# Challapalli Sugar Ltd vs The Commissioner Of Income Tax, A.P. ... on 31 October, 1974

## Equivalent citations: 1975 AIR 97, 1975 SCR (2) 538, AIR 1975 SUPREME COURT 97, 1975 3 SCC 572, 1975 TAX. L. R. 40, 98 ITR 167, 1975 SCC (TAX) 65, 1975 UPTC 227, 1975 2 SCR 538

## Author: Hans Raj Khanna

## Bench: Hans Raj Khanna, A.C. Gupta

PETITIONER:
CHALLAPALLI SUGAR LTD.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME TAX, A.P. HYDERABAD

DATE OF JUDGMENT31/10/1974

BENCH:
KHANNA, HANS RAJ
BENCH:
KHANNA, HANS RAJ
GUPTA, A.C.

CITATION:
1975 AIR 97 1975 SCR (2) 538
1975 SCC (3) 572

ACT:
Indian Income-Tax Act, 1922, Section 10, secs. 10(2), 10(2)(vi), 10(5) and explanation to sec. 10(5) and Section 208(1) of Companies Act, 1956 (Act 1 ,of 1956-Payment of tax in respect of profits or gains-Interest paid before commencement of production on money borrowed for- acquiring and installing the machinery and plant, if could be capitalised and included in actual cost.
Income-tax Act, 1961, as amended by Income-Tax (Amendment ) Act 1972 (Act No. 41 of 1972) Sctions 10(2) (xv) and 40 (iia)- Wealth tax paid by assessee on net wealth, whether deductible as business expenditure under sec. 5 of Amending Act.

HEADNOTE:

In all the three appeals the case of the assessee is that the interest for the .period before the commencement of production on money borrowed for the purpose of acquiring and installing the machinery and Plant should be included in the actual cost of the plant and as such capitalised for the purpose. In Civil Appeal No. 1784, the contention of the assessee is that the wealth-tax payable by the assessee is allowable as a deduction.

Allowing Civil Appeal No. 1353 of 1970 and dismissing Civil Appeals Nos. 1784 and 1785 of 1970.

HELD : (i) So far as the first question is concerned the legal position for determining the actual cost. for the purpose of development rebate is the same as for the purpose of depreciation. A reading of the provisions sees. 10,10(2), 10(2)(vi), 10(5) and the explanation to sec. 10(5) will disclose that, while considering the question of deduction on account of depreciation and development rebate the written down value has to be taken into account. Written down value in its turn depends on the actual cost of the assets to the assessee. As the expression "actual cost" has not been defined in the Act, it should be construed in the sense which no commercial man would misunderstand. It would appear that the accepted accountancy rule for determining the cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in working condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant. the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets which have been created as a result of such expenditure. The above rule of accountancy should be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary. [543B-D, E; 545F-H]

Clause (b) of sub-section (1) of section 208 of the Companies Act, 1956, gives statutory recognition to the principle of capitalising the interest in case the interest is paid on money raised to defray expenses of the construction of any work or building or the provision of any plant in contingencies mentioned in that section even though such money constitutes share capital. The same principle, should hold good if interest is paid on money not raised by way of share capital but taken on loan for the purpose of defraying the expenses of the construction of any work or building or the provision of any plant. The reason indeed would be stronger in case such interest is paid on money taken on loan for meeting the above expenses. [545H-546C]

It is true that for similar fixed assets there can be different actual costs. The fact that there would be a difference in the actual cost of the plant in case its machinery is acquired and installed with the assessee's own money or in case it is acquired and installed with borrowed

money does not consequently militate against the principle that interest paid in such circumstances can be capitalised and included in the actual cost of machinery and plant. [546F-G]

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Hindus. v. Buenos Ayres Grand National Tramways Co. Limited, [1906] 2 Cl, D. 654, Corporation of Birmin gham v. Barnes (H. M. Inspector of Taxes), 19 Tax Cases 195, India Cements Ltd. v. Commissioner of Income-Tax, Madras,[ 1966] 60 ITR 52 referred to.

Commissioner of Income-Tax Madras v. L. G. Balakrishnan and Bros. (P) Lid. [1974] 95 I.T.R. 284 and Commissioner of Income-tax v. J. K. Cotton Spinning' & Weaving Mills. Income-tax reference No. 234 of 1972 decided on My 13. 1974, by Allahabad High Court, approved.

(ii) In Travancore Titanium Product Ltd. v. Commissioner of Income-Tax, Kerala [1966] 60 ITR 277, the Supreme Court held that the amount of Wealth Tax paid by an assessee on his net wealth under the Wealth-Tax Act is not a permissible deduction under sec. 10(2) (xv) of the Act in his income-tax assessment. After this decision when the matter was considered by a larger Bench consisting of five Judges in the case of Indian Almunium Co. Ltd. v. Commissioner of Income-Tax, West Bengal, Lk[ 1972) 84 ITR 735] this Court held that the WealthTax paid by the assessee which was a trading company on assets held by it for the purpose of business was deductible as a business expenditure in computing the assessee's income from business. Subiequent to this decision, the Income-Tax Act, 1961 was amended first by means of an Ordinance and later by means of the Income-Tax (Amendment) Act, 1972 (Act No. 41 of 1972). The result of this amendment is that any sum paid on account of Wealth-Tax cannot be deducted in computing the income of an assessee chargeable under the head "Profits and Gains of business, profession or Vocation" or "Income from other sources". The serving clause contained in section 5 of the amending Act provided

> "Where, before the 15th day of July, 1972 being the date on which the Income-tax (Amendment) Ordinance, 1972 came into force, the Supreme Court has, on: an appeal in respect of the assessment of an assessee for any particular assessment year, held that wealth-tax paid by the assessee is deductible in computing the total income of that year, then, nothing contained in sub-clause (iia) of clause (xv) of section 10, or sub-section (IA) of section 40, or sub-section (IA) of section 58, of the principal Act, as amended by this Act, or, as the case may be, section 4 of this Act, shall apply to the assessment of such assessee for that particular year." [549F-550F]

What is necessary to attract this section is that this Court

should have held before July 15, 1972 on an appeal in respect of an assessment of the assesse for any particular assessment year that the wealth-tax paid by the assessee is deductible in computing the total income of that year. Once that is the effect of a decision given by this Court before July 15, 1972 the fact that the judgment in which the above finding is recorded is given in other appeals, which are heard together along with the appeal of the assessee, and the further fact that assessee's appeal is not disposed of before July 15, 1972, would not take the case of the assessee out of the purview of section 5. The case of the assessee in Civil Appeal No. 1784 is covered by 5 of the Amending Act. [5510-552A]

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1353 of 1970.

From the Judgment and order dated the 5th September, 1969 of the Andhra Pradesh High Court in Case No. 64 of 1965 and Civil Appeals Nos. 1784 & 1785 of 1970.

From the Judgment & Order dated the 18th August, 1965 of the Calcutta High Court in I.T.R. No. 148 and 149 of 1961. N.A. Palkhivala, S. T. Desai and T. A. Ramachandran, for the appellant (in C.A. No. 1353 of 1970.) V. S. Desai, J. Ramamurthi and R. N. Sachthey, for the appellant (in C.A. 1784-85.) V. S. Desai, J. Ramamurthi, S. P. Nayar and R. N. Sachthey, for the respondent (in C.A. 1353 of 1970.) N.. A. Palkhiwala, S. T. Desai, A. K. Varma, Ravinder Narain, J. B. Dadachanji, 0. C. Mathur, and K. J. John, for the Interveners Nos. 1 and 3 (in C.A. No. 1784-85/70.) N. A. Palkhiwala, Bhakta, J. B. Dadachan, Ravinder Narain, O. C. Mathur, for Interveners Nos. 1 and 3 (in C.A. 1784-85/70.) D. N. Gupta for Intervener No. 2 (in C.A. 1784-85/70.) The Judgment of the Court was delivered by KHANNA, J.-Appeal No. 1353 of 1970 on certificate is directed against the judgment of Andhra Pradesh High Court whereby the High Court answered the following question on reference made to it under section 66(1) of the Indian Income-tax Act, 1922 (hereinafter referred to as the Act) against the assessee and in favour of the revenue "Whether the interest payment of Rs.

2,38,614/represents an element on the actual cost of the machinery, plant etc. to the asseessee and as such depreciation and deve- lopment rebate are admissible with reference to this amount also ?"

The matter relates to the assessment year 1959-60, the corresponding accounting year for which ended on June 30, 1958. The assessee is a public limited company engaged in the manufacture and sale of sugar. The company went into production on January 22, 1958. The assessee company had borrowed considerable sum of money from the Industrial Finance Corporation of India for the installation of machinery and plant. During the relevant year and for the period prior to the commencement of its business the assessee paid Rs. 2,38,614 as interest. The case of the assessee is that the payment of interest added to the cost of machinery and plant to the assessee and

as such while calculating depreciation admissible to the assessee, the interest paid should be treated as part of the cost of the machinery and plant to the assessee.

The income)-tax officer rejected the above claim of the assessee and held that the interest paid from year to year was an admissible item of revenue expenditure and no depreciation could be allowed on the capitalised amount of the expenditure incurred on account of interest. No part of the above amount, according to the incometax ,officer, should be taken as expenditure attributable to the erection of the machinery or other assests. The Appellate Assistant Commissioner on appeal reversed the decision of the income- tax officer on this aspect. The Appellate Assistant Commissioner held that during the period of construction when money was borrowed for the purpose of purchasing and installing the machinery, the payment of interest was the "cost of maintaining the borrowal", and as such could be included as part of the capital cost. On further appeal the Income-tax Appellate Tribunal held that the cost to the assessee must include all expenditure which it had to incur for acquiring and installing the asset. The interest paid or payable during the period of acquisition and installation could, therefore, be considered as part of the cost to the assessee.

The question reproduced above was then referred to the High Court. The High Court held that where a plant is constructed out of borrowed money, the interest on the loan up to the date of the commencement of the business could not be capitalised or treated as part of the actual cost of the plant.

Similar question arises in civil appeals Nos. 1784 and 1785 of 1970 which have been filed by the Commissioner of Income- tax on certificate against the judgment of the Calcutta High Court whereby the High Court answered the following question in reference under section 66(1) of the Act for assessment years 1955-56 and 1959-60 against the revenue and in favour of the assessee company :

"Whether on the facts and in the circumstances of the the assessee was entitled under the provisions of sections 10(2)(vi), 10(2)(vi-a) and 10(2)(vi-b) and read With section 10(5) of the Indian Income tax Act to treat the sum of Rs. 23,53,284 being the amount of interest paid on monies borrowed at part of the actual cost for the purpose of depreciation allowances and development rebate ?"

In civil appeal No. 1784 of 1970, which relates to the assessment year 1959-60, the following additional question was also answered by the High Court against the revenue and in favour of the assessee "Whether the wealth-tax payable by the assessee under the provisions of the Wealth- tak Act of 1957 is allowable as a deduction under section 10(1) or under section 10(2)(xv) of the Indian Income-tax Act?"

The assessee company in these two appeals, M/s Standard Vacuum Refining Co. of India Ltd. (now known as Hindustan Petroleum Corporation Ltd.), was incorporated

on July 5, 1952 and commenced its business in September 1954. In June 1953 it borrowed rupees four crores on debenture at-the. rate of Rs. 5 1/4 per cent interest from the public. The interest was to run from June 1953. The above amount together with rupees twelve crores financed by the company was used in setting up a refinery for which plant and machinery were imported from abroad. The refinery started work on September 1, 1954, from which date depreciation began to be calculated. The assessee company capitalised all the expenses during the period of construction, including the interest amounting to Rs. 23,53,284 which had accrued from the date of borrowing to the date, of the commencement of the business on the aforesaid loan and claimed depreciation on full amount. The income-tax officer did not include interest on debentures in arriving at the figure of actual cost and as such rejected the claim of the assessee in this respect. The Appellate Assistant Commissioner agreed with the Incometax officer. The Tribunal on further appeal held that the assessee was also entitled to depreciation on the capitalised interest of Rs. 23,53,284 paid to the debenture holders. The relevant facts so far as the second question in civil appeal No. 1784 of 1970 is concerned were as follows. Ile assessee, company filed a return showing an income of rs. 1,52,88,497 for the assessment year 1959-60, the relevant accounting year for which was the calendar year 1958. In arriving at the above figure of the income, the assessee claimed a sum of Rs. 5,04,000 representing the provision for wealth-tax payable by it for the previous year relevant to the date of valuation, viz., December 31, 1958. The income-tax officer held that the provision for the payment of wealth tax did not amount to expenditure laid out wholly and exclusively for the purposes of the business. 'The Appellate Assistant Commissioner agreed with the income-tax officer. On second appeal the Appellate Tribunal held that the above amount could be allowed at the time when actual payment was made. The High Court, as already mentioned, answered both the questions in favour of the assessee and against the revenue. This judgment would dispose of all the three civil appeals. In appeal before us Mr. Palkhivala on behalf of the assessees in the three appeals has argued that interest for the period before the commencement of production on money borrowed for the purpose of acquiring and installing the machinery and plant should be included, in the actual cost of the plant and as such capitalised for the, purpose. As against that, Mr. Desai on behalf of the revenue has supported theview taken by the Andhra Pradesh High Court. After hearing the learned counsel for the parties, we are of the opinion that the submission made by Mr. Palkhivala is well-founded.

Before dealing with the contentions advanced, we may set out therelevant provisions. Section 10 inter alia provides for the payment of tax in respect of profits or gains of any business by an assessee.Sub-section (2) of that section provides that such profits or gains shall be computed after making the allowances specified therein. Clause (vi) of that sub-section deals with deductions on account of depreciation and provides inter alia that deductions would be permissible in respect of depreciation of machinery or plant used for the purpose of business and being the property of the assessee, of a sumequivalent to such percentage on the written down value thereof as

> may in any case or class of cases be prescribed. "Written downvalue" has been defined in sub-section (5) of section 10 in the caseof assets acquired in the previous year, the actual cost to the assessee, and in the case of assets acquired in the previous year, the actualcost to the assessee, less all depreciation actually allowed to him under this Act or any Act repealed thereby, orunder executive orders issued when the Indian Income-tax Act,1886 was in force. The definition is subject to provisos, but we are not concerned with them. The explanation which has been added to sub- section (5) reads as under
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> "Explation For the purpose of this subsection the expression 'actual cost' means the actual cost of the assetsto the assessee reduced by that portion of the cost thereof,if any, as has been met directly or indirectly by Governments or by any public or local authority, and any allowance in respect of any depreciation carried forward under clause (b) of the proviso to- clause (vi) of sub-section (2) shall be deemed to be depreciation 'actually allowed'."

It has not been disputed that so far as the question before us is concerned the legal position for determining the actual cost for the purpose of development rebate is the same as for the purpose of depreciation.

It would appear from the above that while considering the question of deduction on account of depreciation and development rebate, we have to take into account the written down value. Written down value in its turn depends upon the actual cost of the assets to the assessee. The expression "actual cost" has not been defined in the Act, and the question which engages our attention is whether the interest paid before the commencement of production on the amount borrowed for the acquisition and installation of the plant and machinery can be considered to be part of the actual cost of the assets to the assessee. So far as the interest after the commencement of production in respect of capital borrowed for the purposes of business is concerned, the same can be deducted under clause (iii) of subsection (2) of section 10 of the Act.

In finding the answer to the question mentioned above, we have to bear in mind that it arises in the context of profits or gains of business and the permissible deductions on account of depreciation and development rebate relating to the machinery and plant of the assessee. As the expression "actual cost" has not been defined, it should, in our opinion, be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the above, expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The word "cost", as observed on page 424 of Simon's Taxes B Third Edition, is not synonymous with "price". Other items of expenditure, such for instance as freight or warehouse charges or insurance, must in certain cases be added to the price. The matter has been dealt with in Accountancy by Pickles 1955 Ed.on page 944 under the head "Payment of interest on Construction Capital"as under:

> "In the ordinary course of affairs no dividends may be paid unless such dividends are paid out of profits : interest on debentures (being a charge is, however, payable

> whether profits are earned or not). Where company raises share, capital and out of the proceeds defrays the expenses of the construction of any works or buildings or provision of plant which cannot be made profitable for a lengthened period the company may pay interest on so much of that share capital as is paid up for the period and may charge to capital the sum paid by way of interest, provided that the re strictions imposed under section 65 of the Companies, s Act, 1948 are complied with,"

4-L319Sup.Cl/75 It is further observed "The interest so paid is 'capitalised', that is to say it is treated as part of the cost of construction being added thereto (similarly to legal expenses of acquiring Property or brokers' charges on purchasing investments)." In Spicer & Pegler's Practical Auditing 11th Edition it is observed on pages 190-191 under the head "Interest Payable Out of Capital During Construction"

> "Interest on debentures issued for a similar purpose can be charged to capital during the period of construction (Hinds v. Buenos Ayres Grand National Tramways Co. Ltd. (1906) 2 Ch.
>
> 654)."

In Higher Book-Keeping, & Accounts by Cropper Morris & Fison Seventh Edition, it is-observed as under

> "Capital expenditure over a long period must perforce involve the question of interest as an additional cost. If the work were undertaken by an independent contractor he would, of course take,interest into account when preparing the estimates on which to base his tender. The final cost cost of construction work is' made up of' thecost of machinery, materials, labour, supervision, and establishment charges, plus interest on the capital employed which, but for its employment in that way, would be invested in good securities, paying a reasonable rate of interest."

Section 208 of the Companies Act, 1956 (Act 1 of 1956) deals with payment of interest on share capital in certain contingencies. Subsection (1) of that section reads as under:

> "(1) Where any shares in a company are issued for the purpose of raising money to defray the expenses of the cons-

truction of any work or building. or the provision of any plant, which cannot be made profitable for a lengthy period, the' company may-

(a) pay. interest so much of that share capital as is for the time being paid up, for the period and subject to the conditions and restrictions mentioned in subsections (2) to (7); and

(b) charge the sum so paid by way of interest, to capital as part of the cost of- construction of the work or building or the Provision of the plant."

Exercise of power under sub-section (1) is, however subject to certain restrictions which have been enumerated in the remaining subsections of the section, one of which requires that no such payment shall be made without the previous sanction of the Central Government. , In Statement on Auditing Practices issued by the Institute of Chartered Accountants of India (1974) it is observed in paragraph 2. 5 as under :

> "2.5 Fixed Assets should be valued at cost and depreciation should be written off on a proper and consistent basis.
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> Cost includes all expenditure necessary to bring the assets into existence and to put them in working condition. By way of illustration the following may be mentioned
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> (i) Legal charges and stamp duties in the case of land,
>
> (ii)Architect's fees in the case of buildings,
>
> (iii)Wages, salaries and installation expenses in the case of machinery, and
>
> (iv) Interest on borrowings to the extent specified in paragraph 2.22"

Relevant part of paragraph 2.22 reads as under

> "2.22 The question often arises as to whether interest on borrowings can be capitalised and added to the fixed assets which have been created as a result of such expenditure. The accepted view seems to be that in the case of a newly started company which is in the process of constructing and erecting its plant, the interest incurred before production commences may be capitalised. 'Interest incurred means actual interest paid or payable in respect of borrowings which are used to finance capital expenditure. In no circumstances, should imputed interest be capitalised, such as interest on equity or preference capital at a notional rate. Interest on capital during construction paid in accordance with the provisions of section 208 of the Companies Act, 1956, may, however, be capitalised as permitted by that section. Interest on monies which are specifically borrowed for the purchase of a fixed asset may be capitalised prior. to the asset coming into production, i.e. during the erection stage. However, once production starts, no interest on borrowings for the purchase of machinery (whether for replacement or renovation of existing plant) should be capi-
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> talised..... "

It would appear from the above that the accepted accountancy rule for determining the cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in

working condition. In case money is borrowed by a newly started 'company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets which have been created as a result of such expenditure. The above rule of accountancy should, in our view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.

We have already referred to section 208 of the Companies Act which makes provision for payment of interest on Share capital in ,certain contingencies. Clause (b) of sub- section (1) of that section provides that in case interest is paid on share capital issued for the purpose of raising money to defray the expenses of constructing any work or building or the provision of any plant in contingencies mentioned in that section, the sum so paid by way of interest may be charged to capital as part of 'the cost of construction of the work or building or the provision of the plant. The above provision thus ,gives statutory recognition to the principle of capitalising the interest in case the interest is paid on money raised to defray expenses of the construction of any work or building or the provision of any plant. in contingencies mentioned in that section even though such money constitutes share capital. The same principle, in our opinion, should hold good if interest is paid on money not raised by way of share capital but taken on loan for the purpose of defraying the expenses of the construction of any work or building or the provision of any plant. The reason indeed would be stronger in case, such interest is paid on money taken on loan for meeting the above expenses.

Mr. Desai has argued that if the interest paid on loan incurred for the purpose of acquisition and installing the machinery of a plant is to be taken into account in considering the actual cost of the plant, the result would be that the actual cost would be higher if the machinery for the plant is acquired and installed with borrowed money compared to the cost of such plant in case the money spent for the acquisition and installation of the above machinery is that which belongs to the assessee. This undoubtedly is so but it is inevitable and should not detract from the conclusion at which we have arrived. Let us take the case of an architect constructing his house. In case the architect engages another architect to prepare the plan for his house and to supervise its construction and pays remuneration to that other architect for this purpose, the amount so paid to the other architect shall have to be taken into account in arriving at the figure of actual cost of the house. In case, however, the architect constructing the house himself prepares the plan of the house and supervises its construction, he would naturally be not paying any remuneration to himself for the aforesaid work The result would be that in the latter event the actual cost of the house would be less compared to the cost of the house in the former event even though the house in all other respects is identical. It would therefore, follow that for similar fixed assets there can be different 'actual costs. The fact that there would be a difference in the actual cost of the plant in case its machinery is acquired and installed with the assessee's own money or in case it is acquired and installed with borrowed money does not consequently militate against the answer which we propose to give to the question referred in the three appeals.

In the case of Hinds v. Buenos Ayres Grand National Tramways Company, Limited(1) a trarnway company, for the purpose of converting its undertaking to a system of electric traction, issued conversion debenture stock. The directors passed resolutions that the interest on this stock should

be treated as part of the cost of construction, and chargeable to capital account during the construction of the works. The memorandum and articles of association of the company contained no provisions relating to this subject. It was held that there (1) [1906] 2 Ch. D. 654.

was no general rule of law which compelled companies to charge to revenue account interest on money borrowed for the purpose of constructing works, or prohibited them from charging it, during construction, to capital account. It was further he-Id that in the absence of any provision to the contrary the company was at liberty to charge the interest in question to capital account. Dealing with the question of costs for the, purpose of construction and the question whether the interest paid on money borrowed for such construction could be capitalised, Warrington J. observed :

> "Now, what is it that the company are really proposing to do ? They are creating a capital asset by means of which they will hereafter earn, or they hope to earn, profits for the company. They are not simply employing contractors to find the money and do the work. They are finding the money themselves, and they find the money by borrowing it. What does each mile of line cost them under these circumstanceswhat is it that they expend in constructing each mile of line, taking the amount of the borrowed money expended on that line to be pond s 1 0,000, that being the company's estimate? The money is borrowed for that particular purpose-the pond 10,000. They have to pay interest on that pond 10,000 during the period that construction is taking place. In my opinion that asset which they are so constructing costs them not only the Es 10,000, but the Es 10,000 plus the amount of interest during the period of construction; and that is what they are out of pocket during the construction of that mile of line. Now, it seems to me that the company are entitled-I do not say that they are bound to do it-if they think fit to charge in their accounts as the cost of that mile of line not only pond-s 10,000, but the Es 10,000 and the interest on it during the period of construction."

Mr. Desai has referred to the decision of the House of Lords in the case of Corporation of Birmingham v. Barnes (H. M. Inspector of Taxes).(1) The appellant corporation in this case entered into an agreement with a company to lay a tramway track and establish a tramway service to the company's works. By virtue of the work having been completed and-the service established by a certain date, the corporation received from the company in accordance with the terms of the agreement, a specified sum. The corporation also spent considerable sums of money on the renewal of their tramway tracks and received in that connection grants from the Unemployment Grants Committee. These grants were made under certain conditions to local authorities to assist them 'in carrying out at once approved schemes of public utility on which a substantial number of unemployed persons could be engaged. It was held that the payment by the company and the grant from the Unemployment Grants Committee should not be, taken into account in ascertaining the actual Costs to the corporation of the tramway track in question for the purpose of computing the allowance due to the corporation for (1) 19 Tax Cases 195.

wear and tear of such tracks. Lord Atkin observed in the above case :

> "What a man pays for construction or for the purchase of a work seems to me to be the cost to him; and that whether someone has given him the money to construct or purchase for himself, or before the event has promised to give him the money after he has paid for the work, or after the event has promsed or given the money which recoups him what he has spent. In the present case, the Corporation paid the whole of the cost of the tramways out of their funds unless the first half of the Dunlop contribution was so applied : as to which there is no evidence, nor is it material."

The above observations were made in the context whether money contributed by another party can be taken into account in considering the cost of construction. No such question arises in the present case. On the contrary, what we are concerned with here is whether interest paid on money borrowed for the acquisition and installation of the machinery of a plant accruing before the commencement of production can be, taken into account in considering the actual cost of the plant. Such a question did not arise in the above mentioned case before the House of Lords. Another case to which reference has been made on behalf of the revenue is India Cements Ltd. v. Commissioner of Income-tax Madras.(1). The appellant company in that case obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation by creating a charge on its fixed assets. In connection therewith the company spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fee and claimed this amount as business expenditure. It was held that the amount spent was not in the nature, of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction under section 2(xv) of the Act. The act of borrowing money, it was observed, was incidental to the carrying on of business and the loan obtained was not an asset or an advantage of enduring nature. This Court accordingly held that the amount of Rs. 84,633 was an allowable expenditure. This case too is of no assistance to the revenue. The appellant company in that case at the time it raised the loan was a running concern. Unlike the assessees in the present appeals, the loan raised by the appellant company in the cited case was not before the commencement of production but at a later stage. The question of including the interest paid on loan before the commencement of business in the actual cost of the plant did not arise in that case.

It may be mentioned that as against the view taken by the Andhra Pradesh High Court in the judgment which is the subject (1) [1966] 60 I.T.R. 52.

matter of the appeal, three other High Courts have taken the contrary view and have-field that interest paid in such circumstances can be capitalised and included in the actual cost of the machinery and plant. The decision of the Calcutta High Court in which the contrary view has been taken is the subject matter of appeal before us. The view of Calcutta High Court has been followed by the Madras High Court and the Allahabad High Court. The decision of the Madras High Court is in the case of Commissioner of Income-.tax Madras v. L. G. Balakrishnan and Bros. (P) Ltd.,(1) while that of the Allahabad High Court is in the case of Commissioner of Income-tax v. J. K. Colton Spinning & WVg. MilIs (2). After giving the matter our considera- tion, we are unable to subscribe to the view taken by the Andhra Pradesh High. Court. The correct view in the matter, in our opinion, has been taken by the Calcutta High Court and we affairm the same.

We may now advert to the second question in civil appeal No. 1784 on the point whether the wealth-tax payable by the assessee is allowable as a deduction. The High Court, as already mentioned, answered the second question in favour of the assessee. Subsequent to the judgment of the High Court this Court in the case of Travancore Titanium Product Ltd. v. Commissioner of Income-tax Kerala(3) held that the amount of wealth tax paid by an assessee on his net wealth under the Wealth-tax Act is not a permissible deduction under section 10(2)(xv) of the Act in his income-tax assessment. This Court in that context observed that wealth-tax is imposed on the owner of assets and not on any commercial activity. The fact that in certain special cases the quantum of the liability of a company to wealth-tax is related to the profits earned would not alter the character of the tax. It remains a tax charged upon the net wealth and it is not made a tax related to or incidental to the carrying on of business.

After the above decision, the matter was considered by a larger Bench consisting of five Judges in the case of Indian Aluminium Co. Ltd. v. Commissioner of income-tax West Bengal(4). This Court held that the wealth-tax paid by- the assessee which was a trading company on assets held by it for the purpose of business was deductible as a business expenditure in computing the assessee's income from busi- ness. Sikri, C.J. speaking for four of the Judges observed that when a person has a dual capacity of a trader-cum owner, and he pays tax in respect of property which is used for the purpose of trade, the payment must be taken to be, in the capacity of a trader according to ordinary commercial principles.

Subsequent to the above decision in the case of Indian Aluminium Co. (supra) the Income-tax Act, 1961 was amended first by means of an ordinance and later by means of the Income-tax (Amendment) Act, 1972 (Act No. 41 of 1972). By section 2 of the amending Act such clause (iia) was inserted and wits deemed always to have been (1) [1974] 95 I.T.R. 284.

(2) Income-tax reference No. 234 of 1972 decided on May 13, 1974.

(4) [1972] 84 I.T.R. 735.

(3) [1966] 60 I.T.R. 277.

inserted in clause (a) of section 40 of the Income-tax Act 1961 as under :

> "(iia) any sum paid on account of wealth-tax."

An explanation was added to the above sub-clause, but it is not necessary to reproduce the,, same. Section 40 of the Indian Income-tax Act, 1961 specifies the amounts which shall not be deducted in computing the income chargeable under the heads "Profits or gains of business or profession". According to section 4 of the amending Act, nothing contained in the Indian Income-tax Act, 1922 shall be deemed to authorise, or shall be deemed ever to have authorised, any deduction in the computation of the income of any assessee chargeable under the head "Profits and gains of business, profession or vocation" or "Income from other sources" for the assessment year commencing on the 1st day of April, 1957 or any subsequent assessment year, of any sum paid on account of wealth-tax.

In view of the above provisions, it is plain that any sum paid on account of wealth-tax cannot be deducted in computing the income of an assessee chargeable under the head "Profits and gains of business, profession or vocation"

> or "Income from other sources". There is, however, a saving clause contained in section 5 of the amending Act and it reads as under :
>
> "Where, before the 15th day of July, 1972 being the date on which the Income tax (Amendment) Ordinance, 1972 came into force, the Supreme Court has, on an appeal in respect of the assessment of an assessee for any particular assessment year, held that wealth- tax paid by the assessee is deductible in computing the total income of that year, then, nothing contained in subclause (iia) of clause
>
> (a) of section 40, or sub-section (IA) of section 58, of the principal Act, as amended by this Act, or, as the case may be, section 4 of this Act, shall apply to the assessment of such assessee for that particular year."

Mr. Palkhivala submits that the case of the assessee in respect of the second question in civil appeal No. 1784 is covered by section 5 of the amending Act reproduced above. To appreciate the above submission, we may observe that civil appeals Nos. 1784 and 1785 of 1970 along with civil appeals Nos. 1694 and 1730 of Indian Aluminium Co. and civil appeal No. 1831 of 1970 of Standard Vacuum Oil Co. were argued before the Constitution Bench on February 1, 1972. The Court reserved judgments in civil appeals No. 1694 and 1730 of Indian Aluminium CO. and civil appeal No. 1831 of standard Vacuum Oil Co. As an additional question relating to the inclusion of interest in the calculation of the actual cost arose in civil appeals Nos. 1784 and 1785 of 1970, the Court after hearing some arguments on that point in these appeals directed that they be heard by a Division Bench after the pronouncement of judgment in civil appeals No. 1694, 1730 and 1831. Judgments in those three appeals, i.e. two appeals of Indian Aluminium Co. and one of Standard Vacuum Oil Co. were pronounced on March 29, 1972. The decision in the appeals in the case of Indian Aluminium Co. is reported, as already mentioned, in (1972)84 ITR 735, while that in the case of Standard Vacuum Oil Co. is reported in (1972) '86 ITR 1.

The submission made by Mr. Palkhivala is that even though no final order was pronounced in civil appeal No. 1784 before July 15, 1972, the effect of the judgment in the other three civil appeals Nos. 1694, 1730 and 1831, which were heard along with civil appeal No. 1784 on the point as to whether the wealth-tax paid by the assessee was a permissible deduction, was that this Court held that the same was to be the decision on that point in civil appeal No. 1784. As against that, Mr. Desai contends that there was no finding by this Court before July 15, 1972 in civil appeal No. 1784 that the wealthtax paid by the assessee was deductible in computing the total income of the assessee. There is, in our opinion, force in the submission of Mr. Palkhivala. As stated above, arguments were heard together on February 1, 1972 in civil appeals Nos. 1784, 1694, 1730 and 1831 on the question as to whether the wealth-tax paid by the assessee was a permissible deduction under section 10(2) (xv) of the Indian Income-tax Act. On the conclusion of the arguments on that point, this Court found that an additional question arose in civil appeal No. 1784 on the point as to whether the

interest payable on loan was part of the actual cost of the assets. The Constitution Bench after hearing arguments on this additional point for some, time directed that civil appeal No. 1784 along with the connected civil appeal 1785 should be posted for hearing before a Division Bench after pronouncement of judgment in civil appeals Nos. 1694, 1730 and 1831. The effect of the above order which was made on February 1, 1972 was that the decision in civil appeals Nos. 1694, 1730 and 1831 on the point as to whether the wealth-tax paid by the assessee was a permissible deduction, was also to be the decision in civil appeal No. 1784. After the judgments of the Constitution Bench in civil appeals Nos. 1694, 1730 and 1831 on March 29, 1972 the question as to whether the wealth-tax paid by the assessee was a permissible deduction under section 10(2)(xv) of the Act no longer remained subject of controversy in civil appeal No. 1784 as the decision on that point in the three appeals was also to govern the decision in appeal No. 1784. It is no doubt true that civil appeal No. 1784 was not disposed of before July 15, 1972 but that fact would not prevent the case of the assessee in that appeal 'being covered by section 5 of. the amending Act. What is necessary to attract that section is that this Court should have held before July 15, 1972 on an appeal in respect of an assessment of the assessee for any particular assessment year that the wealth-tax paid by the assessee is deductible in computing the total income of that at year. Once that is the effect of a decision given by this Court fore July 15, 1972 the fact that the judgment in which the above finding is recorded is given in other appeals, which are heard together along with the appeal of the assessee and the further fact that assessee's appeal is not disposed of before July 15, 1972 would not take the case of the assessee out of the purview of section 5. We would, therefore, hold that the case of the assessee in civil appeal No. 1784 is covered by section 5 of the amending Act.

We, however, make it clear that the benefit of section 5 of the amending Act so far as the second question in civil appeal No. 1784 is concerned would be available only in respect of wealth-tax paid and not merely payable. In the light of the above, we dismiss civil appeals No. 1784 and 1785 of 1970. We accept civil appeal No. 1353 of 1970 and discharge the answer given by the High Court. We answer the aforesaid question in the affirmative in favour of the assessee and against the revenue. The assessees shall be entitled to the costs of these appeals. One hearing fee in civil appeals No. 1-784 and 1785 of 1970.

C. As. Nos. 1784 & 1785/70 dismissed V.M.K. C.A. No. 135 3/70 allowed.