(1960) 01 KL CK 0047

High Court Of Kerala

Case No: Income-tax Ref. No. 6 of 1957

Western India Plywood Ltd., Baliapatam		APPELLANT
	Vs	
Commissioner of Income Tax, Madras		RESPONDENT

Date of Decision: Jan. 1, 1960

Acts Referred:

- Income Tax Act, 1922 - Section 10(2)

Citation: AIR 1960 Ker 253 : (1960) 38 ITR 533

Hon'ble Judges: S. Velu Pillai, J; M.A. Ansari, J

Bench: Division Bench

Advocate: T.V. Viswanatha Iyer, A.V. Ramanath Iyer and V.R. Venkata Krishnan, for the Appellant; G. Rama Iyer, for the Respondent

Judgement

Velu Pillai, J.

The assesses is a public limited company carrying on business as manufacturer of plywood furniture and of battens for sale. On October 8, 1950, the Board of Directors of the assessee resolved to raise a loan of three lakhs of rupees, by issusing 600 First Mortgage Debentures of Rs. 500/- each, bearing interest at 71/2 per cent per annum less Income Tax, redeemable in three successive years at one lakh every year, "to be utilised towards the working capital of the company."

The debentures were fully subscribed, and the subscriptions were received between August 24, and November 27, 1950. In issuing the debentures, expenses, by way of stamp paper for the relative trust deed, or underwriting commission, and of registration and lawyer''s fees, totalling Rs. 12,923-14-0 or roughly Rs. 12,924/- were incurred. In the revised statement of the case which is furnished to us, by the appellate Tribunal, it is stated, that "on the basis of the entries in the cash book and on consideration of the cash balances at various dates" the loan raised "can he stated in a rough and ready way to be identified with payments" towards the

purchase of timber and casein for over Rs. 1,76,000 cash purchases on December 18, 1950, for over Rs. 24,000, and discharge of loans on suspense account between October 28 and November 23, 1950, amounting to over Rs. 82,900 and with a deposit of Rs. 5l,500/- under a separate account, for the payment of dividends for the year ended March 31, 1950, as declared at the Annual General Meeting held on November 15, 1950.

The assessee did not claim a deduction of the aforesaid expenditure of 12,924/- In the return of income filed for the year ended March 31, 1950, for the assessment year 1951-1952, but made the claim before the Appellate Assistant Commissioner, which was admitted and allowed. On appeal by the Department of Income Tax, the Tribunal disallowed the claim, holding, that it is in the nature of capital expenditure and therefore inadmissible u/s 10(2)(xv) of the Indian Income Tax Act, 1922, which may be referred to as the Act. At the instance of the assessee, the "Tribunal has referred the following question to this court for decision:

"Whether the aforesaid expenditure of Rupees 12,924/- is a capital expenditure not deductible u/s (2)(xv)."

The contention of the assessee is, that the amount of three lakhs of rupees is not a capital receipt, and that therefore the expenses are deductible.

2. The relevant parts of Section 10 of the Act may be reproduced:

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

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

(XV) "any expenditure not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vacation."

On the arguments addresssed to us, the only question which arises for decision is, whether the sum of Rs. 12,924 is in the nature of capital expenditure. As a first step, it may be taken, that this represents expenditure incurred for the issue of debentures to the extent of three lakhs of rupees. If the amount so raised is capital receipt, money expended to raise it, has to be held to be in the nature of capital expenditure, either as forming part of the capital so raised and reducing the amount available to the assessee pro tanto, or alternatively, as partaking of the same character as such capital itself.

The question therefore resolves itself to whether, the sum of three lakhs of rupees raised by debenture is a capital receipt or a revenue receipt, Though the term

"capital expenditure" is not defined in the Act, as observed by Shah, J. in In re, Tata Iron & Steel Co. Ltd., (1875-83) 1 Tax Cas 125 the words "in tile nature of capital expenditure "make the meaning of the expression elastic in its application to the facts of each case." Capital may be subscribed or borrowed, and as for the latter, the act itself makes allowance for interest payable in respect of it. A borrowing of capital has to be distinguished from securing mete temporary or day to day accommodation, or from banking or overdraft facilities, and may be either by way of addition to the capital, or for improving the capital position.

The above distinction was pointed out by Finlay, J., in European Investment Trust Co. Ltd. v. Jackson, (1932) 18 TC 1 and was affirmed by Lawrence, J. in Ascot Gas Water Heaters Ltd. v. Duff, (1942) 24 TC 171, who considered a temporary accommodation to be an ordinary incident in carrying on the business. In a commercial sense, no one would speak of his banking facilities as part of his capital assets. In Ward v. Anglo-American Oil Co." Ltd., (1934) 19 TC 94, Singleton, J., quoted as follows, from the judgment of the Court of Session, in Scottish North American Trust v. Farmer, (1912) 5 T C 693 :

"it may well be said, that if money is borrowed on a permanent footing, as from year to year, the capital of the concern is in a commercial sense enlarged thereby and the business extended."

The category of short loans which may be contracted in carrying on a business, also comes within the scope of temporary accommodation or of ordinary trading facilities. But the raising of money debentures or mortgage, cannot be regarded as an ordinary incident in carrying on the business, or be treated as on a par with trading or banking facilities, but must prima facie and in the absence of other indications, be considered to affect the capital of the concern and its profit-making structure.

In (1942), 24 T C 171 the assessee became liable to a German company on account of the purchase of raw materials, when, on receipt of a commission, a Dutch company guaranteed payment. The assessee made a further borrowing secured by debenture, the repayment of which was guaranteed by another company on receipt of commission. The court allowed deduction of the first commission, as being for the discharge of an existing trade debt, but disallowed the second, under 8 and 9 Geo. V C. 40, Schedule D, Cases I and II, Rule 3(f), as being for capital facilities.

The same Rule was applied similarly in Bridgwater v. King, (1943) 25 Tax Cas 385 where the assessee, a firm of estate developers, claimed deduction for premium payable on repayment of a loan secured by a legal charge. In (1934) 19 Tax Cas 94 referred to, the issue of notes whether for one year or for a longer period, was held to be a capital nature or of the nature of a fund, employed or intended to be employed as capital, and in any case, as different from what might be regarded by business-men as facilities obtained for trading purposes. To earn profits by business

activities, there must of course be capital, but the arrangements by which capital is raised, are distinct From the activities themselves, and expenditure incurred in relation to such arrangements are of a capital nature, and not for earning profits. Accordingly, in Montreal Coke and Manufacturing Co. v. Minister of National Revenue 1944 13 ITR 1 "the financial readjustment of their borrowed capital" was held to be "an isolated episode, unconnected with the day to day conduct of their business, and the benefit which they derived, was not "earned" by them in their businesses."

To ascertain the profits of a trade, the necessary expenses incurred in earning them have of course to be deducted, but, such ascertainment has. or ought to have nothing to do with how the capital is found; for, as Mathew, J. observed in Texas Land and Mortgage Co. V. Holtham, (1894) 3 Tax Cas 255 here cannot be one law for a company having sufficient money to cany on all its operations and another which is content to pay for the accommodation". A borrowing for capital is thus distin-uishable from obtaining temporary accommodation, or banking or trading facilities for the purpose of carrying on business, though the distinction is a matter of degree. We are not, therefore, impressed by the argument, that the borrowing in the present case though subject to repayment in three years in terms, of the resolution, was a temporary accommodation or a trading facility as distinguished from the acquisition of capital.

3. The resolution of the Board of Directors of the assessee itself reveals, that it had no doubt in its mind as to the nature of the borrowing, which was to furnish the "working capital" of the company; the expenses for raising the loan were not, therefore, claimed as an allowance under the Act, before the Income Tax Officer. A distinction between share capital and borrowed capit''al" was attempted by Finlay, Q. C. in his arguments in 1894 3 TC 255, maintaining that the capital of the company, properly, so-called, is the share capital; but Cave, J. interposed observing, that "to the extent you borrow, you increase the capital of the company." In (1875) 1 Tax Cas 125, observing; that the cost of raising additional capital cannot be treated differently from that of raising the original capital, Macleod, C. J, held, that "expenses incurred in raising capital are expenses of exactly the same character, whether the capital is raised at the floatation of the company or thereafter."

4. But counsel for the assessee maintained, that the borrowing here, represented circulating; capital as distinguished from fixed capital. Viscount Haldane in John Smith and Son v. Moore, (1921) 12 Tax Cas 266 has adopted Adam Smith''s definition of fixed capital as "what the owner turns to profit by keeping it in his own possession," and of circulating capital as "what he makes profit of by parting with it and letting it change masters." The "circulating capital" has thus been used as synonymous with tile term stock-in-trade" or the term "trading assets," as distinguished from fixed capital or capital assets. What is fixed capital for one buisness or trade, may be circulating capital for another, depending on the nature

of the business or trade. The following passage from the judgment of Romer. L. J. in Golden Horse Shoe (New) Ltd. v. Thurgood, (1934) 18 Tax Cas 280 at 300 illustrates, this:

"The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital. The machinery with which a manufacturer makes the article that he sells is part of his fixed capital. The machinery that a dealer in machinery buys and sells is part of his circulating capital, as is the coal that a coal merchant buys and sells in the course of his trade. So, too, Js the coal that a manufacturer of gas buys and from which he extracts his gas."

A seller of annuities may have to purchase them before he sells, as in Gresham Life Assurance Society v. Styles, (1892) 3 Tax Cas 185, an investment or a banking company may have to borrow for making investments as in Farmer v. Scottish North American Trust Ltd., 1912 AC 118, or for lending; the price paid for the annuity in one case, and the amount borrowed in the other, are not capital assets in the real sense, and may be deemed to be trading assets or circulating capital.

But the assessee here is doing no such thing, but purchases the raw materials for manufacture, converts them into finished goods and sells them; we were told, that the need was felt by the assessee to obtain more raw materials; of course on payment. This, as we understand, was only by way of enlarging or extending its business, if it was paying its way, or was by way of establishing its business, if it was not; both mean the same thing.

At one stage of the argument, counsel seemed to assume that the enlargement or extension of business can only be in additional building, plant or machinery; we do not see sufficient warrant for this assumption, though cases of additional business are conceivable without a corresponding addition to capital. It is clear law, that outlay for the extension of business is in the nature of capital (investment; On this, it is sufficient to cite In re, (1947) 15 ITR 185 Lahore decided by a Full Bench of the Lahore High Court. It was urged, that according to the revised statement of the case, over two lakhs of rupees, stated to be out of the amount borrowed had been applied for the discharge of debts incurred in the purchase of raw materials, such as timber and casein. The nature of the receipt by borrowing, whether capital or revenue, is not to be judged solely by the use, which the assessee has found for it subsequently. We are also unable to discover anything contrary to this principle, in the observations of the Supreme Court in Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal, , on which reliance was placed, that ""the aim and object of the expenditure would determine the character of the expenditure whether it is capital expenditure or a revenue expenditure."

This is different from saying that the subsequent use or application of borrowing funds, which may be accidental, is decisive of their character. The resolution of the

Board of Directors which authorised the borrowing, only declared, that the amount was to be utilised as the working capital of the assessee, and made no mention of the discharge of trade debts. While pursuing this line of reasoning the learned counsel had necessarily to agree, that there is no evidence as to the nature of the "hand-loans on suspense account," in discharge of which a sum of over Rs. 82,000 was paid, and also, that the deposit of Rs. 51,500 for the payment of dividend, could not in any view be debited to revenue; he therefore maintained, that at least the balance of the amount borrowed, which may be taken to have been applied towards the purchase of stock-in-trade, may be treated as not capital, and the proportionate Dart of the expenditure, out of Rupees 12,924/-, allowed to be deducted,

It was not disputed by him, that in submitting the return of income, and in the computation of profits of the business, the cost price of raw materials or stock-in-trade was brought into account. The argument thus concedes a dual character to the borrowing, and involves a notional splitting of the borrowed amount and the expenses, for which we see no rational basis, and which is also contrary to the prescription in Section 10(2)(xv), implicit in the expression "laid out or expended wholly and exclusively." but the argument is useful for one purpose, as indicating the limit, to which it can be extended.

5. We have so Far examined the question in the right of the general principles, deducible also from decided cases. We also find, that authorities are not wanting, which have taken a similar view. The learned counsel for the assessee cautioned us, against accepting too readily the decisions of the English Courts, as they are based on different statutory provisions. We agree, that the provisions of the concerned statutes in England and in this country, are not all in pari materia; but in the study and elucidation of fundamental concepts and general principles, like capital receipts and disbursements, revenue receipts and disbursements, as pointed out by the Supreme Court itself in Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons, , English decisions afford considerable help and guidance. Before adverting to them, it has to be borne in mind, that under the English statutes too, from 5 to 6 Vict. C. 35, down to 15 and 16 Geo. 6 and 1 Eliz, 2 C 10 (being the Income Tax Act, 1952) questions do arise as to the nature of the receipt, whether capital or revenue, as no deduction is permissible in respect of any capital withdrawn from or any sum employed or intended to be employed as capital in a trade, profession or vocation.

In 1894 Tax Cas 255 cited, the court decided against deduction of expenditure incurred in issuing debentures, being in the nature of capital receipt. Incidentally, reference was made in the judgment to Anglo-Continental Guano Works v. Bell, (1894) 3 Tax Cas 239, in which interest on short loans from Bankers was not allowed to be deducted in the computation of income; in this respect, it may be mentioned, there is a difference in the corresponding provision in Section 10(2)(iii) of the Act. The case of Anglo-Continental Guano Works, (1894) 3 Tax Cas 239 was distinguished

by the House of Lords in Farmer v. Scottish North American Trust, Ltd., 1912 AC 118, a case also about deduction of interest, on the ground, that the assessee in that case, was a company which carried on investment business, and that therefore the nature of the borrowing was different.

We do not agree, that the authority of 1894-3 Tax Cas 255 has in any way been shaken by this pronouncement. Later, the King''s Bench had occasion to point out in (1932) 18 Tax Cas 1 referred to, that Farmer v. Scottish North American Trust Ltd., 1912 AC 118 was a decision only on the subject of interest as deduction, and not on what is, and what is not capital, for the purpose of the rule adverted to above, with which this case is more directly concerned. In 1932 18 Tax Cas 1, advances made by an American company were held to constitute capital receipts. (1875) 1 Tax Cas 125 was a case in which the deduction claimed of twenty eight lakhs of rupees paid by way of commission to under-writers for the issue of seven hundred thousand preference shares of Rs. 100/-each, was held to be inadmissible u/s 9(2)(ix) of the Indian Income Tax Act, 1918, which in material respects, corresponds to Section 10(2)(xv) of the Act.

In Nagpur Electric Light and Power Co. Ltd. v. Commissioner of Income Tax, 6 ITC 28 (Nag) the expenses of raising a debenture loan was disallowed u/s 10(2)(xv) of the Act, as being of a capital nature. 1942 24 Tax Cas 171, 1943 Tax Cas 385, 1934 19 Tax Cas 94 and 1944 13 ITR 1 which have been cited earlier, have decided against allowing expenses of raising loans, as being of a caoital nature. In ASSOCIATED HOTELS OF INDIA LIMITED Vs. COMMISSIONER OF Income Tax DELHI., the assessee issued debentures in 1916 with a provision to redeem them after the year 1921 on payment of bonus. It was decided, that bonus paid for redemption was an inadmissible allowance, as the view prevailed, that the debentures constituted capital receipts. We consider, that the ratio of these decisions is applicable to the present case. Therefore, both on principle and authority, we come to the conclusion, that the sum of three lakhs of rupees raised by debentures was a capital receipt. To the question, referred, we return the answer that the expenditure of Rs. 12,924/- is capital expenditure, not deductible u/s 10(2)(xv). The assessee shall pay the costs of this reference, including advocate''s fee Rs. 150/-.