Supreme Court of India
State Of Madras vs C. J. Coelho on 30 April, 1964
Equivalent citations: 1965 AIR 321, 1964 SCR (6) 60
Author: S Sikri
Bench: Sikri, S.M.

PETITIONER:
STATE OF MADRAS

Vs.

RESPONDENT:
C. J. COELHO

DATE OF JUDGMENT:
30/04/1964

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

CITATION:
1965 AIR 321 1964 SCR (6) 60
CITATOR INFO :
RF 1965 SC1201 (16)
R 1966 SC1053 (6)

ACT:
Income Tax--lnterest paid on monies borrowed for purchase of plantation-If deductible from the assessable Income-Expenditure if laid out or expended wholly and exclusively for the purpose of plantation-Madras Plantations Agricultural Income-tax Act (Mad. V of 1955). s. 5(e) and (k).

HEADNOTE:
The respondent, assessee purchased an estate, consisting of tea. coffee and rubber plantations. Out of the sale price of Rs. 3,10,000/- he ed Rs. 2,90,000/- at interest. For the assessment year 1955-56.
61
be claimed deduction on interest amounting to Rs. 22,628-9-9 under s. 5(k) of the Madras Plantations Agricultural Income-tax Act. The Agricultural Income Tax Officer allowed only Rs. 1,570-10-7 under the Act. The assessee appealed to the Assistant Commissioner and to the Tribunal, without success. On his revision application, the High Court held that the

deduction claimed by him fell within the scope of s. 5(e) of the Act and that the whole of Rs. 22.628-9-8. should have been deducted from his assessable income. On appeal by special leave, the appellant contended that the interest paid by the asscssee was not deductible under s. 5(e) of the Act on three grounds; first, it was in the nature of capital expenditure; secondly, it was a personal expense of the assessce, and thirdly, it was not laid out or expended wholly and exclusively for the purpose of the plantation.
HFLD:-(i) There is no force in the contention that the payment of interest was capital expenditure within s. 5(e) of the Act. In the instant case the payment of interest was revenue expenditure. No new asset was acquired with.it; no enduring benefit was obtained. Expenditure incurred was par of circulating or floating capital of the assessee. In ordinary commercial practice, payment of interest would not be termed as capital expenditure.
Assam Bengal Cement Co. Ltd. v. Commissioner of Income-tax, [19551 1 S.C.R. 972, relied on.
S.Kappuswami v. Commissioner of Income-tax, Madras, I.L.R. [1954] Mad. 977; and Commissioner of Income-tax, Madras v. Siddareddy Venkatasuhba Reddy, [1949] 17 I.T.R. 157, held inapplicable.
The European Investment Trust Company Ltd. v. Jackson, 18 T.C. I and Greshan Life Assurance Society v. Styles, 3 T.C. 185, distinguished.
(ii)The second contention is equally without substance. It is impossible to hold that any expense to discharge a personal obligation becomes a personal expense Within s. 5(e) of the Act. Personal expenses would include expenses on the person of the assessee or to satisfy his personal needs such as clothes. food etc., or purposes not related to the business for which the deduction is claimed.
(iii)On the facts of the present case it is impossible to dissociate the character of the assessee as the owner of the plantation and as a person working the plantation. The assessee had bought the plantation for working it as a plantation, 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 *aid to be laid out or expended wholly and exclusively for the purpose of the plantation. In principle there is no distinction between interest paid on capital borrowed for the acquisition of a plantation and between interest paid on capital borrowed for the purpose of running an existing plantation, both are for the Purposes Of the plantation.
62
Commissioner of Income-tax. Kerala v. Malavalem Plantation Ltd. C.A. No. 389/63 dated 10th October, 1964, relied on.
Eastern Investments Ltd. v. Commissioner of Income-tax, West Bengal, [1951] S.C.R. 594, Scottish North American Trust v.

Former, 5 T.C. 693, Dharamvir Dhir v. Commissioner of Income-tax, [1961] 3 S.C.R. 359 and Commissioner of Income-tax, Bombay v. Jagannath Kissonlal, [1961] 2 S.C.R. 645, referred to.
Metro Theatre Bombay Ltd. v. Commissioner of Income-tax, 14 I.T.R. 638, distinguished.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 701/1963. Appeal by special leave from the judgment and order dated January 19, 1960 of the Madras High Court in T.R.C. No. 53 of 1957.

A.Ranganadham Chetty and A. V. Rangam, for the appellant.

C. P. Lal, for the respondent.

April 30, 1964. The Judgment of the Court was delivered by SIKRI J.-The respondent, hereinafter referred to as the assessee, purchased an estate in 1950, known as Silver Cloud Estate, consisting of tea, coffee and rubber plantations,. in Gudalur, Nilgiris, Madras State. Out of the sale price of Rs. 3,10,000, he borrowed Rs. 2,90,000, at interest varying from seven to eight per cent per annum. For the assessment year 1955-56, the assessee claimed to deduct interest on this sum, amounting to Rs. 22,628-9-8. The Agricultural Income Tax Officer, Gudalur, disallowed Rs. 21,057-15-1, allowing Rs. 1,570-10-7, under S. 5(k) of the Madras Plantations Agricultural Income-Tax Act (Madras Act V of 1955) (hereinafter referred, to as the Act). The relevant part of the assessment order is reproduced below: "Interest on borrowings Rs. _21,057-15-1. The assessee has claimed Rs. 22,628-9-8 to wards interest. It is seen that about Rs. 80,000 has been borrowed from various parties, for the maintenance of the estate. Under section 5 (k) the interest has to be limited to six per cent on an amount equivalent to 25 per cent of the agricultural income in that year. The gross income is Rs. 1,04,710-13-11. So the borrowing has to be limited to 25 per cent of Rs. 1,04,710- 13-11, which is Rs. 26,177-11-6. Interest at six per cent on this amount is Rs. 1,570-10-7. So a sum of Rs. 21,057-15-1 is disallowed (22,628-9-8 minus 1,570-10-7)." The assessee appealed to the Assistant Commissioner of Agricultural Income Tax, without success. He then appealed to the Madras Plantations Agricultural Income Tax Appellate Tribunal, hereinafter refereed to as the Tribunal. The tribunal observed as follows:

"It is not possible to agree with the, contention that interest paid in the year of account towards a loan borrowed by the proprietor for the purpose of acquisition of the estate will fall within the category of "expenditure wholly and exclusively laid out for the purpose of the plantation". The immediate object of the expenditure. i.e., payment of interest, is to liquidate a personal liability of the proprietor, as a debtor. That after such borrowing the debtor used it as sale price and acquired the estate, cannot make the payment of interest an "expenditure wholly and exclusively laid out for the purpose of the plantation." The language of the various subdivisions of section 5 of the Act referring to the various items of permissible deductions towards expenditure shows that the expenditure and the plantation must have a direct and proximate connection. Here, the proximate connection of the payment is with a personal loan and not with the plantation." The assessee filed a revision application to the High Court under s. 54(l) of the Act, and raised the following question before it:

"Question of law raised for decision by the High Court- Whether interest paid on monies borrowed for the purchase of the plantation is expenditure of the nature referred to in section 5 (e) of the Act and should therefore be deducted in assessing the income of the Plantation during the year." The High Court held that the deduction claimed by the assessee fell within the scope of s. 5 (e) of the Act, and that the whole of Rs. 22,628-9-8, and not merely Rs. 1,570- 10-7, should have been deducted from his assessable income. It ordered that the assessment be revised accordingly. The High Court refused to certify the case as a fit one, under article 133 (1) (c) of the Constitution. But this Court gave special leave to the appellant to appeal against the judgment and order of the High Court.

The relevant statutory provisions are as under. S. 2(a) defines 'agricultural income' and s. 2(r) defines 'planta- tion' "2(a) 'agricultural income' means-

(1) any rent or revenue derived from a planta- (2) any income derived from such plantation in the State by-

(i) agriculture, or

(ii)the performance by a cultivator or receiver of rent-in- kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market. or

iii)the sale by a cultivator or receiver of rent in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (ii);

Explanation I-Agricultural income derive from such plantation by the cultivation of tea means that portion of the income derived from the cultivation, manufacture and sale of tea as is defined to be agricultural income for the purposes of the enactments relating to Indian Income-tax;

Explanation II-Agricultural income derived from such plantation by the cultivation of coffee, rubber, cinchona or cardamom means that portion of the income derived from the cultivation, manufacture and sale of coffee, rubber, cinchona or cardamom, as the case may be, as may be defined to be agricultural income for the purposes of the enactments relating to Indian Incometax;

(2) (r) 'Plantation' means any land used for growing all or any of the following, namely, tea, coffee, rubber, cinchona or cardamom;".

Section 3 is the charging section and it directs that "agricultural income-tax at the rate or rates specified in Part I of the Schedule to this Act shall be charged for each financial year commencing from 1st April, 1955 in accordance with and subject to the provisions of this Act, on the total agricultural income of the previous year of every person." Section 4 describes what is 'total agricultural income'. Section 5 is concerned with the computation of agricultural income and directs the deduction of various items. We are concerned with two sub-clauses and they are set out below "5(e) any expenditure incurred in the previous year (not being in the nature of capital expenditure or personal expenses of the assesse) laid out or expended wholly and exclusively for the purpose of plantation;

(k) any interest paid in the previous year on any amount borrowed and actually spent on the 51 S. C.-5 plantation from which the agricultural income is derived. Provided that the need for borrowing was genuine having due regard to the assets of the assessee at the time; Provided further that the interest allowed under this clause shall be limited to six per cent on an amount equivalent to twenty-five per cent of the agricultural income from the plantation in that year."

The learned counsel for the State contends that the interest paid by the assessee is not deductible under s. 5(e) of the Act on three grounds: First, it is in the nature of capital expenditure; secondly, it is a personal expense of the assessee; and thirdly, it is not laid out or expended wholly and exclusively for the purpose of the plantation. Before adverting to the above grounds, it will be noticed that s. 5 (e) is word for word a reproduction of s. 10 (2)

(xv) of the Income Tax Act, 1928, and as this Court and the High Court have on various occasions considered the said clause, these decisions would be relevant for deciding the present case, which arises under the Act. Is the payment of the said interest in the nature of capital expenditure or not? -Mr. Chetty urges that the assessee ad bought the plantation with borrowed money and that was undoubtedly capital expenditure. He says that it follows logically from this that interest paid on the amount spent on the purchase of the plantation must also be capital expenditure. He invited our attention to a number of cases, with which we will shortly deal.

In order to determine whether an expenditure is revenue or capital expenditure, certain broad principles have to be borne in mind. This Court formulated these principles in Assam Bengal Cement Co. Ltd. v. The Commissioner of Income Tax,(') in the following words:

"(1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of (1) [1955] 1 S.C.R. 972 a business, or for a substantial replacement of equipment: vide Lord Sands in Commissioners of Inland Revenue v. Granite City Steamship Company [(1927) 13 T.C. 1] and City of London Contract Corporation v. Styles [(1887) 2 T.C. 239].

(2) Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade vide Viscount Cave, L. C., in Atherton v. British Insulated and Helsby Cables Ltd., [(1926) 10 T.C. 155]. If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be deducted out of profits by claiming that it relieves the annual labour bill, the business has acquired a

new asset, that is, machinery.

The expressions 'enduring benefit' or 'of a permanent character were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset.

(3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again. it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it." This Court further held that 'one has got to apply these criteria, one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductable allowance under section 10(2) (xv) of the Indian Income Tax Act, 1922.

If we apply these principles to the facts of this case, the answer seems clear that the payment of interest is revenue expenditure. No new asset is acquired with it; no enduring benefit is obtained. Expenditure incurred was part of cir- culating or floating capital of the assessee. In ordinary commercial practice, payment of interest would not be termed as capital expenditure.

The cases relied on by Mr. Chetty do not bear on the precise problem. We may, however, notice them in brief. In S. Kuppuswami v. The Commissioner of Income Tax, Madras('), the assessee was held to have acquired the goodwill by paying a certain share of profits. This was held to be capital expenditure. In Commissioner of Income-Tax, Madras, v. Siddareddy Venkatasubba Reddy('), the assessees had under certain agreements obtained mining rights in different plots of land for periods varying from five to nine years, and claimed deduction of the amounts paid by them under the said agreements. The High Court held the money expended for the acquisition of mining rights to be capital expenditure. In The European Investment Trust Company Limited v. Jackson(') the Court of Appeal was concerned with the inter- (1) I.L.R. (1954) Mad. 977 (2) (1949) 17 I.T.R. I 5 (3) 18 T.C. I pretation of Rules 3 of the Rules applicable to Cases I and 11 of Schedule D of the Income Tax Act, 1918 (8 & 9 Geo. V. c. 40). In the English Act there are a series of prohi- bitions; among other things prohibited to be deducted are any capital withdrawn from or any sum employed or intended to be employed as capital in such trade, profession or employment or vocation, and any annual interest or any annuity or annual payment payable out of profits. the English cases like The European Investment Trust Company case(') are distinguishable because in England there existed the prohibition enumerated above. There are no such prohibitions in the Act with which we are concerned. But apart from these prohibitions, Lord Herschall observed in Gresham Life Assurance Society v. Styles(2) as follows: "I think the fourth rule was primarily designed to meet such a case as that in which a trader had contracted to make an annual payment out of his profits, as for example, when he had agreed to make such a payment to a former partner or to a person who had made a loan on the terms of receiving such a payment. But for the rule it might plausibly have been contended that in such a case a trader was only to return as his profits what remained after such payment". (emphasis supplied).

Accordingly we hold that there is no force in the contention that the payment of interest was capital expenditure within s. 5 (e) of the Act.

The next point, namely, that the payment of interest was a personal expense is equally without substance. We are unable to appreciate that any expense to discharge a personal obligation becomes a personal expense within s. 5

(e). Personal expenses would include expenses on the person of the assessee or to satisfy his personal needs such as clothes, food, etc., or purposes not related to the business for which the deduction is claimed.

(1) 18 T.C. 1.

(2) 3 T.C. 185.

The third fround raised, by Mr. Chetty needs careful scrutiny. This Court, after reviewing English and Indian cases, summarised the position in Commissioner of IncomeTax, Kerala v. Malayalam Plantation Ltd.(') as follows: "The aforesaid discussion leads to the following result : The expression "for the purpose of the business" is wider in scope than the expression "for the purpose of coming profits". Its range is wide. it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the origin of the agency is voluntary or statutory; in that event, he pays the amount on behalf of another and for a purpose unconnected with the business."

Before deciding the question, it is necessary to mention three other decisions of this Court. In Eastern Investments Ltd. v. Commissioner of Income Tax, West Bengal(') this Court held that interest on debentures issued by an investment Company was to be allowed as business expen- (1) C.A. Nos. 384 and 385165 decided on April 10, 1964. (2) [1961] S.C.R 594.

diture under s. 12 (2) of the Indian Income Tax Act. It observed that 'this being an investment company, if it borrowed and used the same for its investments on which it earned income, the-interest paid by it on the loans will clearly be a permissible deduction under s. 12(2) of the Act'.

Earlier, it had observed that Scottish North American Trust v. Farmer(') was a somewhat similar case. In Dharamvir Dhir v. The Commissioner of Income Tax (2), this Court held that a payment of 11/16 of the net profits of the assessee's business was an expenditure wholly and exclusively laid out for the purposes of the business as the assessee had arranged financing 'of the business on the best terms that he could manage.

In the Commissioner of Income Tax, Bombay v. Jagannath Kissonlal(3) this Court upheld the claim of the assessee to deduct the amount it had to pay the bank on a joint promissory note.

The only case cited by Mr. Chetty, which has some resemblance to the present case is the decision of the Bombay High Court in Metro Theatre Bombay Ltd. v. Commissioner of Income Tax (4) . But this case is distin- guishable for the interest claimed to be deducted, and which was disallowed, was in respect of the amount borrowed for acquiring land on 999 years lease, on which a cinema was subsequently built. There was no immediate connection between the interest paid and the cinema business. As Kania J., as he then was, put it, 'if the interest was not paid, the result would be not necessarily the stoppage of showing films, but the assessee will not acquire the lease of this property.

Applying the above principles to the facts of this case, it seems to us that it is impossible to dissociate the charac- ter of the assessee as the owner of the plantation and as a person working the plantation. Ile 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 (1) S.T.C. 693. (2) [1961] 3 S.C.R.

359. 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 purpose of the plantation.' In this connection, it is perti- nent to note that what the Act purports to tax is agricul- tural income and not agricultural receipts. From the agri- cultural receipts must be deducted all expenses which in ordinary commercial accounting must. be debited against the receipts. There is nothing in the Act which prohibits such expenses from being deducted. No farmer would treat interest paid on capital borrowed for the purchase of the plantation as anything but expenses, and as long as the deductions he claims, apart from any statutory prohibition, can be fairly said to lead to the determination of the true net agricultural income, these must be allowed under the Act. In principle, we do not. see any distinction between interest paid on_ capital borrowed for the acquisition of a plantation and that between interest paid on capital borrowed for the purpose of running an existing plantation; both are for the purposes of the plantation. In the result, we agree with the High Court that the deduction claimed by the assessee fell within the scope of s. 5(e) of the Act, and that the whole of Rs. 22,628-9-8 and not merely Rs 1,570-10-7 should have been deducted from his assessable income. The appeal fails and is dismissed with costs.

Appeal dismissed.