

ANDHRA PRADESH HIGH COURT

Vazir Sultan Tobacco Co. Ltd

Vs

Commissioner off Income-Tax

(B Jeevan Reddy, CJ. M.J Rao, J.)

15.04.1988

JUDGMENT

B. Jeevan Reddy, J.

1. Two questions are referred under section 256 (1) of the Income-tax Act, 1961, by the Income-tax Appellate Tribunal, Hyderabad. They are :

"(1) Whether, on the facts and in the circumstances of the case, the assessee is entitled to deduction in the computation of total income of the expenditure of Rs. 20,82,994 incurred for raising additional capital by issue of ordinary shares ?

(2) Whether, on the facts and in the circumstances of the case, the assessee is entitled to deduction of surtax payable under the Companies (Profits) Surtax Act, 1964, as business expenditure under section 37 of the Income-tax Act or alternatively as expenditure incidental to the carrying on of the business deductible under section 28 of the Income-tax Act while computing the income under the head "Business" ?"

2. So far as question No. (2) is concerned, it is conceded by learned counsel for the assessee that this question has to be answered in the negative, i.e., against the assessee and in favour of the Revenue, in the light of the decision of this court in Vazir Sultan Tobacco Co. Ltd. v. CIT , pertaining to this very assessee for a previous assessment year.

We shall, therefore, state the facts only in so far as they are relevant to the first question.

3. In the accounting year relevant to the assessment year 1976-77 concerned herein, the assessee, Vazir Sultan Tobacco Co. Ltd., raised additional capital by issuing ordinary shares. On this account, it claimed deduction in a total sum of Rs. 20,82,994 on account of underwriting commission charges brokerage, printing charges for prospectus, application forms, etc., servicing charges paid to various banks and other miscellaneous expenses. The assessee claimed this as revenue expenditure deductible under section 37 of the Income-tax Act, which was rejected by the Income-tax Officer. Both the appellate authorities have confirmed the Income-tax Officer's order.

4. The expenditure of Rs. 20,82,994 was incurred by the assessee in connection with, and as incidental to, the raising of additional capital. It would, therefore, be an expenditure laid out on

capital account. This is so held in one of the earliest decisions of the Bombay High Court, In re : Tata Iron and Steel Co. Ltd., AIR 1921 Bom 391, which has been approved by the Supreme Court in India Cements Ltd. v. CIT . In the Bombay decision, it was held that money paid to the underwriter on the issue of certain preference shares by the company was not "revenue expenditure" and is in the nature of "capital expenditure". All these decisions are referred to and discussed in a recent decision of the Calcutta High Court in Brooke Bond India Ltd. v. CIT . It is relevant to mention that this decision was rendered subsequent to the decision of the Supreme Court in Empire Jute Co. Ltd. v. CIT , and it deals with, and discusses, the principle enunciated in the said decision. We are saying this because the mainstay of the assessee's case is the said decision of the Supreme Court. It is held by the Calcutta High Court that where the object of incurring an expenditure is to affect the capital structure as a result of which certain incidental advantage flows, the expenditure will be of capital nature. It is not the acquisition of a right of a permanent character alone, the creation of which is a condition for the carrying on of the business, that could be rightly treated as an expenditure on capital account. It was observed that capital expenditure can be incurred after a company is floated or it started business, if it resulted in bringing about a capital advantage. It was further observed that by acquiring capital, the assessee is increasing the earning of his income or profits and that is the physical test. Since the object and purpose of the expenditure was to strengthen the capital structure of the company and, as an incidental result, more funds flowed to the assessee-company, thus making more working funds available to the assessee, it was held that the expenditure cannot be held to be on revenue account. This was also a case where the assessee, Brooke Bond India Ltd., issued 16,75,000 ordinary shares of RS. 10 each at a premium and on that account incurred an expenditure of Rs. 13,99,305, which it claimed as a deductible expenditure. The claim was rejected by all the authorities including the High Court. We are in respectful agreement with the said decision of the Calcutta High Court, the facts of which case are practically identical with the facts of our case. We may point out that the Gujarat High Court also has taken the same view in Shree Digvijay Cement Co. Ltd. v. CIT . It was held that the expenditure incurred by a company in raising new shares is expenditure of a capital nature. It was observed that the shares issued by a company constitute its capital that these shares are an integral part of the permanent structure of the company and are not in any way connected with its working capital.

5. Mr. Y. Ratnakar, learned counsel for the assessee, however, contended that the said expenditure must be held to be deductible under section 37 of the Act, and for that purpose relied upon certain decisions with which we shall presently deal. He referred us in the first instance to Schedule VI to the Companies Act, 1956, which prescribes the form of balance-sheet which a company is obliged to prepare at the end of each financial year by section 211 of that Act. Learned counsel submitted that in this form, the share capital is shown in the column of "liabilities" and not in the column of "assets". He submitted that an expenditure incurred in connection with the liabilities of a company cannot be treated on its capital account and must be allowed as a revenue expenditure. We are unable to see the relevance of the form prescribed by Schedule VI to the Companies Act to the question at issue. The simple question before us is whether the expenditure incurred by the assessee in connection with raising the additional capital is "capital expenditure" or "revenue expenditure". At no time was it held that raising capital adds to the liabilities of the company and, therefore, the expenditure incidental thereto should be allowed as revenue expenditure. Having said this, we may pass on to consider the several decisions cited by learned counsel for the assessee in support of his contention.

6. In CIT v. Kisenchand Chellaram (India) Pvt. Ltd. , the Madras High Court allowed as revenue

expenditure the fees paid by the assessee to the Registrar of Companies for obtaining permission to raise the capital of the company. While we agree with the conclusion arrived at on this aspect in the said decision - which is, indeed, the decision of this court also in Warner Hindustan Ltd. v. CIT , to which one of us (Jeevan Reddy J.) was a party - we are unable to appreciate the reasoning on which the Madras High Court held it to be revenue expenditure. The reasoning of the Madras High Court is that since without capital a company cannot carry on its business, the expenses incurred for increasing the capital are bound up with the functioning and financing of the business. In our opinion, the proposition is stated too widely. In Warner Hindustan Ltd. v. CIT , a Bench of this court also allowed a similar expenditure, but that was on the reasoning that the said expenditure by itself does not amount to an increase in the capital base of the company, and that it is an expenditure laid out merely for obtaining permission for raising the authorised capital. It was held that it is not obligatory for a company obtaining such permission to raise the authorised capital necessarily. It may or may not raise it. It is on the said reasoning that this court held that the fees paid to the Registrar of Companies for obtaining permission for raising the authorised capital cannot be treated as capital expenditure. The said decision of this court was influenced by the decision of the Supreme Court in Empire Jute Co.

7. Ltd. v. CIT . The ratio of this decision cannot be extended, in our opinion, to expenses incurred directly for the purpose of, and in connection with, raising additional capital.

8. The next decision relied upon by Mr. Ratnakar is India Cements Ltd. v. CIT . In this case, the assessee obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation, securing it by a charge on its fixed assets. In that connection, it spent a sum of Rs. 84,633 towards stamp duty, registration fee, lawyer's fee, etc., which it claimed as business expenditure. This was allowed by the Supreme Court holding that the act of borrowing money was incidental to the carrying on of the business and that the loan was not an asset or an advantage of enduring nature. It was observed that the expenditure was incurred for securing the use of money for a certain period, and that a loan obtained cannot be treated as an asset or an advantage for the enduring benefit of the business of the assessee, and hence the expenditure incurred in connection therewith cannot be treated as "capital expenditure". We are unable to see the relevance of this principle to the facts of the case before us. That was a case of raising a loan and not of raising additional capital. While raising a loan does not add to the capital base, raising of capital does.

9. Strong reliance was placed by learned counsel for the assessee on another decision of the Supreme Court in Bombay Steam Navigation Co. (1953) P. Ltd. v. CIT [1965] 56 ITR 52 (SC). Pursuant to a scheme of amalgamation between two shipping companies, the assessee-company was incorporated on August 10, 1953, to take over certain passenger and ferry services carried on by one of the former. On August 12, 1953, the assessee-company took over assets valued at Rs. 81,55,000 and agreed to pay the price partly by allotment of 29,990 fully paid-up shares of Rs. 100 each and the balance was to be treated as a loan secured by a promissory note and hypothecation of all movable properties of the assessee-company. The balance remaining unpaid from time to time was to carry interest at 6% simple. The assessee claimed the interest so paid as deductible expenditure under section 10(2)(iii) or (xv) of the Indian Income-tax Act, 1922. The Supreme Court held it to be business expenditure and allowable as such under section 10(2)(XV) on the reasoning that the expenditure made under a transaction which is so closely related to the business that it could be viewed as an integral part of the conduct of the business, may be regarded as revenue expenditure laid out wholly and exclusively for the purpose of the business.

This decision has to be understood in the particular facts of that case, where it was explained by Shah J., speaking for himself and Sikri J., that in considering the question whether an expenditure is revenue expenditure, the court has to consider the nature and the ordinary course of business and the objects for which the expenditure is incurred. According to the learned judges, the question must be viewed in the larger context of business necessity or expediency and 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 to the carrying on of the business, as was found in that case, the expenditure may be regarded as revenue expenditure. In our opinion, the principle of the said decision has no application to a straight case like the one before us, where the expenditure is directly incurred for raising additional capital for the company.

10. Strong reliance is then placed upon the decision of this court in Warner Hindustan Ltd. v. CIT . Two questions were decided in that case. One related to the fees paid to the Registrar for obtaining permission for raising the authorised capital, which was held to be revenue expenditure. This aspect has already been dealt with by us hereinbefore. The other question decided related to the deductibility of legal and consultation fees paid in connection with the issue of bonus shares. Before issuing bonus shares, it was explained in that case, the assessee had to obtain legal and technical advice and some small expenditure was incurred in that behalf. The legal and technical opinion pertained to the question whether bonus shares should be issued or not. In that sense, the expenditure was unconnected with the bonus shares actually issued. They could as well not have been issued after obtaining the said opinion. In this case, it is not the fee paid to lawyers as in that case, but it is brokerage and other commission paid in connection with the actual issue of additional shares. We are, therefore, unable to see the relevance of the principle of the said decision in the facts of this case.

11. We may now deal with the decision of the Supreme Court in Empire Jute Co. Ltd. v. CIT . Learned counsel for the assessee suggested that this decision marks a departure, an improvement, upon the law hitherto obtaining. He submitted that unless the capital base or capital structure is improved, no expenditure can be held to be on capital account. We do not think that any such absolute proposition is laid down in this case. It would be appropriate to notice the facts of the case first. Because of the slackness in the demand for jute products in the world market and the excess available production capacity of the jute mills in India, their association evolved a "working time agreement", where under each mill was allotted a certain number of working hours. It was transferable. The assessee purchased these loom hours from other mills and thus worked for more number of hours than were actually allotted to it. The amount paid for purchasing the loom hours was claimed as business expenditure, which was disallowed by all the authorities as well as by the Calcutta High Court . The Supreme Court, however, held it to be revenue expenditure on the reasoning that the working time agreement constituted merely a contractual restriction on the mill's right to work to full capacity, and that the purchase of loom hours had the effect of removing that restriction so as to enable the mill to work for more hours than allotted and thus to earn more profits. The expenditure incurred for earning more profits was revenue in nature. By the purchase, no new asset was created and there was no addition to the profit-making apparatus. Nor was a new source of profit or income acquired. The expenditure, it was held, was part of the cost of operating the profit-earning apparatus and hence revenue in nature. Having so held, the court made certain observations to the effect that even expenditure

laid out for acquiring an advantage of enduring nature does not necessarily belong to the capital field, and that in judging the said question, one must look at the advantage in a commercial sense. Unless the advantage was in the capital field, and was only meant to facilitate the assessee's trading operations more profitably or efficiently, it was observed, it cannot be disallowed. The main thrust of the reasoning was to emphasise that the test of enduring benefit is neither an invariable nor a mechanical test. Applying the principles enunciated in this decision too, it must be held that the expenditure concerned herein is capital in nature, since it was laid out for adding to the capital structure of the assessee, besides acquiring an asset of enduring nature.

12. The decision of the Supreme Court in *State of Madras v. Coelho (G.J.)*, turned upon the particular language employed in clause (e) of section 5 of the Madras Plantations Agricultural Income-tax Act, 1955. According to the said clause, expenditure "laid out or expended wholly and exclusively for the purpose of plantation" was deductible and, therefore, it was held that the interest paid on moneys borrowed for the purpose of purchasing the plantations should be deducted thereunder.

13. The last decision cited is in *CIT v. Madras Auto Service Ltd.*, a decision of the Madras High Court. In this case, the assessee-company had taken an old building located in an important locality, on lease. It entered into an agreement with the landlord to demolish the said old building and construct a new one in consideration of the landlord agreeing to a long lease at a very low rent. The company claimed the cost of the building as revenue expenditure which was allowed. It was observed that the said agreement was entered into by the assessee because of the obvious saving in rent charges and because of the advantage it would get by locating its office in the new building. There can hardly be any controversy about the proposition in this case, but it has no analogy to the case before us.

14. For the above reasons, we answer the first question in the negative, i. e., in favour of the Revenue and against the assessee.

15. Mr. Y. Ratnakar then argued that a sum of Rs. 1,19,119 paid towards interest on term-deposit and on allotment of shares should, in any event, abate and should be allowed as a permissible deduction. We, however, find that this aspect was not argued before the Tribunal, nor has it been dealt with by it in its order. It cannot, therefore, be said that the said question arises from the order of the Tribunal. The Tribunal may look into this aspect while passing orders under section 260 of the Act, and if it finds that this amount is entitled to be allowed as a deduction, it may do so.

16. Reference ordered accordingly. In the circumstances of the case, there shall be no order as to costs.

17. Mr. Y. Ratnakar, learned counsel for the assessee, makes an oral request for grant of a certificate under section 261 of the Act. We are informed that so far as the second question is concerned, which we have answered against the assessee and in favour of the Revenue relying on an earlier decision of this court, leave has already been granted against the said decision. Accordingly, a certificate shall issue so far as the second question is concerned in this case. So far as the first question is concerned, we do not think that in our opinion, it is a fit case for being certified under section 261. Accordingly, we decline to grant a certificate with respect to question

No. 1.