Commissioner of Income-Tax, Madras

Vs

Indian Bank Ltd

Civil Appeal No. 1095 of 1963

(K. Subha Rao, J. C. Shah, S. M. Sikri JJ)

26.10.1964

JUDGMENT

SIKRI, J.

This is an appeal by special leave against the judgment of the Madras High Court, answering a question referred to it under section 66(1) of the Indian Income-tax Act, 1922, hereinafter referred to as the Act, against the Revenue.

The question referred to it was the following :

> "Whether on the facts and circumstances of the case the bank was entitled to claim deduction of the entire interest paid by it on fixed deposits, either under section 10(2)(iii) or 10(2)(xv) ?"

The relevant facts and circumstances are these. The respondent, the Indian Bank Ltd., Madras, hereinafter referred to as the assessee, carried on the business of banking. In the normal cause of its business, it received deposits from constituents and paid interest to them. It invested a large sum in securities both of the Central and State Government (including Mysore Government). The interest on Mysore Government securities was exempt from income-tax and super-tax under the provisions of a notification issued under section 60 of the Act. It bought and sold these securities and the profits and losses on the purchase and sale of such securities were duly taken into computing the income of the assessee, under the head 'Business'. For the assessment year 1951-52 (accounting year, calendar year 1950) it claimed a deduction of Rs. 25,91,565 as interest paid to various depositors, under section 10(2)(iii) of the Act. The income-tax officer the appellate assistant commissioner and the Income-tax Appellate Tribunal disallowed interest amounting to Rs. 2,80,194. This amounts was arrived at by calculating the proportionate interest which would be payable on money borrowed for the purchase of Mysore securities for Rs. 2,49,93,511. we need not describe the formula adopted for calculating the proportionate interest for noting turns on it.

The grounds given by the Appellate Tribunal for disallowing the deduction of the proportionate interest were two-fold : First, as 'income from securities can be taxed only under section 8, the allowance that could be a charge on that income can only come under that section and no other'; and, secondly, 'the trend of authorities also seems to be in favour of the Department's view that the assessee is not entitled to a double benefit, (i) exemption from tax in respect of certain securities, and (ii) to an allowance of interest on the money utilised to purchase those securities".

At the instance of the assessee, the Appellate Tribunal referred the question reproduced above to the

High Court. The High Court has answered the question in favour of the assessee on the ground that the entire interest paid by the bank was a permissible deduction under section 10(2)(iii) of the Act.

It is common ground among the parties that section 8 of the Act does not apply. The learned counsel for the revenue, Mr. Rajagopala Sastri, submits that there is a general principle that no expenditure can be allowed as a deduction from the profit of a business unless that part of the business to which the expenditure is attributable is capable of producing income or profits liable to be taxed under the Act. In other words, he contends that if a part of profits of a business is not taxable, no expenditure incurred for the purpose of earning those profits can be allowed as a deduction. He says this is the position specially after the amendments made in the Act by the Amending Act of 1939, in section 4, whereby all income accruing or deemed to accrue to a person resident in India is attributed a taxable quality. He goes on to say that if a particular income has no taxable quality, it also loses quality for qualifying for expenditure allowable under section 10.

The learned counsel for the assessee, Mr. R. Venkatram, says that even if the proposition be accepted, it does not assist the revenue in this case. He points out that in the case before us it is not controverted that the profits and losses accruing from the sale and purchase of securities have been included in the assessment. Therefore, the tax-free securities are capable of producing profits and losses. There is force in the contention of Mr. Venkartram, and the appeal must fail on this ground alone. But as the question has been debated before the High Court, and before us, we do not desire to rest our decision on this narrow ground.

Then is there such a principle as has been formulated above ? If there is one, can it be invoked to cut down the express language of section 10(2)(iii), which expressly allows as a deduction interest on capital borrowed for the purpose of the business ? In our opinion, in construing the Act, we must adhere closely to the language of the Act. If there is ambiguity in the terms of a provision, recourse must naturally be had to well-established principles of construction but is not permissible first to create an artificial ambiguity and then try to resolve the ambiguity by resort to some general principle.

We are concerned with the interpretation of section 10. Let us then look at the language employed. Sub-section (1) directs that an assessee be taxed in respect of the profits and gains of business carried on by him. What is the business of the assessee must first be looked at. Does he carry on one business or two business or along with the business carried on by him some activity which is not a business ? If he is carrying on an activity which is not business we must leave out of account the receipts of that activity. That is the first step. Secondly, we must look at section 10(2) and deduct all the allowances permissible to him. In allowing a deduction which is permissible the question arises : Do we look behind the expenditure and see whether it has the quality of directly or indirectly producing taxable income ? The answer must be in the negative for two reasons : First, Parliament has not directed us to undertaken this enquiry. There are no words in section 10(2) to that effect. On the other hand, indications are to the contrary. In section 10(2)(xv), what Parliament requires to be ascertained is whether the expenditure has been laid out or expended wholly and exclusively for the purpose of the business. The legislature stops short at directing that it be ascertained what was the purpose of the expenditure. If the answer is that it is for the purpose of the business, Parliament is not concerned to find out whether the expenditure has produced or will produce taxable income. Secondly, the reason may well be that Parliament assumes that most types of expenditure which are laid out wholly and exclusively for the purpose of business would directly or indirectly produce taxable income, and it is not would the administrative effort involved to go further and trace the expenditure to some taxable income.

Therefore, it seems to us that is nothing in the language of section 10 from which it can be fairly implied that an expenditure or allowance falling within the section must fulfil some other condition before it can be allowed.

A similar question arose in England in Hughes v. Bank of New Zealand (21 TC 472), and all the judges took the view that interest paid by the bank on capital borrowed in the course of its business an utilised in buying tax-free securities had to be deducted in arriving at the taxable profits of the business notwithstanding that the interest earned by the bank on the tax-free securities could not be taxed.

Lord Thankerton put the reason shortly thus :

> "It is perhaps enough to say that Crown are unable to point to any statutory provision in support of their contention, whereas the respondents find full justification for their resistance in the provisions of Rule 3 of the rules applicable to cases I and II of Schedule D".

This rule is similar to section 10(2)(xv) of the Income-tax Act. After setting out the rule and noticing its effect, he says :

> "It seems to me to be incontrovertible that, in the present case, the investments in question were part of the business of the Respondents' trade, and that the expense connected with them was wholly and exclusively laid out for the purposes of the trade. Expenditure in course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purpose of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense."

Although the Master of the Rolls found force in the argument of the Crown, he could find nothing in the language of the English Act to eliminate a part of the expenses of an indivisible trade. Similarly, Greene L.J., could find no warrant in the language of the statute to give effect to the contention of the Crown. He observed that "when the statute says that interest is to be exempt, I am quite unable to read it as meaning that in giving effect to that exemption by implication, some repercussion is to take place on a different provision of the Act altogether .... I can find nothing in the statute which requires this interest too be treated, so to speak, as a trade within a trade. This is really what the Crown contend, that in some way this interest which is to be brought into account as an item of receipt is to be taken out of it with some apportioned expenses appropriated to it as though it were a trade by itself."

Mr. Sastri urges that the authority of the above decision has been shaken in Mitchell and Edon (H. M. Inspectors of Taxes) v. Ross (40 T.C. 11), but we are unable to accept this contention. The point urged in this case was that the authority of Fry v. Salisbury House Estate ([1930] A.C. 432) had been qualified by the decision in Hughes v. Bank of New Zealand (21 T.C. 472), but this was negatived.

A number or Indian cases have been cited before us and we will now proceed to examine them.

The Madras High Court's decision in Commissioner of Income-tax v. Somasundaram Chettiar (A.I.R. 1928 Mad. 487) does not assist Mr. Sastri. The assessee carried on business at Madras, where his head office was, and Ipoh, a place in the Federated Malay. Money was borrowed at

Madras and part of it sent to Ipoh where it was used as capital in the conduct to Ipoh business. The High Court held that interest on the part of the borrowed money used at Ipoh was rightly disallowed as a deduction because the business which was being taxed was the business at Madras and not the business at Ipoh. No exception can be taken to the decision but it does not advance the appellant's case because we are concerned with one indivisible business.

In Provident Investment Co. Ltd. v. C. I. T. Bombay (6 I.T.C. 21) the assessee, an Indian finance company, borrowed some money in India and purchased sterling securities out of it and retained them in India. The Bombay High Court held that interest on the borrowed money could not be deducted because "qua the capital which it (the company) is using outside British India and retaining for that length of time outside British India, is not carrying on business in respect of which profits assessable to Indian Income-tax can be earned so that allowance can be claimed for interest on capital borrowed within the meaning of section 10(2)(iii). "It appears to us that the Bombay High Court divided the business into two separate business. But the business of the present assessee cannot be divided into two separate businesses. It is one and indivisible.

In Chellappa Chettiar v. Commissioner of Income Tax Madras ([1937] 5 I.T.R. 97) the assessee carrying on business as a moneylender had borrowed money and lent it out to constituents. He was obliged to receive agricultural lands in repayment of his debts from such constituents. The question arose whether he was entitled to a deduction in respect of the interest paid by him on capital represented by the agricultural lands. The court, following Hughes v. Bank of New Zealand (21 T.C. 472) held that he was entitled notwithstanding that agricultural income was not taxable under the Income Tax Act. Mr. Sastri says that this was wrongly decided and was in fact dissented from by the Rangoon High Court in C. I. T. Burma v. N. S. A. R. Concern ((1938) 6 I.T.R. 194) Dunkley J., in the Rangoon case, distinguished Hughes v. Bank of New Zealand (21 T.C. 472) because he thought that the scheme of the Burma Income Tax Act was entirely different from the scheme of the English Income Tax Act, 1918. He observed that "in England a person is assessed to income tax in respect of his income, while under the Burma Act it is the income which is taxed. Under the English Act no class of income is outside the scope of the Act, whereas by section 4(3) of the Burma Act the Act is made inapplicable to a number of classes of income. The English Act merely confers certain exemptions on a person in respect of his income up to a certain amounts or of certain kinds, similar to the exemptions conferred on certain classes of income by the provisos to section 8 and 9 of the Burma Act. "Then he noted the difference between the wording of section 10(2)(ix) of the Burma Act and the corresponding clause in the English Act. But we are unable to appreciate that these differences necessitate the rejection of the Principle laid down in Hughes v. Bank of New Zealand (21 T.C. 472). It is true that under the Indian Income-tax Act it is income that is taxed but it is not taxed in vacuo. It is taxed in the hands of a person. In England, the interest of tax-free securities was exempted much in the same way as in India. It did not matter there who held them. Hughes v. The Bank of New Zealand (21 T.C. 472) cannot be distinguished on the grounds mentioned by the Rangoon High Court. In our judgment Chellappa Chettiar v. C. I. T. Madras ((1937) 5 I.T.R. 97) was correctly decided.

The decision of this Court in Indore Malwa United Mills v. C.I.T. (Central) Bombay ([1962] Supp. 3 S.C.R. 310) is distinguishable. It appears to us that it was because section 14(2)(c) and section 4(1)(a) and (c) existed at the relevant time that the words 'profits and gains' in section 24 were limited to such profits and gains as would have been assessable in British India or the taxable territories. This is apparent from the judgment and from the following observations of Das J.

"Reading the provisions in section 24 with the provisions in section 4(1)(a) and (c)

> and section 14(2)(c) it seems clear to us that section 24(1) when it talks of profits or gains has reference to taxable profits or taxable gains; in other words, it has reference to such profits and gains as would have been assessable in British India or the taxable territories. It has no reference to income accruing or arising without British India or with out taxable territories which were not liable to be assessed in the case of non-residents."

We cannot imply from this judgment that there is a general principle that if a part of the income of a business is tax-free, expenditure incurred for the purpose of earning this income is outside the purview of section 10.

In the result we agree with the High Court that the answer to the question is in the affirmative. The appeal is accordingly dismissed with costs.

Appeal dismissed.

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