
(1989) 09 BOM CK 0102

In the Bombay High Court

Case No : Income-tax Reference No. 561 of 1976

Commissioner of Income Tax

APPELLANT

Vs

Glaxo Laboratories (India) Ltd.

RESPONDENT

Date of Decision : 28-09-1989

Acts Referred:

Income Tax Act, 1961 — Section 37, 37(1)

Citation : (1990) 81 CTR 69 : (1990) 181 ITR 59

Hon'ble Judges : T.D. Sugla, J;S.P. Bharucha, J

Bench : Division Bench

Judgement

S.P. Bharucha J.

1. This reference is made at the instance of the Revenue u/s 256(1) of the Income Tax Act, 1961. It raises the following question :

"Whether, on the facts and in the circumstances of the case, the assessee was entitled to claim that the share issue expenses of Rs. 9,32,946 was an expenditure of revenue nature allowable u/s 37(1) of the Income Tax Act of 1961 ?"

2. The reference relates to the assessment year 1970-71, the relevant previous year having ended on June 30, 1969.

3. The assessee manufactures pharmaceuticals. It had entered into an agreement of technical collaboration with its parent company in the United Kingdom which was due to expire in the beginning of 1967. The assessee applied to the Government of India for permission to enter into a fresh technical collaboration agreement so that it could continue to obtain the benefit of research being carried out by the parent company and also day-to-day advice in respect of the manufacture of existing and new products. It is, according to the statement of the case, common ground that the Government informed the assessee that it would approve of such an agreement only if the assessee agreed to dilute the shareholding of the parent company in its capital by offering at least

25% thereof to the Indian public. As the Government insisted upon the fulfilment of this pre-condition, the assessee issued fresh equity capital. It did so although it had a cash balance of over Rs. 50 lakhs and a borrowing capacity from banks of more than Rs. 10 crores. It was common ground that had the assessee resorted to the acquisition of additional working funds by borrowings, it would have been cheaper than issuing of fresh capital. For issue of fresh capital, the assessee incurred an aggregate expenditure of Rs. 9,32,946.

4. This was on account of underwriters' fees, printing, bank collection charges, stamp duty, etc.

5. The assessee claimed the said expenditure of Rs. 9,32,946 as a revenue expenditure allowable under the provisions of section 37(1). It claimed, in the alternative, that, should it be held to be a capital expenditure, deduction should be made therefrom of the sum of Rs. 5,53,917 earned as interest upon the application moneys that had been received. The Income Tax Officer rejected both claims. The Appellate Assistant Commissioner upheld the Income Tax Officer's order. The assessee thereupon filed a second appeal before the Income Tax Appellate Tribunal. The Tribunal held, in the words of the statement of the case, thus :

"There was a direct nexus between the expenditure of Rs. 9,32,946 and the earning of income by the assessee because, without incurring this expenditure, the Government of India would not have permitted it to enter into a fresh collaboration agreement with the U. K. - parent company, which was essential for the company in order to run its business more profitably. The Tribunal was of the opinion that had the company not agreed to the issue of fresh capital, it would have suffered in its business in the absence of the collaboration agreement. It was on the peculiar facts on this case that the Tribunal was of the opinion that the expenditure of Rs. 9,32,946 was in the nature of revenue expenditure, even though it was incurred for the issue of fresh capital ?"

6. Mr. Jetley, learned counsel for the Revenue, drew our attention to section 37 and pointed out that capital expenditure could not be allowed as a deduction in the computation of income chargeable under the head of "profits and gains of business". He submitted that the said expenditure having been incurred in connection with the raising of capital, it was capital expenditure. He relied upon several authorities in support of this proposition. The proposition is not disputed so long as the aim and object of the party incurring the expenditure is to raise capital. In none of the cases cited by Mr. Jetley was this an issue.

7. Mr. Jetley submitted what had occasioned the said expenditure was the issue of additional share capital. The such issue had met the dilution requirement imposed by the Government for the approval of the technical collaboration arrangement was not relevant to the question posed in the reference. Mr. Dastur, learned counsel for the assessee, submitted, on the other hand, that the object and the purpose of the said expenditure was to obtain the continuance of the

technical collaboration arrangement with the parent company and not that of obtaining additional funds. The object and purpose of the expenditure had to be determined from a businessman's point of view.

8. Had the capital not been raised, the Government would not have permitted the assessee to continue its technical collaboration arrangement with its parent company which was essential for the assessee. Had the company not issued the fresh capital, it would have suffered. It was common ground that, had the assessee resorted to the acquisition of more working funds by borrowings, it would have been cheaper than issuing of fresh share capital. Upon these facts, the Tribunal drew the conclusion that the said expenditure was in the nature of revenue expenditure, even though it had been incurred upon the issuance of fresh capital. The findings of fact arrived at by the Tribunal bind us but the inference to be drawn therefrom is subject to review by this court in a reference, it being a matter of law.

9. That the court must look to the object and purpose of the expenditure and that from the point of view of the businessman is well-established.

10. It was laid down in *Anglo-Persian Oil Co. Ltd. v. Dale* [1931] 16 TC 253, that it was the object of the expenditure alone that counted. It was not necessary that the expenditure should have resulted in bringing an asset into existence. The fact that the expenditure had, in fact, resulted in the coming into existence of some advantage which would ensure for several years was not of consequence.

11. The Supreme Court, in *BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY,*, laid down the test in these words (at page 59) :

"Whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. The question must be viewed in the larger context of business necessity or expediency. If the outgoing or expenditure is so related to the carrying on or conduct of the business, that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on the business, the expenditure may be regarded as revenue expenditure."

12. The Patna High Court in the case of *Commissioner of Income Tax Vs. Kirkend Coal Co.,*, was concerned with an assessee which carried on coal mining. It had spent monies upon certain operations called "stowing". The Income Tax Officer considered that expenditure to be capital expenditure because the extraction of coal had thereby been made possible for a score of years. The matter went up in reference to the High Court. The High Court noted the observations in the cases of *Anglo-Persian Oil Co. Ltd. v. Dale* [1931] 16 TC 253 and *BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY,* set out above. It also noted that the Supreme Court in *Assam Bengal*

Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal, , had said that if the expenditure had been made not for the purpose of bringing into existence an asset or advantage for the enduring benefit of the business but for running the business or working it with a view to produce profits, it was a revenue expenditure and that "the aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure."

13. Applying the tests to the case before it, the Patna High Court held that the money expended on stowing operations was by way of revenue disbursement. The decision of the Patna High Court was the subject of an appeal to the Supreme Court in CIT v. Kirkend Coal Co. [1970] 77 ITR 531 and it was upheld. The Supreme Court quoted with approval a passage from the case of BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., which we have set out above.

14. In Brooke Bond India Ltd. Vs. Commissioner of Income Tax, , the assessee had issued shares and incurred expenditure which had been claimed as a revenue deduction. The Tribunal had found that the assessee had itself stated that, by the expenditure, the capital base of the assessee was reinforced on a permanent basis and that this was the main purpose of the assessee. It was submitted before the Calcutta High Court that the object and purpose of the expenditure was to strengthen the capital structure and, only as an incidental result, more funds had flowed to the assessee making more working funds available to it. The High Court held that that could not change the essential object and purpose of incurring the expenditure and the resultant fact, that is to say, the fundamental change in the income-earning machinery and structure. It held that, therefore, the Tribunal had been right in disallowing the expenditure. In its exhaustive judgment, the High Court said that if the main object, purpose and nature of the transaction was to affect the income-earning machinery or structure as such and not only to make the inflow of more funds available, then the expenditure would be on the capital side. It was true that the alteration in the capital structure by raising the share capital would make more funds available, then the expenditure would be on the capital side. It was true that the alteration in the capital structure by raising the share capital would make more funds available, but that was not decisive. The essential object and purpose for incurring the expenditure and the resultant fact was the fundamental change in the income-earning machinery or structure. It was the resultant advantage obtained by incurring the expenditure, along with the purpose and object of incurring the expenditure, which was the guide to answering the question.

15. Our attention was drawn by Mr. Dastur to the judgment of the Supreme Court in Patnaik and Co. Ltd. Vs. Commissioner of Income Tax, Orissa, , whose facts are noteworthy. The assessee dealt in automobiles and spare parts. It had subscribed to certain Government loans and had sustained a loss when re-selling them. It claimed the loss as a revenue loss. The Tribunal found that, having

regard to the sequence of events and the close proximity of the investment with the receipt of Government orders for motor vehicles, the conclusion was inescapable that the investment had been made in order to further the sales of the assessee and boost its business. It had been made by way of commercial expediency for the purpose of carrying on the business and, therefore, the loss suffered by the assessee was a revenue loss. The High Court had re-examined the facts and had come to the contrary conclusion. On appeal by the assessee, the Supreme Court reversed the High Court's decision. It held that the High Court had been in error when it had proceeded to reappreciate the evidence. It affirmed the finding of the Tribunal that the investment made by the assessee in Government loans had been by way of commercial expediency for the purpose of carrying on the assessee's business and that, therefore, the loss suffered by the assessee upon the sale of the investment had to be regarded as a revenue loss. The Supreme Court approved the decisions of the Madras and Orissa High Courts that took views similar to that taken by the Tribunal.

16. It is clear that we must find the aim and objects, from a businessman's point of view, in incurring the said expenditure. It is established, upon the Tribunal's finding, that the assessee had no need for funds. It is established that it had need only of the technical collaboration arrangement to run profitably. What, therefore, motivated the businessman in the assessee was the expediency of ensuring the continuance of the technical collaboration arrangement. The object and purpose of the said expenditure, therefore, seen from the businessman's point of view, must be held to be to obtain the approval of the Government to the continuance of the technical collaboration arrangement. This being the object and purpose, the said expenditure must be held to be revenue expenditure and an allowable deduction. That an advantage of an enduring character, namely, the increase in the share capital resulted cannot, in the circumstances, be held to be decisive.

17. In the result, we are of the view, upon the peculiar facts of this case, that the Tribunal was right in holding that the said expenditure of Rs. 9,32,946, though incurred in connection with the issue of fresh share capital, was in the nature of revenue expenditure. The question is, accordingly, answered in the affirmative and in favour of the assessee.

18. No order as to costs.