Bombay Steam Navigation Co. (1953) ... vs Commissioner Of Income-Tax, Bombay on 21 October, 1964

Equivalent citations: 1965 AIR 1201, 1965 SCR (1) 770, AIR 1965 SUPREME COURT 1201

Author: J.C. Shah

Bench: J.C. Shah, S.M. Sikri

PETITIONER:
BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, BOMBAY

DATE OF JUDGMENT:
21/10/1964

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
SUBBARAO, K.
SIKRI, S.M.

CITATION:
1965 AIR 1201 1965 SCR (1) 770
CITATOR INFO :
R 1966 SC1053 (8)
R 1968 SC 745 (5)
RF 1970 SC1586 (5)
RF 1977 SC2394 (6)
RF 1980 SC1946 (11)
R 1989 SC1866 (13)
R 1991 SC 227 (8)

ACT:
Income Tax Act, 1922 (11 of 1922), s. 10(2)(iii)-Interest paid on unpaid balance of purchase price of assets acquired for a business-Whether such unpaid balance amounts to a loan-Therefore whether interest allowable as a deduction on borrowed capital--Or whether allowable as a deduction under s. 10 (2) (xv).

HEADNOTE:
The assessee company was incorporated with the object of taking over certain passenger and ferry services on the Konkan Coast. The ass company purchased the assets required for its business from the Scindia Steam Navigation Company and paid part of the consideration by allotting its own fully paid shares, leaving the -balance unpaid. It was provided in the contract of purchase that interest at 6 per cent per annum would be paid to the Scindia Company on any unpaid balance until the whole of it was fully paid.
The Income Tax authorities disallowed the claim of the assessee company in the computation of its profits and gains for deduction of such interest paid to the Scindia Steam Navigation Company, and the High Court affirmed that -view.
HELD : Interest paid by the assessee company was a permissible deduction under s. 10(2) (xv). [779 F-G]
Per Shah and Sikri JJ.-BY s. 10(2) (iii) only interest paid in respect of capital actually borrowed for the purpose of the business, profession or vocation, is a permissible allowance. An agreement to pay the balance of consideration due by the purchaser does not give rise to a loan. Although a loan of money undoubtedly results in a debt, every debt does not involve a loan. In this case the unpaid balance did not amount to capital borrowed and the interest paid thereon could not therefore be allowed as a deduction under s. 10(2) (iii). [774 H; 775 B-C; 776 C-D]
Metro Theatre Bombay Ltd. v. C.I.T., (1946) 14 I.T.R. 638 and V. Ramaswami Ayyangar and another v. C.I.T., Madras, (1950) 18 I.T.R. 150, referred to and approved.
C.I.T., Madras v. S. Ramsay Ungar, (1947) 15 I.T.R. 87, distinguished
Subba Rao J. reserved his opinion on the application of cl. (iii) of sub-s. (2) of s. 10 of the Indian Income-tax Act, 1922 to the claim for deduction of the interest paid. [771 B]

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1023-1024 of 1963.

Appeals from the judgment and order dated August 9, 1962, of the Bombay High Court in Income-tax Reference No. 3 of 1961. A. V. Viswanatha Sastri, T. A. Ramachandran, J. B. Dadachanji, O. C. Mathur and Ravinder Narain, for the Appellant (in both the appeals).

C. K. Daphtary, Attorney-General, K. N. Rajagopala Sastri, R. H. Dehbar and R. N. Sachthey, for the respondent (in both the appeals).

The Judgment of J. C. Shah and S. M. Sikri JJ. was delivered by Shah J.

Subba Rao J. I agree with the conclusion, but I would prefer not to express my view on the construction of cl. (iii) of Subs. (2) of s. 10 of the Indian Income-tax Act, 1922. Shah J. The Bombay Steam Navigation Company Ltd. which plied its passenger and ferry services on the Konkan coast:

> and in the Bombay harbour was amalgamated with effect from June 30, 1952 with -the Scindia Steam Navigation Company Ltd.-hereinafter called "the Scindias". The scheme of amalgamation was sanctioned by the High Court of Bombay and the Scindias were authorised by the scheme to float and establish a joint stock company with the object of taking over the services on the Konkan coast and in the Bombay harbour which were originally plied by the Bombay Steam Navigation Co. Ltd. Pursuant to this authority the Bombay Steam Navigation Co. (1953), Private Ltd.-hereinafter called "the assessee Company" was incorporated on August 10, 1953. The assessee Company contracted with the Scindias on August 12, 1953 to purchase certain steamers, launches, boats, barges, buildings, furniture, fixtures and vehicles for a consideration provisionally estimated at Rs. 80 lakhs. It was provided by the agreement that the price of the assets sold will be satisfied by allotment to the Scindias of 29,900 shares credited as fully paid-up of the face value of Rs. 100 each in the share capital of the assessee Company, and the balance will be treated by the assessee Company as a loan granted by the Scindias. The agreement by cl. 3(b) provided for payment of interest at 6% on the unpaid balance of the purchase price. clause stood as follows:
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> "The balance shall be treated by the Transferee Company as a loan granted by the Transferor Company secured by a Promissory Note duly executed by the Transferee Company in favour of the Transferor Company and until it is repaid in full it shall carry interest of 6% per annum (simple) and shall be further secured by hypothecation of all movable properties of the Transferee Company in favour of the Transferor Company.
>
> L2Sup.165-6 On final valuation of the assets transferred it was found that the assessee Company was liable to pay Rs. 81,55,000 to the Scindias. By a supplemental agreement dated September 16, 1953, the agreement was rectified and the original cl. 3(b) was substituted with retrospective effect from August 12, 1953 by the following clause:
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> "The balance shall be paid by the Transferee Company to the Transferor Company on completion of the transfer referred to in Clause 2 above and until it is repaid in full the said balance or so much thereof as for the time being remains unpaid shall carry interest of 6% per annum (simple) and shall further be secured by hypothecation of all movable properties of the Transferee Company in favour of the Transferor Company.$$ In proceedings for assessment of tax for the assessment years 1955-56 and 1956-57 the Income-tax Officer, Companies Circle II (1), Bombay, disallowed the claim of the assessee Company in the computation of its profits and gains, for allowance of Rs. 2,74,610 paid by it to the Scindias in the account year ending June

> 30, 1954, as interest on the outstanding balance of purchase price due by it and for allowance of Rs. 2,86,823 paid as interest in the year ending June 30, 1955. The order of the Income-tax Officer was confirmed by the Appellate Assistant Commissioner and by the Appellate Tribunal. The High Court of Bombay answered the following question submitted by the Income-tax Appellate Tribunal in the negative:
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> "Whether on the facts and in the circumstances of the case the said sum of Rs. 2,74,610 and Rs. 2,96,823 being the interest paid by the assessee is allowable as a deduction under the Income-tax Act under any of the sections 10(2)(iii), 10(2)(xv) or 10(1) ?"

With certificate of fitness under S. 66A(2) of the Income- tax Act, the assessee Company has appealed to this Court. In the computation of profits and gains of the business carried on by it the assessee Company claimed the two amounts paid as permissible allowances under S. 10 (2) (iii) or under S. 10 (2) (xv). Alternatively, the assessee Company claimed that in the computation of the true profits of 'the business under S. 10 (1) the amounts paid as interest are necessarily allowable. Section 10, by the first clause, provides :

> "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."

Tax is payable under s. 10(1) by an assessee on its profits or gains earned in the business, profession or vocation carried on by him in the year of account. If no business at all is carried on in that year; liability to tax does not arise under s. 10(1).

Clause (iii) of sub-s. (2) of s. 10 provides :

> "Such profits or gains shall be computed after making the following allowances, namely :-
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> (iii) in respect of capital borrowed for the purposes of the business, profession or vocation, the amount of interest paid."

The proviso - and the Explanation with which we are not concerned in these appeals need not be set out. The expression "such profits or gains" in sub-s. (2) on the plain language used by the Legislature means profits or gains of a business carried on in the year of account. In the computation of profits and gains of a business carried on in the year of account, allowances set out in cls. (i) to

(xv) are permissible : some of these permissible allowances are of the nature of revenue outgoings, and others are of the nature of capital outgoings. Gross profits or gains must undoubtedly be of the nature of revenue receipts. But in the computation of taxable profits from the receipts of the

business, not only revenue deductions but certain capital deductions are permitted to be made, e.g. deprecia- tion, sums paid to scientific research associations, expenditure of a capital nature on scientific research and other expenditure of a capital nature. By cl. (iii) of sub- s. (2), interest paid in respect of capital borrowed for the purpose of the business, profession or vocation is a permissible allowance in the computation of the profits or gains. The expression "capital" used in cl. (iii) in the context in which it occurs means money and not any other asset, -for interest is payable on capital borrowed and interest becomes payable on a loan of money and not on any other asset acquired under a contract. Interest paid need not however bear the character of a revenue outgoing. To be admissible as an allowance under cl. (iii), interest must be paid in respect of capital borrowed : interest paid, but not in respect of capital borrowed cannot be allowed. There was in the present case, in truth no capital borrowed by the assessee Company. To recapitulate the facts: the assessee Company purchased the assets required for its business from the Scindias and paid part of the consideration by allotting shares of the value of Rs. 29,99,000 leaving the balance of Rs. 51,56,000 unpaid. In cl. 3(b) of the contract as originally executed it was recited that this amount was to be treated as a loan by the Scindias to the assessee Company, but with retrospective operation the covenant was modified, and the amount due was to be treated as balance of purchase money remaining unpaid. Mr. Viswanatha Sastri argued that the assessee Company owed a debt of Rs. 51,56,000 to the Scindias, payment of which was secured by the execution of a promissory note and a charge on the assets of the assessee Company. The substance of the transaction, according to Counsel, was a loan given by the Scindias to its subsidiary-the assessee Company-for procuring the assets required for carrying on the business, even though the formal transaction did not record it as a loan, and as a contractual liability to pay a debt was incurred, the Court would be justified in regarding the transaction as one involving borrowing of the amount agreed to be paid by the assessee Company. It was said that if the assessee Company had borrowed the amount of Rs. 51,56,000 from a stranger and had paid the entire consideration to the Scindias, interest paid to the stranger would indisputably be an allowance admissible in the computation of taxable profits of the assessee Company, and there was no reason why a different principle should be applied when the Scindias in substance had made the requisite funds available to enable the assessee Company to purchase the assets. The transaction with the vendor could be regarded, it was also urged, as a composite transaction(i) a transaction of borrowing Rs. 51,56,000 from the Scindias and (ii) a transaction for payment of the entire consideration due for purchasing the assets from the Scindias.

In our judgment this is not a permissible approach in ascertaining the true nature of the transaction. The parties had agreed that assets of the value of Rs. 31,55,000 be taken over by the assessee Company from the Scindias. Out of that consideration Rs. 29,99,000 were paid by the assessee Company and the balance remained unpaid. For agreeing to deferred payment of a part of the consideration, the Scindias were to be paid interest. An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan. A loan of money undoubtedly results in a debt, but every debt does not involve a loan. Liability to pay a debt may arise from diverse sources, and a loan is only one of such sources. Every creditor who is entitled to receive a debt cannot be regarded as a lender. If the requisite amount of consideration had been borrowed from a stranger interest paid thereon for the purpose of carrying on the business would have been regarded as a permissible allowance; but that is wholly irrelevant in considering the applicability of cl. (iii) of sub-s. (2) to the problem arising in this case. The Legislature has under

cl. (iii) permitted as an allowance interest paid on capital borrowed for the purposes of the business; if interest be paid, but not on capital borrowed, cl. (iii) will have no application.

In Metro Theatre Bombay Ltd. v. Commissioner of Income- tax(1) the Bombay High Court held that a mere purchase of a capital asset on a long-term credit with a stipulation for payment of interest on the reduced balance did not amount to borrowing capital within the meaning of s. 10(2)(iii). Under an arrangement to receive a long-term lease of property the assessee in that case agreed to pay the consideration stipulated in half-yearly instalments spread over a number of years with interest at five per cent on the balance outstanding. Interest paid on the balance was disallowed as a permissible deduction in computing the total assessable income. In Metro Theatre's case(1) liability to pay interest arose under an agreement to receive a lease in future, whereas liability in the present case arises under an agreement to pay under a completed sale transaction the balance of consideration unpaid. But that is not a real ground of distinction. The amounts in both the cases were paid as interest, but ih neither case was interest paid in respect of capital borrowed.

In V. Ramaswami Ayyangar and Anr v. Commissioner of Income-tax, Madras(2) the assessee who was carrying on a money-lending business claimed that in computing his business income he was entitled under s. 10(2) (iii) to deduct interest paid on death duty to the Government of Ceylon on properties left by a deceased person. The Court negatived the claim for such deduction. The amount which was not paid as death duty was used for the purposes of the business, but it could in no sense be regarded as a borrowing from the Government of Ceylon. The Court held that s. 10(2) (iii) contemplates lending of money and borrowing of the lender's money by the borrower with a contractual stipulation for repayment with interest on the loan : if a loan so borrowed is employed in or for the purpose of the business of the assessee interest paid on such loan is a permissible deduction.

(1) (1946) 14 I.T.R. 638.

(2) (1950) 18 I.T.R. 150.

But an amount due under a statute cannot be regarded as borrowed capital, for the expression "capital borrowed"

predicates the relation of a borrower and a lender, which relationship did no exist in that case.

The principle of Commissioner of Income-tax, Madras V. S. Ramsay Unger(1) on which strong reliance was placed by Mr. Viswanatha Sastri does not come to his aid, for in that case the Court held on the facts and circumstances that in substance the

transaction which gave rise to the liability to pay interest was one of borrowing capital and therefore the whole of interest debited in the books of the assesses must be allowed as interest paid on such capital. We therefore agree with the High Court that the claim for deduction of the amount of interest under S. 10 (2) (iii) is not admissible.

But in our judgment interest paid by the assessee Company is a permissible deduction under S. 10(2) (xv) which permits "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" as a permissible allowance in the computation of profits or gains of the business carried on in the year of account. Payment of interest is expenditure; but it is not an allowance of the nature described in cl. (iii) and there is no other clause in cls. (i) to (xiv) to which the payment of interest on unpaid balance of consideration for sale of assets may be attracted. The expenditure was incurred after the commencement of the business. Ile expenditure is not for any private or domestic purposes of the assessee Company. It is in the capacity of a person carrying on business that this interest is paid.

The question then is whether the expenditure is of a capital nature. It is not easy ordinarily to evolve a test for ascertaining whether in a given case expenditure is capital or revenue, for the determination of the question must depend upon the facts and circumstances of each case. Ile Court has to consider the nature and ordinary course of business and the objects for which the expenditure is incurred. The assessee Company urged that the payment of interest was revenue expenditure for the purposes of the business of the assessee Company, because in the event of (1) (1947) 15 I.T.R. 87.

failure to pay interest accruing due the Scindias would enforce the hen, and the business of the assessee Company would come to an -end and that in any event the expenditure was necessary on grounds of business expediency and incurred in order directly -or indirectly to facilitate the carrying on of business. If the principal or the interest accruing due was not paid the Scindias had undoubtedly a right to enforce their lien against the assets of the assessee Company's business, but that cannot be regarded as a -round for holding that the expenditure fell within s. 10 (2) (xv). Even in respect of a liability wholly unrelated to the business, it would be open to a creditor to sequester the assets of the assessee's business and such sequestration may result in stoppage of the operations of the business. Expenditure for satisfying liability unrelated to the business even if incurred for avoiding danger apprehended or real to the conduct of the business cannot be said to be revenue expenditure. Nor can it be said that because a liability has some relation to the business which is carried on, expenditure incurred for satisfaction of such liability is always to be regarded as falling within s. 10(2) (xv). 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 Tight 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 in a recent case State of Madras v. G. J. Coelho(1) this Court to consider the permissibility of a deduction under s. 5(e) of the Madras Plantations Agricultural Income-tax Act, 1955. Section 5(e), it may be observer, is in terms similar to s. 10 (2) (xv) of the Income-tax Act. Section 5 Permits deductions of various items of expenditure in the computation of agricultural income. Clause (e) provides for the deduction of any expenditure incurred in the previous year (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or explended wholly and exclusively for the purpose of plantation. The assessee in that case had purchased an estate consisting of tea, coffee and rubber plantations in the Nilgiris mountains for Rs. 3,10,000.

(1) (1964) 53 I.T.R. 186.

He borrowed Rs. 2,90,000 on interest and claimed to deduct the interest paid out of the income of the plantations in the assessment year 1955-56. The claim was made under cls.

(e) and (k) ,of s. 5. The claim under cl. (k) was not admissible because interest was not payable on the amounts borrowed and actually spent on the plantations in the previous year, and the sole question which fell to be determined was whether it was a permissible allowance under s. 5 (e). It was held that the payment of interest was not in the nature of capital expenditure in the year of account. The Court held that payment of interest even in respect of capital borrowed for acquiring assets to carry on business must be regarded as revenue expenditure in commercial practice and should not be termed as capital expenditure. Dealing with the application ,of S. 5 (e) it was observed :

> "The assessee had bought the plantation for working it as a plantation, i.e. for growing tea, coffee and rubber. The payment of interest on the amount borrowed for the purchase of the plantation when the whole transaction of purchase and the working of the plantation is viewed as an integrated whole, is so closely related to the plantation that the expenditure can be said to be laid out or expended wholly and exclusively for the pur- pose of the plantation. In this connection, it is pertinent to note that what the Act purports to tax is agricultural income and not agricultural receipts. From the agricultural receipts must be deducted all expenses which in ordinary commercial accounting must be debited against the receipts must be deducted all expenses do not see any distinction between interest paid on capital borrowed for the acquisition of a plantation and interest paid on capital borrowed for the purpose of existing plantations : both -are for the purposes of the plantation."

The test laid down by this Court therefore was that 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 purposes

of the business. The assessee Company had undoubtedly acquired the assets by pledging its credit. The assessee Company was formed for the purpose of taking over the business which the Scindias had acquired and for carrying on that business the assets with which the business was to be carried on were required. For obtaining those assets the assessee Company rendered itself liable for a sum of Rs. 51,56,000 and agreed to pay that sum with interest at the rate stipulated. The transaction of acquisition of the assets was closely related to the commencement and carrying on of the business. Interest paid on the amount remaining due must in the normal course be regarded as expended for the purpose of the business, which was carried on in the year of account. There is no dispute that if interest was paid for the purpose of the business, it was laid out or expended wholly and exclusively for that purpose.

Mr. Rajagopala Sastri on behalf of the Revenue contended that as profits which arise after the business is closed are not taxable under s. 10(1), expenditure the source of which is a liability incurred before the actual commencement of business cannot also be regarded as a permissible outgoing under s. 10(2)(xv.). It is unnecessary to examine the correctness of this argument, for it has no basis in fact. The assessee Company was formed on August 10, 1953, it had entered into an agreement on August 12, 1953, and interest was paid in the years of account ending June 30, 1954 and June 30, 1955. The source of liability cannot be said to have arisen prior to the date on which the business of the assessee Company was commenced. Section 10(2) requires that in computing the taxable profits or gains of a business which is carried on in the year of account allowances of the nature described in cls. (i) to (xv) should be made. If no business was carried on in that year, the allowances are not permissible. But interest in respect of which allowance is claimed was paid at a time when the business was carried on, and the source of liability to pay interest was also incurred within the period in which the business was carried on.

We are, therefore, of the view that the allowance claimed is a permissible deduction under s. 10(2)(xv). We do not, in the circumstances, feel called upon to consider whether in computing the income of the assessee under s. 10(1) interest paid may be regarded as a necessary outgoing for the purpose of the business of the assessee Company.

The appeals are therefore allowed with costs in this Court. One hearing fee.

Appeals allowed.