KERALA HIGH COURT

M.N. Ramaswamy Iyer

Vs

Commissioner of Income-Tax

(Isaac J.)

01.08.1968

JUDGMENT

Isaac J.

1. These two references have been made by the Madras Bench of the Income-tax Appellate Tribunal under section 66(2) of the Indian Income-tax Act, 1922, as directed by this court on the application made by the assessee. The assessee is a Hindu undivided family carrying on business of banking and conducting chits. The assessees accounting year ends on 31st December; and I.T.R. No. 19 of 1967 relates to the assessment year 1958-59, while the other case relates the year 1959-60. For the assessment year 1958-59, the assessee returned a net loss of Rs. 19,302 under business. In arriving at this figure, it made a deduction of Rs. 38,193 by way of interest paid to various parties on loans. This amount included a sum of Rs. 18,525 made up as follows :

Rs.
1. Palghat Financing Co. (P.) Ltd.
12,148
2. Palghat Investment Corporation Ltd.
1,890
3. Narasimha Bank, Alathur 4,487 For the assessment year 1959-60, the assessee returned a net loss of Rs. 1,890 under business. The deductions made by the assessee in arriving at the above amount consisted of sum Rs. 17,514. The represented interest paid on loans to the following parties :

Rs.
1. Palghat Financing Co. (P) Ltd.
10,080
2. Palghat Investment Corporation Ltd.
1,995
3. Narasimha Bank 3,090
4. M. N. Ramaswamy Iyer & Co. Ltd.
2,349 The amount paid as interest by the assessee to the aforesaid concerns in the two years of

assessment did not relate to amounts which it borrowed for its banking or chit business, but it represented amounts invested for acquiring shares in the said concerns. The assessee however, claimed to deduct the said amounts under clauses (iii) and (xv) of section 10(2) of the Act on the ground that the investment in shares was part of its business, and that, at any rate, the acquisition of shares in the said concerns was necessary for the purpose of furtherance of preservation of its own business. The claim was disallowed by the Income-tax Officer on the ground that these investments did not relate to his business, and that they did not yield any income. It filed appeals before the Appellate Assistant Commissioner, and urged the above claims not only under section 10(2) of the Act, but also under section 12. The Appellate Assistant Commissioner rejected the assessees claim under section 10(2) on the same ground as was stated by the Income-tax Officer. It also held that the claim was not admissible under section 12 of the Act, as the investments in shares was not a regular investment. The assessee filed appeals before the Income-tax Appellate Tribunal. The appeals were dismissed by a common order dated 26th February, 1964; and these references arose out of the said order. The question referred in I.T.R. No. 19 of 1967 are :

> "(1) Whether, on the facts and circumstances of the case, the assessee is not entitled to the deduction of the sum of Rs. 18, 525 in computation of his business income for the assessment year 1958-59 under section 10(2)(iii) or (xv) or under section 12 of the Indian Income-tax Act, 1922 ?
> (2) Whether, on the facts and circumstances of the case, the disallowance of the interest of Rs. 18,525 as not admissible under section 10(2)(iii) or (xv) or under section 12 of the Indian Income-tax Act, 1922, is valid in law ?"

The questions referred in I.T.R. No. 20 are exactly the same, except that Rs. 17,514 has to be substituted for Rs. 18,525. In substance, questions Nos. 1 and 2 are the same; and they can admit of only the same answer. Both the questions consist of two parts : and we shall first deal with the first part.The question whether the acquisition of shares by the assessee in the concerns referred to above was for the purpose of furtherance or preservation of its own business is one of fact. The Appellate Tribunal, after a detailed consideration of the facts and circumstances of the case, held that the said investments were unconnected with the assessees business. In the light of this finding, the learned counsel for the assessee did not rightly press the assessees claim for deduction on this ground. The assessee is not admittedly a dealer in shares; and purchase of shares is not obviously a part of its business. If any income arose to the assessee out of the investments on shares, it would not fall under the head "business", but only under the head "other sources". So the expenditure incurred by way of interest paid in respect of investments made for buying shares cannot be claimed as a business expenditure of the assessee. It must, therefore, follow that the first part of the questions referred to us in both these cases must be answered against the assessee. The next question for consideration is whether the claim can be allowed under section 12 of the Act. The reason for disallowing this claim is stated by the Appellate Tribunal in paragraph 25 of its order; and it reads as follows :

> "In our opinion, section 12 has also no application. The case relied on by the assessees learned counsel, Appa Rao v. Commissioner of Income-tax, proceeded on the finding that the expenditure by way of payment of interest was incurred solely for the purpose of making or earning such income from the shares acquired with the amount borrowed. The only point made out by the department was that there was no income. The facts in the assessees case are entirely different. The Appellate Assistant Commissioner stated that the

> shares had come out of borrowals but that was on an overall position of the capital account and profits and the amount of investments from year to year. There is no direct connection between the money borrowed and the purchase of shares. Even according to the assessee there is no correlation between the purchase of shares and the amounts standing to the credit of the accounts of Palghat Financing Company (Private) Ltd., etc."

We are not quite able to follow what the Appellate Tribunal has meant by saying that "there is no direct connection between the money borrowed and the purchase of shares", and that "there is no correlation between purchase of shares and the amounts standing to the credit of the accounts of Palghat Financing Company (Private) Ltd., etc." In paragraph 10 of the statement of the case in I.T.R. No. 19 of 1967, the Appellate Tribunal said.
"The Income-tax Officer disallowed the above sums for the reasons that the above were sister concerns of the assessee, that the amounts on which interest had been paid had been used in the purchase of shares, and that these amounts had not been used for the purpose of the business."The Appellate Assistant Commissioner has dealt with the character of the investment; and it concluded as follows :

> "From the history of the investment given above it will be seen that the share is not a business transaction nor is it a regular investment. It follows that the interest payment attributable to the borrowal utilised in the investment is not a permissible deduction either under section 10(2)(iii) or under section 10(2)(xv)."

Dealing with the assessees contention that the two amounts concerned in these cases would fall under clause (iii) or (xv) of section 10(2) of the Act, the Appellate Tribunal stated as follows in its order in the assessees appeals :

> "Now it is no doubt true that purchase of shares is a normal activity for a person carrying on banking business. But in the circumstances of the case, we are not satisfied that the purchase of shares in the Palghat Financing Company (Private) Ltd., Palghat Investment Corporation Ltd., M. N. Ramaswamy Iyer & Co. Ltd., were in the course of the normal banking business. Even according to the assessee the purchase of the shares was to prevent some scare. We may mention here that beyond making this claim, no material was placed before us to show that there was a real threat to any of the businesses.

The pattern of investment shows the preference to shares in which the assessees family was interested. Except a sole purchase of a share in Nedungadi Bank Ltd., the assessee had not made any investment in any other industrial shares, or shares in other companies. Normally a banker invests in shares with a view to supplant his income but in this case it cannot b said that the purchase of these shares had been made with any such purpose. In our opinion the investment of Rs. 6,69,243 in the year ending December 31, 1957, and Rs. 6,81,633 in the year ending December 31, 1958, was not for the purpose of business and, therefor, the interest paid on moneys corresponding to that amount cannot be allowed as a deduction". It is, therefore, not in dispute that the sums of Rs. 18,525 and Rs. 17,514 which the assessee claimed for the assessment years 1958-59 and 1959-60 respectively represented the interest attributable to the amounts invested on shares. This is the basis on which the claim of the assessee in respect of the said amounts has been dealt with by the Appellate Tribunal, and the subordinate authorities.
It is not disputed that, if the assessee earned any dividend on the shares held by the assessee, it

would be income under the head "other sources". Admittedly, during the two previous years concerned in these cases, the assessee did not receive any dividend; but it had incurred expenditure by way of interest paid on amounts borrowed for acquiring shares. The question for determination is whether the said expenditure is allowable under section 12(2) of the Act in computing the income of the assessee under "other sources". We shall now quote the relevant parts of section 12 :

> "12. Other sources. - (1) The tax shall be payable by an assessee under the head income from other sources in respect of income, profits and gains of every kind which may be included in his total income (if not included under any of the preceding heads).
> (1A) Income from other sources shall include dividends.....
> (2) Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains, and further in the case of any income by way of dividend, for any reasonable sum paid by way of commission or remuneration to a banker or any other person realising such dividend on behalf of the assessee, provided that no allowance shall be made on account of -
> (a) any personal expenses of the assessee, or
> (b) any interest chargeable under this Act which is payable without the taxable territories, not being interest on a loan issued for public sub-scription before the 1st day of April, 1938, or not being interest on which tax has been paid or from which tax has been deducted under section 18, or
> (c) any payment which is chargeable under the head salaries, if it is payable without the taxable territories and tax has not been paid thereon nor deducted therefrom under section 18."

The learned counsel for the assessee relied on a decision of the Madras High Court in P. V. Mohamed Ghouse v. Commissioner of Income-tax. In that case, the owner of a transport business borrowed money for purchasing shares in another transport company and claimed the interest, which he had paid on the money borrowed, as a deduction against his income from transport business under section 10(2)(iii) of the Act, and alternatively under section 12(2). The contention that it would fall under section 10(2)(iii) was rejected by the High Court; but it allowed the claim under section 12(2). Upholding the claim, their Lordships said :

> "It cannot be doubted that if the assessee had earned income by way of dividend from these shares, the interest payment of Rs. 7,500 would be a proper charge on that income. So much is conceded by Mr. Ranganathan, learned counsel for the department. But then, it is pointed out that the assessee did not earn any dividend income from these shares in the relevant year, and, in fact, he had no income to be assessed under the miscellaneous head of section 12. The submission on behalf of the revenue is that the absence of any income by way of dividend or other miscellaneous income under section 12 operates as a bar against the assessee to claim the interest payment as a revenue charge.

It is now a well accepted rule of income-tax law that what the statute allows as a proper allowance or expenditure, and which can be brought on the debit side of the assessees profit and loss account to off-set his credit receipts and to compute the income, profits and gains chargeable, cannot be defeated by the mere accident of the assessee not being in a position to show that the receipts exceed the expenses or that the credit side is larger in amount than the

debit side." This decision fully supports the claim of the assessee.
The learned counsel for the revenue advanced before us the same contention as was put forward by his counterpart before the Madras High Court in the above case, and submitted that the above decision did not lay down the correct law. He relied on the decision of the Calcutta High Court in Madanlal Sohanlal v. Commissioner of Income-tax in support of his contention. In that case, P. B. Mukharji J. said :

> "Whether a return of income under section 12 ultimately is reduced to nil or a loss is immaterial so long as there is some gross income or return, but where there is only an expenditure and no income whatever and no return whatever, than, I do not think it will be proper to apply the principle of deduction recognised in section 12(2) of the Act."

Bose J. took the same view by a concurring judgment. The question has been considered at some length by the learned judges in the above case; and it would be seen that they followed the decision of the Patna High Court in Maharajadhiraj Sir Kameshwar Singh v. Commissioner of Income-tax as against the view taken by the Bombay High Court in Ormerods (India) Private Ltd. v. Commissioner of Income-tax and the High Court of Allahabad in Chhail Behari Lal v. Commissioner of Income-tax. All these three decisions were considered by the Madras High Court in K. Appa Rao v. Commissioner of Income-tax; and that court adopted the view of the Bombay High Court, which dissented from the view of the Patna High Court. Now all these decisions including the Calcutta case relied on by the learned counsel for the revenue have been reviewed in the decision of the Madras High Court in P. V. Mohamed Ghouse v. Commissioner of Income-tax. All that could be said for and against the contention that an expenditure incurred solely for the purpose of making or earning an income under "other sources" is an allowable deduction under section 12(2) of the Act, even if there is no income under that head during the previous year, has been said and considered in the aforesaid decisions; and it is, therefore, unnecessary for us to re-state them. With respect, we may say that the view taken by the High Courts of Bombay, Allahabad and Madras appeals to us as the correct one.
Lord Thankerton, in his speech in the decision of the House of Lords in Hughes v. Bank of New Zealand, said :

> "Expenditure in the course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense."

In Eastern Investments Ltd. v. Commissioner of Income-tax, the Supreme Court was dealing with a claim under section 12(2) of the Act for deduction of interest paid by the assessee on debentures; and it said :

"It is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned."According to the decision of the Patna and the Calcutta High Courts, the question of allowance of the expenditure under section 12(2) of the Act does not arise, unless there is some income actually received under the head "other sources". It is this view that was pressed before us by the learned counsel for the revenue. He did not say that the position would be the same in respect of income under other heads. But he submitted that it was so in the case of income under "other sources"; and he relied on the following statement of P. B. Mukharji J. in Madanlal Sohanlal v. Commissioner of Income-tax :

> "The principles for deduction of expenditure are different in different sections under different heads of income. It is a wrong attempt to find or seek any universal principle of deduction for allowance for expenditure."

With respect, we agree with the above observation; but it does not lead to the conclusion that a claim under section 12(2) of the Act for deduction of expenditure would lie only when there is a receipt of income. If that were so, an assessee, who does not receive any income under the head "other sources", and incurs an expenditure of Rs. 10,000, would not be entitled to set off this amount, which happens to be a loss under that head, against his income under other heads as provided by section 24 of the Act whereas, if his income is Rs. 10 as against the same expenditure of Rs. 10,000, he would be entitled to set off the loss of Rs. 9,990 against his income under other heads. The learned counsel for the revenue submitted that what is stated above would be the correct position on a true construction of section 12 of the Act. This is a totally unreasonable and almost an assured position. The language employed in section 12 of the Act does not compel us to construe it in that manner. Viewed in the light of the right given to an assessee under section 24 of the Act to set off loss under one head against his income or profits under other heads, and the scheme adopted in the Act for computing the total income of an assessee, which is charged to tax, we feel no hesitation in holding that an assessees right for allowances under section 12(2) of the Act does not depend on the fact whether, in the particular year concerned, he received any income under the head "other sources". We, therefore, hold that the amounts paid by the assessee by way of interest on account of investments on shares are allowances admissible under section 12(2) of the Act. In the result, we answer the first part of the first question referred to this court in both the cases in the negative, and against the assessee. We answer the second part of the said question in the affirmative, and in favour of the assessee. The above answer would given the second question in both the cases. In the circumstances of this case, the parties will bear their own costs. A copy of this judgment will be sent to the Income-tax Appellate Tribunal as required by section 66(5) of the Act.