

Madras Industrial Investment Corporation Ltd.

Vs

Commissioner of Income-Tax.

Civil Appeal No. 3531 of 1982

(S. C. Agarwal, Sujata V. Manohar JJ)

04.04.1997

JUDGMENT

MRS. SUJATA V. MANOHAR J. –

The appellant is a public limited company. The present appeal filed by it pertains to the accounting year ending June 30, 1967, relevant to the assessment year 1968-69.

On December 10, 1966, a public issue of the debentures of the appellant-company was made. The total value of the debentures was Rs. 1.5 crores repayable with interest at the rate of 5.3/4 per cent. per annum. The debentures were issued at a discount of two per cent., redeemable after 12 years. The issue price of a debenture of Rs. 100 was Rs. 98. The total discount on the issue of Rs. 1.5 crores amounted to Rs. 3 lakhs. For the assessment year 1968-69, the appellant-company wrote off Rs. 12,500 out of the total discount of Rs. 3 lakhs being the proportionate amount of discount for the period of six months ending with June 30, 1967, taking into account the period of 12 years which was the period of redemption and dividing the discount of Rs. 3 lakhs over the period of 12 years.

Earlier the appellant had issued debentures at a discount of one per cent. redeemable after 10 years. The discount relating to these debentures was being written off periodically. For the assessment year 1968-69, the appellant-company wrote off a discount of Rs. 10,000. Thus, in the balance-sheet as of June 30, 1967, on the liabilities side the debentures issued during the relevant accounting year were shown at the figure of Rs. 1.50 crores. On the assets side, the discount account of these debentures was as follows :

"Discount allowed on issue of bonds (to the extent not written off)

Rs. Up to last balance-sheet 22,500 Additions during the year 3,00,000 3,22,500 Less
: Amount written off 22,500 ----- 3,00,000 -----##

The discount of Rs. 22,500 represented Rs. 12,500 written off out of the discount of Rs. 3,00,000 and Rs. 10,000 written off as discount on the previous issue.

The Income-tax Officer by his assessment order dated January 31, 1969, disallowed the claim of the appellant for deduction of Rs. 22,500 on the ground that discount on bonds and debentures was not allowable as an expenditure. On appeal, the Appellate Assistant Commissioner, by his order dated July 4, 1969, held that the discount allowed at the time of the issue of debentures was to be treated as a part of the expenditure for such issue. He upheld the claim for deduction of Rs. 12,500 but

rejected the claim as regards Rs. 10,000 on the ground that it related to discount on debentures issued in an earlier year and hence it did not pertain to the relevant previous year.

The assessee then preferred an appeal before the Appellate Tribunal. The assessee contended, inter alia, that (1) the Appellate Assistant Commissioner had erred in sustaining the disallowance of Rs. 10,000 on the ground that it related to an earlier year, and (2) the Appellate Assistant Commissioner having held that discount allowed at the time of issue of debentures was to be treated as part of the expenditure incurred for such issue, should have further allowed a sum of Rs. 2,87,500 being the balance amount of the total discount of Rs. 3,00,000 relating to the issue of debentures of Rs. 1.5 crores. Before the Tribunal, the Department contended that the appellant-company had, for the first time, made a new claim before the Tribunal for deduction of Rs. 2,87,500 and the Tribunal had no jurisdiction to examine this claim. This objection was rejected by the Tribunal. The Tribunal held that the expenditure of Rs. 3,00,000 was incurred during the relevant previous year although it was proportionately written off

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in permitting the assessee to raise the contention that the entire amount of Rs. 3,00,000 being the discount relating to the issue of debentures for Rs. 1.5 crores during the relevant previous year was to be allowed as a permissible deduction ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee had incurred an expenditure of Rs. 3,00,000 during the relevant previous year by way of discount paid to the persons who had subscribed to the debentures issued by it for Rs. 1.5 crores during the relevant previous year and the same was allowable as a revenue expenditure ?"

The Madras High Court by its judgment and order dated November 5, 1979 (CIT v. Madras Industrial Investment Corporation Ltd. [1980] 124 ITR 454) answered the first question in favour of the appellant-assessee. The High Court reframed the second question as follows (at page 470) :

"Whether there was any expenditure in the sum of Rs. 2,87,500 and whether it was revenue expenditure ?"

It held that the discount of Rs. 3,00,000 did not represent any payment made to any one so as to constitute expenditure. It held that no expenditure was laid out or incurred by the assessee/appellant-company which could be allowed as a deduction. It noted that out of the total discount of Rs. 3,00,000, a discount of Rs. 12,500 had been allowed by the Tribunal which the Department had not challenged. Hence, the High Court was concerned only with the balance amount of Rs. 2,87,500 which the High Court held could not be considered as expenditure. Therefore, the second part of the question whether it was revenue expenditure or not, did not require consideration.

The present appeal is filed by the appellant-company against the second question as reframed by the Madras High Court and answered as above. We have first to consider whether the discount of Rs. 3,00,000 on debentures which were issued by the appellant-company is expenditure incurred by the appellant-company for the purposes of its business. The appellant-company actually received Rs. 1.47 crores as against which it incurred a liability to return a sum of Rs. 1.50 crores with interest at the end of 12 years (the date of redemption). This liability which the assessee incurred, to pay the amount of Rs. 3,00,000 in addition to what it actually received, is being written off over the period of 12 years. Can it be treated as expenditure ? In the case of Indian Molasses Co. (Private) Ltd. v.

CIT [1959] 37 ITR 66 this court considered the meaning of "expenditure" under section 10(2)(xv) of the Indian Income-tax Act, 1922. The High Court was concerned with the sums which were transferred by the company to the trustee

Thus, "expenditure" is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date. However, a contingent liability which may have to be discharged in future cannot be considered as expenditure.

In the case of CIT v. Chandulal Keshavlal and Co. [1960] 38 ITR 601 (SC), the assessee-firm was the managing agent of a company. In accordance with the managing agency agreement the commission for the relevant accounting year was a sum of Rs. 3,09,114. But at the request of the managed company the assessee agreed to accept a sum of rupees one lakh only as its commission. The Appellate Tribunal found (i) that the financial position of the managed company was rather unsatisfactory, (ii) that the assessee had been remitting a part or the whole of its commission in the past whenever the profits of the managed company were unsatisfactory, (iii) that the waiver was neither a bounty nor mala fide, and (iv) that the business of the assessee was so linked up with the managed company that if the latter was put on a sounder position the assessee would get a larger commission in the future. It held that the part of the commission remitted by the assessee was given up for reasons of commercial expediency and was business

In the case of CIT v. Indian Jute Mills Association [1982] 134 ITR 68 (Cal), Sabyasachi Mukharji J., as he then was, of the Calcutta High Court, considered the meaning of the expression "expenditure" and said that the expression must be understood in the context in which it is used. The Legislature has used the expression "allowances and depreciation" in several sections in the scheme in Chapter IV of the Income-tax Act, 1961. Section 37 of the Income-tax Act, 1961, enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purpose of the business or profession should be allowed in computing the income chargeable under the head "Profits and gains of business or profession". In sections 30 to 36, the expressions "expenses incurred" as well as "allowances and depreciation" have been used. Therefore, the Legislature was using the expression "any expenditure" in section 37 to cover both. He interpreted section 44A and the te

Therefore, although expenditure primarily denotes the idea of spending or paying out, it may, in given circumstances, also cover an amount of loss which has not gone out of the assessee's pocket but which is all the same, an amount which the assessee has had to give up. It also covers a liability which the assessee has incurred in praesenti although it is payable in futuro. A contingent liability that may arise in future is, however, not "expenditure". It would also cover not just a one-time payment but a liability spread out over a number of years.

The question whether a discount on bonds should be treated as "expenditure", directly arose before the Madhya Pradesh High Court in the case of M.P. Financial Corporation v. CIT [1987] 165 ITR 765. The Madhya Pradesh High Court was required to deal with a case where the State Financial Corporation had issued bonds at a discount. The court held that the expression "expenditure" as used in section 37 of the Income-tax Act, 1961, may, in the circumstances of a particular case, cover an amount which is really a loss and the said amount has not gone out from the pockets of the assessee. In the case of issue of bonds at a discount, it said that the same principles as are applicable in the case of issue of debentures at a discount, would be attracted. The amount of discount, in effect, represents deferred interest and an assessee would not be justified in claiming deduction of the

entire amount of discount in the accounting year in question. But it would be entitled to proportionate deduction spread over the period (at page 240 which is as follows (at page 769) :

"The discount on the issue is, in effect, deferred interest, and should accordingly be written off over the period having the use of the money raised by the debentures, unless a sinking fund is created to accumulate the full redemption price, including the discount."

It has also relied upon a paragraph in Batliboi's "Principles and Practice of Auditing" which is as follows (at page 769) :

"When debentures are issued at discount, an account styled 'Discount on Debentures Account', will be debited with the discount allowed on the issue. The debentures account will be credited in the books at their nominal value and will appear at that value as a liability in the balance-sheet. The loss thus arising need not be completely written off in the year in which the debentures are issued, since the benefit to be derived from the amount borrowed will continue till the debentures are redeemed. Where the debentures are redeemable at the end of a fixed period, a proportionate amount of discount should be written off out of revenue every year during which the debentures are outstanding."

The Madhya Pradesh High Court also referred to the judgment of the Madras High Court which is under challenge before us and differed from it, preferring the decision of the Calcutta High Court in the case of CIT v. Indian Jute Mills Association [1982] 134 ITR 68. The Madhya Pradesh High Court held that the assessee would not be justified in claiming deduction of the entire amount of discount in the accounting year in question but it would nevertheless be entitled to proportionate deduction spread over the period for which the bonds would remain outstanding.

Therefore, when a company issues debentures at a discount, it incurs a liability to pay a larger amount than what it has borrowed, at a future date. We need not go into the question whether this additional liability equivalent to the discount, which is incurred in praesenti but is payable in future, represents deferred interest or not. That may depend upon the totality of circumstances relating to the issue of debentures, including its terms. The liability, however, to pay the discounted amount over and above the amount received for the debentures, is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. The amounts so obtained by issue of debentures are used by the company for the purposes of its business. This would, therefore, be expenditure.

Section 37(1) further requires that the expenditure should not be of a capital nature. In the case of India Cements Ltd. v. CIT [1966] 60 ITR 52 (SC) the appellant-company had obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection with this loan it spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fees, etc., and claimed this amount as business expenditure. This court considered whether the expenditure so incurred was business expenditure or whether it was capital expenditure. This court quoted with approval the observations of Shah J. in Bombay Steam Navigation Co. (1953) P. Ltd. v. CIT [1965] 56 ITR 52, 59) that 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 exp

Our attention was drawn to the case of Lomax (Inspector of Taxes) v. Peter Dixon and Son Ltd., a decision of the English Court of Appeal reported in [1944] 12 ITR (Suppl) 1, where the English Court had treated discount or premium in the hands of the recipient as a receipt of a capital nature. But the character of payment in relation to the payer can be different from the character of that payment in the hands of the recipient. In the light of the ratio laid down by this court in the case of India Cements Ltd. [1966] 60 ITR 52, any liability incurred for the purpose of obtaining the loan would be revenue expenditure.

The Tribunal, however, held that since the entire liability to pay the discount had been incurred in the accounting year in question, the assessee was entitled to deduct the entire amount of Rs. 3,00,000 in that accounting year. This conclusion does not appear to be justified looking to the nature of the liability. It is true that the liability has been incurred in the accounting year. But the liability is a continuing liability which stretches over a period of 12 years. It is, therefore, a liability spread over a period of 12 years. Ordinarily, revenue expenditure which is incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. It cannot be spread over a number of years even if the assessee has written it off in his books over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. In fact, allowing the entire expenditure in o

Issuing debentures at a discount is another such instance where, although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over a number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures.

The appellant, therefore, had, in its return, correctly claimed a deduction only in respect of the proportionate part of discount of Rs. 12,500 over the relevant accounting period in question. In this connection, we agree with the reasoning and conclusion of the Madhya Pradesh High Court in the case of M.P. Financial Corporation v. CIT [1987] 165 ITR 765. The view that we have taken is also in conformity with the accounting practice of showing the discount in the "discount on debentures account" which is written off over the period of the debentures.

The appellant is, therefore, entitled to deduct a sum of Rs. 12,500 out of the discount of Rs. 3,00,000 in the relevant assessment year. The balance expenditure of Rs. 2,87,500 cannot be deducted in the assessment year in question. Question No. 2 (as reframed), therefore, which is the subject-matter of appeal before us, is answered in the negative in so far as it relates to the deduction of Rs. 2,87,500 in the assessment year in question though for reasons entirely different from those given by the High Court. The second part of the reframed question is answered in the affirmative. But only a proportionate part of the discount can be deducted in the assessment year in question as set out earlier. The appeal is disposed of accordingly and the judgment of the High Court is set aside. There will be no order as to costs in the circumstances of the case.