no leg to stand, they are accordingly cancelled. In other words, assessee's penalty appeal challenging confirmation of penalty under section 271(1)(c) of the Act is allowed, whereas Revenue's appeal is dismissed.

64. In the combined result, quantum appeal of the assessee in ITA No.1747/Ahd/2009 is allowed; penalty appeals of the assessee in ITA No.1657/Ahd/2015 is allowed, and Revenue's appeal in ITA No.1471/Ahd/2015 is dismissed.

**Order pronounced in the Court on 30<sup>th</sup> November, 2022 at Ahmedabad.**

**Sd/-  
(T.R. SENTHIL KUMAR)  
JUDICIAL MEMBER**

**Sd/-  
(ANNAPURNA GUPTA)  
ACCOUNTANT MEMBER**

Ahmedabad, dated 30/11/2022

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