

# KERALA HIGH COURT

Commissioner of Agrl. Income-tax

Vs

Nilambur Rubber Co. Ltd

Income Tax Referred Case Nos. 1 and 2 of 1967

(M.U. Isaac and P. Narayana Pillai, JJ.)

20.08.1968

## JUDGMENT

### **Isaac, J.**

1. These are two references made by the Kerala Agricultural Income-tax Appellate Tribunal under Section 60 (1) of the Agricultural Income-tax Act 1950 (hereinafter referred to as the Act) on the application of the Commissioner of the Agricultural Income-tax, Kerala. The assessee is the same in both the cases; and the questions of law referred are also the same, and they read as follows :-

1. Whether in the circumstances of the case the expenses for preparation of the Agrl. Income-tax returns are expenses allowable in determining the assessable income under the Agrl. Income-tax Act.
2. Whether in the circumstances of the case, the floating charge on the estates in Kerala will come under "mortgage or other capital charge" in Section 5 (f) of the Agrl. Income-tax Act.
3. Whether the floating charge on the estate in Kerala can be a charge on the said property unless and until the amount or a portion of it becomes irrecoverable from the properties specifically mortgaged for the amount and such a contingency had not arisen in the accounting year.

2. The assessee is an incorporated company, deriving agricultural income from lands situate in the States of Kerala and Mysore. The assessee has issued debentures for which its Mysore properties are mortgaged; and it has created also a floating charge on its properties in Kerala State. For the assessment year 1962-63, for which the previous year ended on 31st September 1961, the assessee submitted a return showing a net loss of ₹ 80,674. In computing the said loss, the assessee had made several deductions from its income. We are concerned in these cases only with two items. One was an amount of ₹ 50 which it claimed as the remuneration paid to its auditor for preparing the necessary statements and filing the return of its income before the

Income-tax Officer. The other item was a sum of ₹ 8,822, which it claimed as interest paid on the debenture on account of the floating charge on its Kerala properties. The Income-tax Officer disallowed these claims, as well as other deductions which the assessee claimed. The assessee filed an appeal before the Appellate Assistant Commissioner. He disallowed the claim for ₹ 50 and allowed the claim on account, of debentures. The Income-tax Officer as well as the assessee filed appeals before the Appellate Tribunal from the order of the Appellate Assistant Commissioner. The appeals were disposed of by a common order, upholding the assessee's claim for deduction for both the amounts. The Commissioner of Agricultural Income-tax, therefore, filed an application in each of the two appeals for referring the questions, which we have extracted above, for the decision of this Court. That is how two references happened to be made for decision of the same questions in respect of the same assessment.

3. The subject matter of the first question is a sum of ₹ 50 paid to the auditor of the assessee for preparing the necessary statements and filing the income-tax return before the Income-tax Officer. Though the amount involved is very small, the question whether such an expenditure is allowable in computing the total agricultural income of the assessee is one of general importance. Section 3 of the Act is the charging section and the tax is charged on the total agricultural income of the previous year. Section 5 of the Act provides that the agricultural income of a person shall be computed after making the deductions enumerated therein. According to the assessee's learned counsel, remuneration paid to an auditor for preparing the income-tax return and necessary statements to be filed before the Income-tax Officer would fall under Clause (j) of Section 5. It reads as follows :-

"5. Computation of agricultural income :- The agricultural income of a person shall be computed after making the following deductions, namely :-

x x x x

(j) any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of deriving the agricultural income;

x x x x

The learned counsel submitted that the above clause corresponds to Clause (xv) of Section 10 (2) of the Indian Income-tax Act, 1922 and to Section 37 of the Income-tax Act, 1961. We shall also read the relevant part of Section 10 of the 1922 Act :-

"10. Business. - (1) The tax shall be payable by an assessee under the head "profits and gains of business, profession or vocation" in respect of the profit or gains of any business, profession or vocation carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely :-

x x x x

(xv) any expenditure (not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal

expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation.

x x x x

The learned council for the Revenue submitted that the provisions of the two statutes are not the same in this respect. He submitted that under clause (j) of Section 5 of the Agricultural Income-tax Act, the expenditure must be one laid out or expended "for the purpose of deriving the agricultural income", while under clause (xv) of Section 10 (2) of the Indian Income-tax Act, it is enough if it is laid out or expended "for the purpose of such business, profession or vocation". He submitted that the expression "the purpose of such business" has got a far wider range than the expression "for the purpose of deriving the agricultural income". In the former case, the expenditure need not have any relation to the profits or gains; but in the latter case it must relate to the deriving of the income. We do not agree with this contention. Though there is difference in the words employed in the two statutory provisions, we think that their effect is the same. It is not necessary that there must be income for claiming the allowance under Clause (j) of Section 5 of the Agricultural Income-tax Act. All that is required is that it should have been expended for the purpose of deriving the income, whether the adventure results in profits or gains. The same is the position under the Indian Income-tax Act. The purpose of a business is deriving profits and gains; and in our opinion, an expenditure for the purpose of business is one for the purpose of deriving income therefrom.

4. It was not disputed that an expenditure incurred for maintaining accounts and getting them audited is a permissible deduction; but it was submitted that an expenditure incurred for preparing return of income and statements to be filed before the Income-tax Officer, or the remuneration paid to a counsel or other representative for conducting the case before the Income-tax authorities is not an allowable deduction. The leading English decision on this question is that of the House of Lords in *Smith's Potato Estates, Ltd. v. I. T. Commissioner*<sup>1</sup>, In that case the controversy was whether the legal and accountancy expenses incurred in prosecuting an appeal to the Board of Referees against a decision of the Commissioner of Inland Revenue was a permissible deduction in computing the profits of an assessee for income-tax purposes. The relevant provision in the English Statute concerned in that case was very similar to Clause (xv) of Section 10 (2) of the Indian Income-tax Act, 1922. The House of Lords by a majority of three against two decided that these expenses were not allowable. Lord Porter, in his majority judgment, said :-

"I should myself draw a marked distinction between accounts made up on the purely trading basis and those which are prepared for and accepted by the Inland Revenue. If there were no obligation to ascertain and pay either of these taxes, there would be no necessity for making up accounts on income tax principles - it would suffice to make up the ordinary commercial accounts. The computation of accounts for tax purposes is, therefore, not directly associated with the carrying on of the business. It is an obligation imposed upon the company for another and extraneous purpose, i.e. for the purpose of ascertaining the tax to be paid out of profits. It is not, at any rate directly, undertaken for trade purposes but to satisfy the Revenue authorities.

It is true that as a matter of convenience the most of making up accounts for the

<sup>1</sup>(1949) 17 ITR (Supp) 1 (HL)

Inland Revenue is allowed by the authorities as a deduction from profits as is the cost of making up the strictly business accounts of the trade, but this is not a matter of principle but of expediency."The opposite view has been very forcibly expressed by Viscount Simon. He said :

"It seems to me that it is essential for the proper carrying on of a trade that the trader should know what portion of his profits in a given year is left to him after the Revenue has taken its share by taxation. If, therefore, he considers that the Revenue seeks to take too large a share and to leave him with too little, the expenditure which the trader incurs in endeavoring to correct this mistake is a disbursement laid out for the purposes of his trade. If he succeeds, he will have more money with which to earn profits next year. It is true that the result of his success is to reduce the tax he has to pay - alternatively, one may say that the result is to show that the profit of the year's trading left to him after paying tax is greater than the Revenue was willing to admit - but to my mind the purpose was a trading purpose and nothing else."

5. The High Courts of Bombay and Allahabad followed the majority opinion in the above decision of the House of Lords, while the High Courts of Madhya Pradesh and Calcutta preferred the minority view. In *S. D. Sharma v. Commissioner of Income-tax*<sup>2</sup>, the Bombay High Court held that the fees paid by an assessee to his income-tax consultant in connection with proceedings before the Income-tax Officer were not allowable under Section 10 (2) (xv) of the Indian Income-tax Act, 1922. Similarly, the Allahabad High Court held in *J. K. Cotton Manufacturers Ltd. v. Commissioner of Income-tax*<sup>3</sup>, that the fees paid by an assessee to chartered accountants and lawyers who appeared for it before the Income-tax investigation Commissioner were not allowable. In *Binodiram Balchand v. Commissioner of Income-tax*<sup>4</sup>, the Madhya Pradesh High Court held that fees paid to income-tax adviser for conduct of assessment proceedings are allowable. Similarly, the Calcutta High Court held in *Birla Cotton Spinning and Weaving Mills Ltd. v. Commissioner of Income-tax*<sup>5</sup>, that fees paid to Lawyers for appearing before the Income-tax investigation Commissioner were allowable. There is a very long and detailed discussion of the case law on this question in the decision of the Calcutta High Court; and all the arguments that could be advanced in support of the two views have been considered in this case. It is, therefore, unnecessary for us to re-state them. Suffice it to say we are in respectful agreement with the decision of the House of Lords in *Smith's Potato Estate's Case*, which has been followed by the High Courts of Bombay and Allahabad. The following statement appears in the *Law of Income-tax in India* by V. S. Sundaram - Ninth Edition at page 553 :

"Legal expenses incurred in presenting the assessee's case to the Revenue authorities are not deductible, since the profits are not altered by this expenditure, but fees paid to Accountants for preparing accounts in the ordinary course of business and not specifically for contesting liability or conducting proceedings before tax authorities are an ordinary business expense and allowable as such. The point is that expenditure antecedent to the

<sup>2</sup>45 ITR 107 : AIR 1963 Bom 33

<sup>4</sup>48 ITR 548

<sup>3</sup>(1962) 46 ITR 970 (All)

<sup>5</sup>(1967) 64 ILR 568 (Cal)

ascertainment of profits is allowed, not that relating to the appropriation of profits. In practice however, Accountant's and Lawyer's fees are allowed for appearance before the

Income-tax Officer but not on appeal or revision."

In our opinion, this passage states the correct legal position. In the matter of assessment of income-tax, the Central Board of Revenue appears to have issued a Circular for allowing reasonable expenses incurred by an assessee by way of remuneration paid to auditors and advocates for conduct of the assessment proceedings before the Income-tax Officer.

6. Question No. 3 does not actually arise out of the order of the Appellate Tribunal. It only contains the argument of the Commissioner of Agricultural Income-tax, which we have to consider for the decision of question No. 2. The claim for deduction of ₹ 8822 said to have been paid by the assessee as interest on debentures is made under Section 5 (f) of the Act. It reads as follows :-

"5. Computation of agricultural income : The agricultural income of a person shall be computed after making the following deductions, namely :-

x x x x

(f) Where the land from which the agricultural income is derived is subject to a mortgage or other capital charge, any interest paid in the previous year in respect of such mortgage or charge;

x x x x

The deed creating the alleged mortgage or the charge on the properties has not been appended to the orders of reference, nor do we get the necessary particulars regarding its contents either from the orders of the Appellate Tribunal or of the Subordinate authorities. As already stated, the claim is made on account of interest said to have been paid on debentures issued by the assessee; and admittedly, there is a floating charge on the assessee's lands in Kerala for the said debentures. Therefore, the answer to the second question depends on the true meaning of "floating charge", which is otherwise called "floating security".

7. Lord Macnaghten defined a "floating security" as follows in his speech in the decision of the House of Lords in the *Governments Stock and Other Securities Investment Company v. Manila Railway Co*<sup>6</sup>.,

"A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favor the charge is created intervenes. His right to intervene may of course be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever he pleases after default."

<sup>6</sup>(1897) Ac 81

Vaughan Williams, L. J. in his judgment delivered in *Yorkshire Woolcombers Association*

Limited, *In re, Houldsworth v. Yorkshire Woolcombers Association, Ltd*<sup>7</sup>., quoted the above definition and made the following comment.

"It will be seen, therefore, by that definition that even Lord Macnaghten, who is remarkable for his accuracy of language, cannot succeed in defining a floating security without using some terms which are not really applicable to the subject-matter, but are only applicable by way of analogy. He talks of the charge as being "dormant." You want a definition of when and under what circumstances a charge is properly spoken of as "dormant";"

This decision went in appeal before the House of Lords in *Illingworth v. Houldsworth*<sup>8</sup>, In his speech delivered in the above case, Lord Macnaghten noticed the above comment made by Vaughan-Williams, L. J.; and the learned Law Lord clarified his earlier statement as follows :-

"With regard to the criticism which Vaughan-Williams L. J. passed, not I think unkindly, on some words of mine in the Manila Case, (1897) AC 81, I only wish to observe that what I said was intended as a description, not as a definition, of a floating security. I should have thought there was not much difficulty in defining what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

8. The passages quoted above from the speeches of Lord Macnaghten have become classical, and have been accepted at all hands as a correct and comprehensive description of a floating charge - Vide Halsbury's Laws of England, Third Edition, Volume 3, page 472; Palmer's Company Law - Twentieth Edition - Page 389; and Buckley on the Companies Acts - Thirteenth Edition - Pages 224 and 225. Palmer quotes the above passages, and states that they contain the best general description of a floating charge. To put it briefly, a floating charge is one which floats with the property, which it is intended to affect, until some event occurs or some act is done which ceases it to settle and fasten on the subject of the charge within its reach and grasp. There is no case for the assessee that any event has occurred or anything has been done to cause the floating charge to settle and fasten to the Kerala properties. Until it happens, the lands in Kerala State would not be "subject to a mortgage or other capital charge" within the meaning of Section 5 (f) of the Act. All that is there is a possibility of a charge coming into existence and operation, on the happening of something which would cause the floating charge to attach itself to the property.

9. The Appellate Tribunal has relied on a decision of this Court in *Union of India v. Coorg Estates Ltd., (In liquidation)*<sup>9</sup>, in support of the view that it has taken. In that

<sup>7</sup>(1903) 2 Ch 284

<sup>9</sup>1963 Ker LJ 605 : AIR 1963 Ker 301

<sup>8</sup>(1904) AC 355

case, a suit was instituted to recover the amounts due to the plaintiff by sale of the properties, over which the plaintiff had a floating charge. Before the institution of the suit, the said properties

were attached by the Collector for recovery of provident fund contributions due from the debtor. A preliminary decree was passed for recovery of the suit amount by the sale of the properties; and a few months later, the Collector sold the said properties pursuant to the attachment which he had made. The question arose whether on the facts of the case the security had become crystallized on the date of the sale by the Collector, in which event the sale would be only subject to the plaintiff's charge. This Court said :-

"So we hold that the effect of the attachment and seizure of the movables by the Collector was that the company became unable thereafter to carry on its business, and it virtually ceased to carry on the business from that day. If that is so, there was crystallization of the security as the cessation of the company to carry on the business is one of the events which in law would operate to crystallize the security."

This decision has quoted with approval the passages which we have extracted above from the speeches of Lord Macnaghten; and we are unable to see how it can support the decision of the Appellate Tribunal. As we see it, it is an authority for the opposite position.

10. The Appellate Tribunal has extracted the following passage from the above decision and has underlined it :-

"A floating charge is no doubt an existing charge and is rightly termed so, but care must be taken to remember that it does not settle down and fasten on the property which is the subject of the charge until a particular act is done."

The above statement appears to be based on the decision of the Court of Appeal in *Evans v. Rival Granite Quarries, Ltd*<sup>10</sup>, Fletcher-Moulton L. J. in his concurring judgment, after quoting the passage which we have extracted above from the speech of Lord Macnaghten in 1904 AC 355 said :-

"I think that Lord Macnaghten was here keeping in view the two characteristic features of floating charges - (1) the non-permanence of the property which is the subject of the charge, and its constant change from time to time, and (2) that a floating charge does not of itself fasten and settle even on the property existing at the moment. This explanation removes all difficulties arising from decisions which speak of a floating charge as an existing charge. It is an existing charge, and is rightly termed so, but care must be taken to remember that it has not settled down and fastened on the property which is the subject of the charge. I find no difficulty in grasping such a concept."

We are unable to see how the passage underlined by the Appellate Tribunal would support its conclusion. On the other hand, it emphasizes the legal position that a floating charge does not get itself attached or fastened to the property which it is

<sup>10</sup>(1910) 2 KB 979

intended to charge, until some event which would cause it to crystallize and fasten on the property occurs. Admittedly, no such event has occurred in this case.

11. The learned counsel for the assessee referred us to a decision of the Calcutta High Court in *G. Bhar and Co. v. United Bank of India Ltd*<sup>11</sup>. In that case, the plaintiff, who had a floating charge on the stock-in-trade of a shop belonging to defendants 1 to 3, instituted a suit for money due from them under a mortgage. Before that suit was instituted, the 4th defendant had filed a suit for money due from defendants 1 to 3 and attached the stock-in-trade in the shop. The question arose whether the plaintiff was entitled to a charge on the stock-in-trade as it had already been attached by the 4th defendant, before the institution of the plaintiff's suit on the mortgage. In upholding the plaintiff's claim, the Court said :-

"In the present case, the charge on mortgage became crystallized as soon as the attachment before judgment was effected at the instance of the appellant, because, after that date, the stock-in-trade of the business became fixed, and the borrower could not possibly deal with the stock-in-trade after the attachment. The mortgage suit was, no doubt, instituted some time after attachment. That does not mean that the stock-in-trade was not the subject-matter of the mortgage from the very date of the execution of the bond."

On the authority of the above statement, the learned counsel contended that a floating charge creates a charge on the property which it is intended to affect from the date of the execution of the bond. If the learned Judges of the Calcutta High Court have laid down any such proposition, with great respect, we are unable to agree with them. Such a charge would be a specific charge, and not a floating charge. We shall, however, point out that the following passage from the judgment of Buckley, L. J. in (1910) 2 KB 979, was quoted by the learned Judges of the Calcutta High Court as containing a correct statement of law :

"A floating security is not a future security; it is a present security, which possibly affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a license to the mortgagor to dispose of them in the course of the business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security."

We respectfully agree with the above statement of the law; and it is clear from the said statement that a floating charge is not a specific mortgage of the property, and that it does not specifically affect any property until some event occurs or some act on the part of the mortgagee is done to crystallize it into a fixed security.

12. In the result, we answer question Nos. 1 and 2 referred to this Court in the

<sup>11</sup> AIR 1961 Cal 308

negative, and against the assessee. We hold that question No. 3 is not one which arises out of the

order of the Appellate Tribunal. In the circumstances of the cases, the parties will bear their own costs. A copy of this judgment will be forwarded to the Appellate Tribunal as required by Section 60 (6) of the Act. Advocate Shri. K. S. Paripoornan appeared in this case as amicus curiae, and placed before us all the authorities on the question whether the expenditure incurred by an assessee for conduct of assessment proceedings is allowable in computing the total income. We record our appreciation for the above assistance received from him.

Reference answered.