

(2000) 11 DEL CK 0075

Delhi High Court

Case No: Income Tax R. No's. 279 and 280 of 1979

Commissioner of Income Tax

APPELLANT

Vs

Saraswati Chemicals and Allied
Industries (P.) Ltd.

RESPONDENT

Date of Decision: Nov. 29, 2000

Acts Referred:

- Income Tax Act, 1961 - Section 256(1), 36(1)

Citation: (2001) 1 AD 796 : (2001) 167 CTR 150 : (2001) 89 DLT 208 : (2001) 249 ITR 235 :
(2001) 114 TAXMAN 564

Hon'ble Judges: Dr. Arijit Pasayat, C.J; D.K. Jain, J

Bench: Division Bench

Advocate: R.C. Pandey and Ajay Jha, for the Appellant; None, for the Respondent

Judgement

Arijit Pasayat, C.J.

These two cases involve identical disputes and shall be governed by the common judgment.

2. On being moved by the Revenue, the following questions have been referred for opinion of this court, by the Income Tax Appellate Tribunal, New Delhi (in short, "the Tribunal"), u/s 256(1) of the Income Tax Act, 1961 (in short, "the Act") :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the amounts of salaries due to the directors of the company, but not paid to them and utilised by the company for the purposes of its business, constituted capital borrowed for the purposes of its business within the meaning of Section 36(1)(iii) of the Income Tax Act, 1961 ?"

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the interest paid by the assessed to the directors on such undisbursed salaries constituted interest on capital borrowed for the purposes of

the business within the meaning of Section 36(1)(iii) of the Act ?"

3. A brief reference to the factual position, as indicated in the statement of case, would suffice.

4. The assessed, a private limited company, credited interest totalling Rs. 4,905 and Rs. 5,866 for two assessment years, i.e., 1974-75 and 1975-76, with which we are concerned, to the accounts of its directors, which showed the credit balances on account of salaries due to them but not paid. These interests in question were claimed as deduction u/s 36(1)(iii) of the Act. The Income Tax Officer disallowed the claim on the ground that the conditions required to bring in application of Section 36(1)(iii) were absent. The assessed filed appeals before the Appellate Assistant Commissioner (in short, "the AAC"), and contended that the Income Tax Officer was wrong in disallowing the claim. The Appellate Assistant Commissioner accepted the claims and held that the Income Tax Officer erred in disallowing them.

5. The matter was carried in appeal by the Revenue before the Tribunal. It was contended that there was no capital borrowed, which was the fundamental requirement for bringing in application of Section 36(1)(iii) of the Act. The Tribunal did not accept the plea and held that had the payments been made to the directors, the assessed would have been required to borrow funds to pay interest. Therefore, the funds, which were utilised by the assessed for the purpose of its business had a clear link with the amounts which would, otherwise, have been required to be borrowed for the purpose to carry on its business. Accordingly, it was held that the amounts in question were allowable in terms of Section 36(1)(iii) of the Act.

6. On being moved for a reference, the questions, as set out above, have been referred for the opinion of this court.

7. We have heard learned counsel for the Revenue. There is no appearance on behalf of the assessed in spite of notice. The only question that needs adjudication according to us is whether the Tribunal was justified in holding that the amounts, which were due to the directors and had not been paid but utilised in the manner described by the Tribunal, constituted capital borrowed for the purpose of its business within the meaning of Section 36(1)(iii) of the Act. Section 36(1)(iii) of the Act reads as follows :

"36. (1)(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :

Explanation.--Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfill such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause ;"

8. The provision is almost in pari materia with the provision of Section 10(2)(iii) of the Indian Income Tax Act, 1922 (in short, the "old Act"). What constitutes "capital

borrowed" has been dealt with by the apex court in *Bombay Steam Navigation Co. (1953) P. Ltd. v. CIT* [1065] 5 ITR 52. The expression "capital borrowed" used in Section 36(1)(iii) of the Act in the context in which it is placed in the provision means money and not any other asset. By clause (iii) of Sub-Section (1) of Section 36, interest paid in respect of capital borrowed for the purpose of the business or professional act is a permissible allowance in the computation of profits or gains. Interest paid need not, however, bear the character of a revenue outgoing. To be admissible as an allowance under the concerned provision, interest must be paid in respect of the capital borrowed. However, interest paid but not in respect of the capital borrowed cannot be allowed. Interest payable on capital borrowed means interest which actually becomes payable on an amount of money and not on any other asset. An amount due under a statute cannot be regarded as borrowed capital for the expression "capital" predicates the relationship of a borrower and a lender, which relationship has to be found as a matter of fact. Conceptually, for the purpose of Section 36(1)(iii) "interest" is relatable only to money borrowed and not on debt incurred. The word "interest" has a basic meaning of advantage or profit and with reference to a loan it means the profit or advantage of the creditor which he gets by giving to another the use of his money. Interest can be described as consideration paid either for use of money or for forbearance in demanding it after it has fallen due. It is a compensation allowed by law or fixed by parties or permitted by custom or usage, for use of money belonging to another or for delay in paying the money after it has become payable. Both, the Appellate Assistant Commissioner and the Tribunal, accepted that the amounts, which were due to the directors by way of salaries were not disbursed during the years. The further finding that they would have been required to borrow capital to disburse other obligations cannot per se make the amount, which was in fact a liability, a capital borrowed for the purpose of the business. That is only a hypothetical conclusion.

9. The above being the position, the Appellate Assistant Commissioner and the Tribunal were not justified in their respective conclusions about the amount involved being capital borrowed. Therefore, both the questions referred are answered in the negative, in favor of the Revenue and against the assessed.