
(1977) 09 AP CK 0022

In the Andhra Pradesh High Court

Case No : Case Referred No. 36 of 1976

Addl. Commissioner of Income Tax

APPELLANT

Vs

Challapalli Sugars Ltd.

RESPONDENT

Date of Decision : 28-09-1977

Acts Referred:

Income Tax Act, 1961 — Section 36(1)
Income Tax Rules, 1962 — Rule 7, 7(1)

Citation : (1979) 116 ITR 255

Hon'ble Judges : Obul Reddi, C.J; Ramachandra Raju, J

Bench : Division Bench

Advocate : P. Rama Rao, for the Appellant; S. Parvata Rao Advocate, for the Respondent

Judgement

Ramachandra Raju, J.—The question referred u/s 256(1) of the Income Tax Act, 1961, for our decision is :

"Whether, on the facts and in the circumstances of the case, the interest paid by the assessee-company on advances is allowable expenditure in computing the income from the business of the company ?"

2. The assessee is a public limited company carrying on business in the manufacture of sugar. It owns about 2,000 acres of agricultural land on which it grows sugarcane for the purpose of manufacture of sugar. The company borrowed certain amounts. Those amounts are credited to the agricultural section, for which separate accounts are maintained. The interest that the company had to pay on the borrowings has been claimed as a deduction out of the business income. The ITO disallowed an amount of Rs. 2,03,750 towards proportionate interest attributable to the advances credited to agricultural section. On appeal by the assessee, the AAC upheld the disallowance made by the ITO. When the company went up in appeal, the Tribunal following its decision in I.T.A. Nos. 828 and 965 dated August 24, 1972, allowed the appeal, setting aside the disallowance made by the ITO. The Tribunal in giving its decision

followed the Supreme Court decision in Commissioner of Income Tax, Bombay Vs. Maharashtra Sugar Mills Ltd., Bombay, . It is not disputed that the cultivation of sugarcane and manufacture of sugar by the assessee-company constituted one single and indivisible business. Section 28 of the I.T. Act, 1961, enumerates what are profits and gains of business. Section 36 provides for deductions in computing the income referred to in Section 28. Clause (iii) of Sub-section (1) of Section 36 provides for deduction of the amount of the interest paid in respect of the capital borrowed for the purpose of the business. Therefore, when it is not in dispute that cultivation of sugarcane and manufacture of sugar constituted one single and indivisible business, normally, the amount of interest in question paid by the assessee goes as a deduction provided in Section 36(1)(iii). But, this provision has to be read subject to Rule 7(1) of the I.T. Rules, 1962, which reads as follows :

"In the case of income which is partially agricultural income as defined in Section 2 and partially income chargeable to Income Tax under the head "Profits and gains of business", in determining that part which is chargeable to Income Tax the market value of any agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilised as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deductions shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind."

3. Admittedly, the market value of the sugarcane raised by the assessee was deducted from the income. After deducting the market value of the sugar-cane, the question is whether the assessee is also entitled to deduct interest paid by it on the borrowings made and utilised for the purposes of expenditure in raising the sugarcane. What is prohibited from further deduction under Rule 7 is any deduction in respect of any expenditure incurred by the assessee as a cultivator. Therefore, question arises whether interest paid by the assessee can be said to be an expenditure incurred by the assessee as a cultivator.

4. We see considerable force in the argument of Sri Parvata Rao, learned counsel for the assessee, that the interest paid by the assessee on the borrowings made, though they were spent for the purpose of raising sugarcane, cannot be said to be an expenditure incurred by the assessee as a cultivator. According to the learned counsel, only that expenditure incurred by the assessee directly for the purpose of cultivation can be said to be an expenditure incurred by the assessee as a cultivator, and not any other expenditure which the assessee might incur indirectly for the purpose of agriculture by way of payment of interest on the borrowings utilised for the purpose of producing sugarcane. In CIT v. Raja Bahadur Kamakhya Narayan Singh [1948] 16 ITR 325 the Privy Council was considering whether interest received on rent payable in respect of land used for agricultural purpose is an agricultural income within the definition of Section 2(1) of the Indian I. T. Act, 1922. The Privy Council said that interest paid on rent is

not revenue derived from land. It observed (page 328) :

"It is no doubt true that without the obligation to pay rent--and rent is obviously derived from land--there could be no arrears of rent and without arrears of rent there would be no interest. But the affirmative proposition that interest is derived from land does not emerge from this series of facts. All that emerges is that as regards the interest, land rent and nonpayment of rent stand together as *causae sine quibus non*. The source from which the interest is derived has not thereby been ascertained..... There is no commercial connection between the interest and the rented land and an effective source--not land--has become apparent."

5. In the present case also the money borrowed might have been utilised by the assessee in cultivating and producing sugarcane, but at the same time, it cannot be said that the expenditure incurred in payment of interest had any connection or was attributable directly to the agricultural operation. Borrowing money and payment of interest is a mere commercial transaction. In *Commissioner of Income Tax, Bombay Vs. Maharashtra Sugar Mills Ltd., Bombay*, decided by the Supreme Court, the assessee-company owned extensive lands on which it grew sugarcane and used the sugarcane for manufacture of sugar in its factory. The Tribunal found that the cultivation of sugarcane and the manufacture of sugar by the assessee constituted one single and indivisible business. The question that arose in that case was whether a part of the managing agency commission paid by the company could be disallowed on the ground that that part related to management of sugarcane cultivation, income from which was exempt from tax as agricultural income. The Supreme Court held that the entire managing agency commission was laid out or expended for the purpose of the business carried on by the assessee and was allowable u/s 10(2)(xv) of the Indian I. T. Act, 1922, and that the fact that the income from a part of the business was not exigible to tax under the Act was not a relevant circumstance. The Supreme Court said that there is no basis for the view that only expenditure incurred in respect of a business activity giving rise to income, profits or gains taxable under the Act can be allowed as a deduction u/s 10(2)(xv) and not otherwise. To find out whether a deduction claimed is permissible under the Act or not, all that has to be done is to examine the relevant provisions of the Act. Equitable considerations are wholly out of place in construing the provisions of a taxing statute. The provisions of the statute have to be taken as they stand. If the allowance claimed is permissible under the Act, then the same has to be deducted from the gross profit. If it is not permissible under the Act, it has to be rejected. The Supreme Court also considered Rule 23 of the I. T. Rules, 1922, which is same as present Rule 7 and said that reference to the expenditure incurred by the assessee as a cultivator mentioned in Rule 23 applies to the process ordinarily employed by a cultivator in raising the crops.

6. In *Commissioner of Income Tax, West Bengal, Calcutta Vs. Raja Benoy Kumar Sahas Roy*, the Supreme Court also said that "agriculture" in its primary sense denotes the cultivation of the field and is restricted to cultivation of the land in

the strict sense of the term, meaning thereby tilling of the land, sowing of the seeds, planting and similar operations on the land.

7. Therefore, it is only the money actually spent for agricultural operations like those mentioned above that can be said to be expenditure incurred by the assessee as a cultivator within the meaning of Rule 7. We have no doubt that the assessee is entitled to a deduction of the interest he paid on the borrowings, though they were utilised for the purpose of raising sugar- cane. Accordingly, we answer the question in the affirmative and against the revenue, with costs. Advocate's fee Rs. 250.