

India Cements Ltd

Vs

Commissioner of Income-Tax, Madras

Civil Appeal No. 1106 of 1964

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

08.12. 1965

JUDGMENT

SIKRI J. –

This appeal by special leave is directed against the judgment of the High Court of Judicature at Madras answering the following question of law in favour of the respondent :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the sum of rupees 84,633 expended by the assessee in obtaining the loan or any part thereof is an allowable expenditure ?"

The facts and circumstances of the case as stated by the Tribunal in the statement of the case are as follows : The appellant, India Cements Limited, Madras, hereinafter referred to as the assessee, is a public limited company. The question arises in respect of the assessment year 1950-51, accounting period April 1, 1949, to March 31, 1950. During the accounting year it obtained a loan of 40 lakhs of rupees from the Industrial Finance Corporation of India. This loan was secured by a charge on the fixed assets of the company. Since Mr. S. T., Desai, the learned counsel for the respondent, has disputed some facts as stated by the Appellate Tribunal, it would be convenient to give these facts in the words of the Appellate Tribunal. It is stated in the statement of the case that "the proceeds of this loan was utilised to pay off a prior debt of Rs. 25 lakhs due to Messrs. A. F. Harvey Limited and Madurai Mills Limited. It can be stated definitely how the balance of Rs. 15 lakhs was used but the directors, while

#Stamps 60,023 0 0Registration fees 16,067 0 0Charges for certified copy of the mortgage deed 28
0 0Indemnity deed by Essen and Company Limited 15 0 0Vakil's fee for drafting deed 7,500 0
0Legal fees 1,000 0 0 ----- TOTAL 84,633 0 0 -----##

The assessee did not charge this expenditure in the profit and loss account for that year. It was shown in the balance-sheet as mortgage loan expenses. It continued to be so shown till March 31, 1952. In the accounts for March 31, 1953, this was written off by appropriation against the profits of the year.

The Income-tax Officer refused to allow the deduction of Rs. 84,633. He observed :

"As per the information furnished by the auditors, Rs. 25 lakhs of the loan was to be paid to Messrs. A. F. Harvey Limited and Madurai Mills Limited in discharge of the amount borrowed from them and utilised on the capital assets of the company.

Though in the company's books the amount of Rs. 84,633 was not charged to revenue but capitalised and carried forward in the balance-sheet, for purposes of income-tax, the company's auditors claim the same as an admissible item of revenue expenditure."

He held that the expenditure was incurred in obtaining capital and should be distinguished from interest on borrowed capital which was alone admissible as a deduction under section 10(2)(iii). According to him, section 10(2)(xv) specifically excludes from consideration any item of capital expenditure. He further held that the case was not distinguishable from the decision in Nagpur Electric Light and Power Co. v. Commissioner of Income-tax. Appellate Assistant Commissioner agreed with the Income-tax Officer. The Appellate Tribunal distinguished the case of Nagpur Electric Light and Power Co. v. Commissioner of Income-tax on the ground that in the Nagpur Electric Light case money was expended for obtaining capital. It observed as follows :

"Here we find the position to be different. A study of the balance sheets of the company as at 31st March, 1949, discloses the fact that the paid-up capital was sufficient to cover the entire capital outlay of the company and that the further borrowal of Rs. 25 lakhs was for augmenting the working funds of the company. It appears to us that even at that early stage the money was borrowed and used not for capital purposes but for augmenting the working funds of the company. We, therefore, consider that the whole of the mortgage loan was used firstly to discharge the loan of Rs. 25 lakhs and the balance for working funds and, as such, the whole of the amount was purely for the purposes of augmenting the working capital of the company and that it could not be stated that it was used for capital of the company and that it could not be stated that it was used for capital purposes. In this view of the matter, we hold that the money expended in obtaining the loan is an allowable expenditure."

The High Court, after noticing the findings of the Income-tax Officer and the Tribunal, preferred the findings of fact made by the Income- tax Officer. It observed :

"At this stage, we may point out that the conclusion reached by the Tribunal that the money was borrowed only for working expenses and not for capital investment proceeded on an inference based upon the balance-sheet. The Tribunal did not investigate how the sum of Rs. 25 lakhs earlier borrowed from. A. H. Harvey and Madurai Mills Ltd. was actually utilised. Though in the order of the Income-tax Officer it is found stated that that amount was utilised on the capital assets of the company and that statement was based on the authority of the information furnished by the auditors of the assessee, the Tribunal either overlooked or ignored this circumstance. In the face of the statement so recorded by the Income-tax Officer, the Tribunal does not appear to have been justified in relying upon inferences in ascertaining whether the earlier borrowal was on capital or revenue account."

The High Court, after reviewing various cases, observed :

"If we ask for what purpose the expenditure in the present case was incurred, the only answer must be that it was incurred for the purpose of bringing into existence as asset in the shape of borrowing these Rs. 40 lakhs. The further question would then be whether this asset or advantage was not for the enduring benefit of the business and

whether the expenditure incurred was one which was incurred once and for all. The answer to both questions would again be in the affirmative. It is true that the borrowed money was to be repaid and it cannot be an enduring advantage in the sense that the money becomes part of the assets of the company for all time to come. But, it certainly is an advantage which the company derives for the duration of the loan and undoubtedly it could not have been for any purpose other than an advantage to the business. That it is not enduring in the sense that the borrowing has to be repaid after a short or long period, as it were, cannot affect the conclusion that it was never-theless an

The learned counsel for the assessee-company, Mr. A. V. Viswanatha Sastri, urges that the expenditure is admissible as a deduction under section 10(2)(xv) of the Act. He says that the High Court erred in holding that the expenditure was made to acquire any asset or advantage of an enduring nature within the test laid down by Viscount Cave and approved by this court in *Assam Bengal Cement Co. Ltd. v. Commissioner of Income-tax*. He further says that what was secured by the expenditure was a loan and in Indian money expended in raising a loan, whether by means of a debenture or a mortgage and whether you call it a loan capital or not, is not an expenditure in the nature of capital expenditure. He further submits that the expenditure was expended wholly and exclusively for the purpose of the business of the company.

The learned counsel for the revenue, Mr. S. T. Desai, supports the reasoning of the High Court. He says that the High Court was right in preferring the findings of Income-tax Officer on the ground that there was no material for the finding made by the Appellate Tribunal and the finding was based on surmises and material evidence was ignored. He says that the High Court in a reference is entitled to ignore any findings of fact made by the Appellate Tribunal if those findings are vitiated. In the alternative, he says that the question referred is wide enough to include the question whether there was any material for the finding of the Appellate Tribunal. On the merits he contends that expenditure takes the colour from the thing on which the expenditure is made. If the money is spent to obtain capital then the expenditure assumes the nature of capital expenditure, but if the money spent to obtain raw materials then the expenditure takes the colour of revenue expenditure. He further says that the borrowed money

A number of cases have been referred to during the hearing of the case by both the counsel but we do not propose to refer to all of them. We must start first with the cases decided by this court and see what principles have been laid down for distinguishing revenue expenditure from expenditure in the nature of capital expenditure, and especially those cases which dealt with similar problems. We will first consider *State of Madras v. G. J. Coelho*. This was not a case arising under the Indian Income-tax Act but under the Madras Plantations Agricultural Income-tax Act, 1955, in which a section exactly similar to section 10(2)(xv) existed. In brief, the facts in that case were that the assessee had borrowed money for the purpose of purchasing the plantations and he claimed that in computing his agricultural income from these plantations the entire interest paid by him on moneys borrowed for the purpose of purchasing the plantation should be deducted as expenditure under section 5(e) of the Act. In the Madras Act

It will be remembered that there was no section like section 10(2)(iii) of the Act in English Income

Tax Act. On the other hand, there were certain rules prohibiting the deduction in respect of "any capital with drawn from, or any sum employed or intended to be employed as capital in such trade..." or "any interest which might have been made if any such sums as aforesaid had been laid out at interest". Lord Atkinson first held in that case that the express prohibitions did not apply to the facts of the case and then proceeded to discuss general principles. These observations show that where there is no express prohibition, an outgoing, by means of which an assessee procures the use of a thing by which it makes a profit, is deductible from the receipts of the business to ascertain taxable income. On the facts of this case, the money secured by the loan was the thing for the use of which this expenditure was made. In principle, apart from any statutory provisions, we see no distinction between interest in resp

"... it appears to me, simply, amounts to this that the word 'capital' must, in this rule, be held to bear a wholly artificial meaning differing altogether from this its ordinary signification, though there be no context in the clause requiring that there should be given to it a meaning different from that which it bears in ordinary commercial transactions."

He then referred to the decision in *Bryon v. Metropolitan Saloon Omnibus Co.* to show that the borrowing by a joint stock company of money by the issue of debentures does not amount to an increasing of the capital of the company.

In *Bombay Steam Navigation Co. v. Commissioner of Income-tax*, this court again examined the question of distinguishing between capital expenditure and revenue expenditure. This court first held that, on the facts of the case, clause(iii) of section 10(2) did not apply, because the assessee in that case had agreed to pay the balance of consideration due by the purchaser and this did not, in truth, give rise to a loan. There Shah J. observed :

"Whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. The question must be viewed in the larger context of business necessity or expediency. If the outgoing or expenditure is so related to the carrying on or conduct of the business, that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure."

We will now briefly deal with the relevant decisions of the High Courts. The first case referred is *In re Tata Iron and Steel Co. Ltd.* In that case, the Tata Iron and Steel Co. Ltd. had incurred an expenditure of Rs. 28 lakhs as underwriting commission paid to underwriters on an issue of Rs. 7 lakhs preference shares of Rs. 100 each and the company claimed to deduct this amount as expenses under section 9(2)(ix) of the Indian Income-tax Act, 1918 (VII of 1918). Macleod C.J. observed :

"If then it is admitted that the cost of raising the original capital cannot be deducted from profit after the first year, it is difficult to see how the cost of raising additional capital can be treated in a different way. Expenses incurred in raising capital are expenses of exactly the same character whether the capital is raised at the flotation of the company or thereafter : *Texas Land and Mortgage Company v. William Holtham.*"

He further observed that " as long as the law allows preliminary expenses and goodwill to be treated as assets, although of an intangible nature, the money so spent is in the nature of capital expenditure just as much as money spent in the purchase of land and machinery". The Chief Justice accordingly held that Rs. 28 lakhs could not be treated as expenditure (not in the nature of capital expenditure) solely incurred for the purpose of earning the profits of the company's business. Shah J. also came to same conclusion, and he thought that the ratio decidendi in Texas Land and Mortgage Co. v. William Holtham and the principles underlying the decision in Royal Insurance Co. v. Watson lent support to this conclusion.

At this stage it would be convenient to consider the case of Texas Land and Mortgage Co. v. William Holtham relied on in this decision. We have already mentioned that the statute law in England is different from the law in India and the observations of the learned judges in the English cases must be appreciated in the light of the background of the English Income Tax Act. In this case a mortgage company had raised money by the issue of debentures and debenture stock and incurred expenses for the issue of mortgage and raising of such debentures and debenture stock. The company claimed to deduct these expenses but the High Court held that the expenses could not be deducted under Schedule D of the English Income Tax Act as trading expenses. Mathew J. gave the following reasons for disallowing the claim :

"The amount paid in order to raise the money on debentures, comes off the amount advanced upon the debentures, and, therefore, is so much paid for the cost of getting it, but there cannot be one law for a company having sufficient money to carry on all its operations and another which is content to pay for the accommodation. This appears to me to be entirely concluded by the decision of yesterday (Anglo-Continental Guano Works v. Bell)."

In the course of arguments, Cave J. had remarked :

"It is only so much capital. A man wants to raise pounds 1,00,000 of capital, and in order to do that he has to pay pounds 4,000. That makes the capital pounds 96,000. That is all."

In reply to the argument of Finally Q.C. that "the capital of the company, properly so-called, is the share capital", Cave J. remarked :

"To the extent that you borrow you increase the capital of the company."

In our opinion, if one keeps in mind the background of the English Income Tax Act, the observations reproduced above have no relevance to cases arising under the Indian Income-tax Act. In the face of rule 3, Case I, section 100 (5 and 6 Vict., Ch. 35) prohibiting the deduction of any expenditure in respect of any sum employed or intended to be employed as capital, Mathew and Cave JJ. were only concerned with the question whether the amount secured by debentures and the amount obtained by the issue of debentures and debenture stock could be called capital employed or intended to be employed within the meaning of this rule. Rightly or wrongly, the English courts have held that the amount obtained by the issue of debentures is capital employed within the meaning of the rule, but this does not give us any guidance in interpreting the words "capital expenditure" occurring in section 10(2)(xv) of the Act. In our opinion, the Bombay High Court was wrong in relying on Texas Land and Mortgage Company v. William Holtham

In *Nagpur Electric Light and Power Co. v. Commissioner of Income-tax* the Court of Judicial Commissioner, Nagpur, held that expenses for raising debenture loan required for changing the system of supplying current from D.C. to A.C. and for discharging a prior loan was not allowable as deduction of the company's assessable income. The Judicial Commissioner followed the case of *Texas Land Mortgage Co. v. William Holtham* and *In re Tata Iron and Steel Company Ltd.* After referring to these two cases, the only additional reason given was that "apart from authority, it seems to us to stand to reason that money expended in obtaining capital must be treated as capital expenditure". With great respect we must hold that this case was wrongly decided.

The Kerala High Court in *Western Indian Plywood Ltd. v. Commissioner of Income-tax* held that the expenditure incurred by the company to raise a loan by debenture was a capital expenditure and was therefore not deductible under section 10(2)(xv). The High Court, relying on *European Investment Trust Co. v. Jackson* and *Ascot Gas Water Heater v. Duff* and some other cases, drew a distinction between the borrowing of capital and securing merely temporary or day-to-day accommodation or banking or trading facilities. According to the High Court, the expenses for borrowing capital could not be treated as revenue expenditure. This distinction may be valid in English law but we are unable to appreciate how the distinction is valid under the Indian Income-tax Act. As the decision is mainly based on this distinction and relies, inter alia, on *In re Tata Iron and Steel Co. Ltd.* and *Nagpur Electric Light and Power Co. v. Commissioner of Income-tax*, we must, with respect, hold that the case was wrongly decided.

In *Vizagapatnam Sugars and Refinery Ltd. v. Commissioner of Income-tax* the Andhra Pradesh High Court relying on *Texas Land and Mortgage Co. v. William Holtham* and the decision in *Western Indian Plywood Ltd. v. Commissioner of Income-tax* held that, on the facts and circumstances of that case, brokerage and commission of four annas on every maund of sugar paid by the assessee-company was not revenue expenditure but capital expenditure. In our opinion, the decision, as far as the brokerage was concerned, was wrong, but we do not say anything in this case with respect to the decision as far as the commission on sale of goods was concerned.

The Calcutta High Court examined the question in great detail in *Sri Annapurna Cotton Mills Ltd. v. Commissioner of Income-tax*. Bachawat J. held that the loan of Rs. 10 lakhs obtained by the company was an asset or advantage for the enduring benefit of the business of the assessee. He placed reliance on a number of cases, some of which we have already considered. But we are unable to agree that a loan obtained can be treated as an asset or advantage for the enduring benefit of the business of the assessee. A loan is a liability and has to be repaid and, in our opinion, it is erroneous to consider a liability as an asset or an advantage within the test laid down by Viscount Cave and approved and applied by this court in many cases. Sinha J., after referring to a number of cases, felt that the raising of capital by issue of debentures was a recognised mode of raising capital and he felt that the decided cases had laid down the proposition that borrowing money by the issue of debentures was an acquisition of ca

In *S.F. Engineer v. Commissioner of Income-tax*, the Bombay High Court held that the expenditure incurred for raising loan for the carrying on of a business cannot in all cases be regarded as an expenditure of a capital nature. On the facts of the case, they held that as construction and sale of the building was the sole business of the firm and the building was its stock-in-trade, and the loan was raised and used wholly for the purpose of acquiring this stock-in-trade and not for obtaining any fixed assets or raising any initial capital or for expansion of the assessee's business, the expenditure incurred for the raising of loan was not an expenditure of capital nature but revenue expenditure. Although the conclusion of the High Court was correct, we are not able to agree with the principle

that the nature of the expenditure incurred in raising a loan would depend upon the nature and purpose of the loan. A loan may be intended to be used for the purchase of raw material when it is negotiated, but the company

To summarise this part of the case, we are of the opinion that : (a) the loan obtained is not an asset or advantage of an enduring nature; (b) that the expenditure was made for securing the use of money for a certain period; and (c) that it is irrelevant to consider the object with which the loan was obtained. Consequently, in the circumstances of the case, the expenditure was revenue expenditure within section 10(2)(xv).

The last contention of Mr. Desai is that even if it is revenue expenditure, it was not laid out wholly and exclusively for the purpose of business. Subba Rao J. reviewed the case law in Commissioner of Income-tax v. Malayalam Plantations and observed as follows :

"The expression 'for the purpose of the business' is wider in scope than the expression 'for the purpose of earning profits'. Its range is wide : it may take in not only the day-to-day running of a business but also the rationalisation of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for carrying on of a business : it may comprehend many other acts incidental to the carrying on of business."

Mr. Desai says that the act of borrowing money in this case was not incidental to the carrying on of a business. We are unable to accept this contention. In Eastern Investments Ltd. v. Commissioner of Income-tax this court held that the Eastern Investments Ltd., an investment company, when it borrowed money on debentures, the interest paid by it was incurred solely for the purpose of making or earning such income, profits or gains within the purview of section 12(2) of the Indian Income-tax Act. It held on a review of the facts that the transaction was voluntarily entered into in order indirectly to facilitate the running of the business of the company and was made on the ground of commercial expediency.. This case, in our opinion, directly covers the present case, although Mr. Desai suggests that the case of an investment company stands on a different footing from the case of a manufacturing company. In some respects, their position may be different but in determining the question whether raising money is i

The case of Dharamvir Dhir V. Commissioner of Income-tax also supports the conclusion we have arrived at on this part of the case. It was held in that case that the payment of interest and a sum equivalent to 11/16th of the profits of the business of the assessee in pursuance of an agreement for obtaining loan from the lender were in a commercial sense expenditure wholly and exclusively laid out for the purpose of the assessee's business and they were, therefore, deductible revenue expenditure.

Before we conclude, we must deal with the point raised by Mr. Sastri that the High Court erred in law in preferring the findings of the Income-tax Officer to that of the Appellate Tribunal. It is not necessary to decide this question but it seems to us that, in a reference, the High Court must accept the findings of fact made by the Appellate Tribunal and it is for the person who has applied for a reference to challenge those findings first by an application under section 66(1). If he has failed to file an application under section 66(1) expressly raising the question about the validity of the

findings of fact, he is not entitled to urge before the High Court that the findings are vitiated for one reason or the other.

To conclude, we hold that the expenditure of Rs. 84,633 was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business. The answer to the question referred, therefore, must be in the affirmative. the appeal is allowed, the judgment of the High Court set aside and the question referred answered in the affirmative. The appellant will have its costs incurred here and in the High Court.

Appeal allowed.

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