
(1996) 09 KL CK 0019

In the High Court Of Kerala

Case No : Income-tax Reference No. 145 of 1992

Commissioner of Income Tax

APPELLANT

Vs

G.T.N. Textiles Ltd.

RESPONDENT

Date of Decision : 13-09-1996

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1997) 137 CTR 338 : (1997) 1 ILR (Ker) 244 : (1997) 227 ITR 713

Hon'ble Judges : V.V. Kamat, J;K. Narayana Kurup, J

Bench : Division Bench

Advocate : P.K.R. Menon and N.R.K. Nair, for the Appellant; C.N. Ramachandran Nair, for the Respondent

Judgement

V.V. Kamat, J.—The question for the assessment year 1981-82 is as to whether the bank guarantee commission paid by the assessee could be an allowable deduction. The question is as follows :

"Whether, on the facts and in the circumstances of the case, the guarantee commission paid by the assessee was an allowable deduction ?"

2. In other words, if for the purchase of capital assets by payment on instalment the seller insists on furnishing bank guarantee, whether the amount of commission towards furnishing bank guarantee charged by the concerned bank from the purchaser would have any connection with the amount being attributable to the capital asset or whether it would be understood as an expenditure of revenue character incurred in the process ?

3. An amount of Rs. 78,913 was paid by the assessee to the Central Bank of India. The Central Bank of India guaranteed the payment of purchase price of machinery as an assurance on regularity in the payment of instalments by the assessee. The Income Tax Officer acted u/s 143(3) of the Income Tax Act. He held that while considering the claim of the assessee treating the amount of Rs. 78,913 as a revenue deduction paid to the bank as the bank guarantee for

regularity in payment of instalments, that were payable under the deferred payment scheme. The Income Tax Officer took the view that since the expenditure has been incurred for acquisition of capital items, the same has to be treated as capital in nature. In reaching the above conclusion, the Income Tax Officer observed that in fact, the Commissioner of Income Tax (Appeals) had upheld the disallowance of guarantee commission as a revenue expenditure in the earlier years and, accordingly, had chosen to follow the practice for the year in question also treating the guarantee commission as capital expenditure. This was by the order dated March 26, 1985.

4. The further travel of the proceedings before the Commissioner of Income Tax (Appeals) appears to have received a rubber stamp endorsement on the basis that for the earlier years, the guarantee commission has been treated as capital expenditure and in this way, the first appellate authority preferred to be in line.

5. The Income Tax Appellate Tribunal considered the submissions before it.

6. On behalf of the Department, it was contended that the guarantee commission is on par with interest payable on deferred payment scheme and it is only the commission which is payable as on the date of production that could be viewed as revenue expenditure. Reliance was placed on Explanation 8 to Section 43(1) of the Income Tax Act. It was urged on behalf of the Department that the commission was paid in connection with the acquisition of asset and, therefore, it was rightly disallowed.

7. On behalf of the assessee, reliance was placed on the decision of the Madras High Court in Sivakami Mills Ltd. Vs. Commissioner of Income Tax, . The Tribunal has observed that the Madras High Court held that the payment of guarantee commission was unrelated to the working out of the cost of acquisition of any depreciable machinery, plant or other asset but was an expenditure which was incurred in the course of carrying on the business and was not incurred prior to the commencement of the business. The Tribunal relied on the reasoning that the payment was so closely related to the business that it could be viewed as an integral part of the conduct of the business and would, therefore, be a revenue expenditure. Reliance was also placed on the continuance of the reasoning in the process that it did not bring into existence any asset of an enduring nature nor did it bring any other advantage of an enduring benefit. It is observed by the Tribunal that the acquisition of the machinery on instalment terms was only a business exigency. The very nature of the expenditure and the time at which it had been incurred would justify the claim of the expenditure as revenue expenditure. The guarantee commission was paid after the commencement of the business and during the subsistence of the business, as it was incurred by an existing business undertaking. It is only when guarantee commissions are paid in relation to the acquisition of assets prior to the commencement of the business itself, that would call for treating the same as capital expenditure and not the expenditure that is incurred after the commencement of the business. The Tribunal has further recorded that guarantee commission which is payable during

the construction period or the pre-commencement period of a business would have to be naturally treated as capital expenditure, and not the expenditure that is incurred during the subsistence of the business after its commencement. Following this logic, the Tribunal held that the assessee is entitled to a deduction of Rs. 78,913 on the basis that it is in the process of incurring of revenue expenditure, this decision of the Tribunal required the Revenue to bring the proceeding before us, expecting our answer to the question formulated at the outset.

8. We have heard learned senior tax counsel in extenso and with regard to the necessary aspects, we have heard learned counsel for the assessee.

9. Learned senior counsel referred to the necessary statutory provisions, firstly of Section 37 of the Income Tax Act, 1961, specifying that any expenditure laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". Learned senior counsel was particular enough to emphasise the bracketed portion as an exception to the allowance of expenditure concerned. The said bracketed portion is as follows :

"(not being expenditure of the nature described in Sections 30 - 36 and Section 80W and not being in the nature of capital expenditure or personal expenses of the assessee)."

10. Therefore, learned senior counsel had an occasion to submit resorting to the provisions of Section 32 of the Act that even though the concerned expenditure is laid out or expended wholly and exclusively for the purposes of business or profession, in a situation covered by the provisions of Section 32 of the Act, there would be a situation otherwise. Learned senior counsel contended that in dealing with the question of deduction, the provisions of Section 32 of the Act would have an interplay. In other words, learned senior counsel submitted that ultimately the question will have to be appreciated in the context of connection or surrounding situations for the purpose of determination of the question of deduction. Learned senior counsel submitted that the Tribunal considered the solitary decision of the Madras High Court *Sivakami Mills Ltd. Vs. Commissioner of Income Tax*, and, therefore, consequently, the Tribunal did not have the benefit of the other point of view in the context. Learned senior counsel placed before us the decisions of the Gujarat High Court *CIT v. Vallabh Glass Works Ltd.* [1982] 137 ITR 389 and of the Chhabirani Agro Industrial Enterprises Ltd. Vs. Commissioner of Income Tax, .

11. We have been taken through the above decisions. It must be stated that all the three decisions of the Madras, Gujarat and Patna High Courts drew upon the declaration of law by the apex court in regard to the relationship of an item of expenditure to the two sources, viz., capital and revenue. Reading the above three decisions, although there would not be any dispute and any kind of quarrel in regard to the principle, the question would be one of application of undisputed

principles under the factual matrix before us available to us from the final fact-finding authority as well as from the meaningful consideration of the situation in the normal conduct of business by the business community engaged in the activity under consideration.

12. At the cost of repetition, it would have to be emphasised the following observations of the Tribunal when it proceeded to consider the situation as governed by the decision of the Madras High Court in *Sivakami Mills Ltd. Vs. Commissioner of Income Tax*, . The Tribunal has made the following factual observations :

"... The payment was so closely related to the business that it could be viewed as an integral part of the conduct of the business and would be a revenue expenditure. It did not bring into existence any asset of an enduring nature nor did it bring in any other advantage of an enduring benefit. The acquisition of the machinery on instalment terms was only a business exigency. The very nature of the expenditure and the time at which it had been incurred would justify the claim of the expenditure as revenue expenditure. We may add that in this case guarantee commission was paid after the commencement of business and during the subsistence of business as it was incurred by an existing business undertaking. It is only when guarantee commissions are paid in relation to acquisition of assets prior to the commencement of the business itself that would call for treating the same as capital expenditure and not the expenditure that is incurred after the commencement of the business. In other words, guarantee commission which is payable during the construction period or the pre-commencement period of a business alone would be entitled to be treated as capital expenditure and not the expenditure that is incurred during the subsistence of the business after its commencement.

In this view of the matter, we hold that the assessee is entitled to a deduction of Rs. 78,913."

13. As the business exigency or strategy, it has to be meaningfully understood that the capital assets such as machinery, etc., are thought of to be purchased on instalment basis. It is fairly well known and, therefore, becomes appreciable and understandable that the sum total of all the payments of instalments naturally exceeds the cost price of the purchase of the capital asset in question, In other words, the total of all the instalment payments understandably includes interest thereon, making up the precise amount as regards the payment of instalments in regard thereto. Such scheme, in common parlance, is understood as easy instalment scheme or deferred payment scheme. Naturally, therefore, whatever gets connected inevitably in the process acquires the character of expenditure connecting it to the capital asset, consequently to be governed by the provisions of Section 32 of the Act. If purchase under the deferred payment scheme is taken up for consideration as a business exigency or strategy, it would be difficult to see any kind of relationship of such an expenditure to be linked with the expenditure inevitably related to the capital assets. We have already

emphasised and this is to be accepted as a common meaningful experience that the acquisition of the machinery on instalment terms, in common parlance and business activity, is being understood as business exigency or strategy.

14. Apart therefrom, if it is found that the expenditure in question is incurred during the subsistence of the business after its commencement, then naturally, the accepted link of the expenditure in question with the capital assets gets snapped by reason of the expenditure having been incurred during the subsistence of the business after its commencement. After dealing with the factual basis, we now proceed to consider only necessary decisions in regard to the situation that is placed before us by the present proceeding. We are more than tempted to open up our consideration with the cautionary warning and vital remarks of this court in CIT v. Jacob (P.) Ltd. [1979] 120 ITR 197, in approaching the eternal and ever-changing relationship of an expenditure attributable to capital assets and revenue character. Our court (page 200) has observed in the following manner :

" The question that we have to consider is whether the amount sought to be deducted represents a capital expenditure or a revenue expenditure. The problem is a familiar one that has haunted the courts time and again for determination, and which, each time has proved to be an elusive will-of-the-wisp. Decisions are numerous, which have dealt with, and explained, the principles to be applied in telling one type of expenditure from the other. We do not propose at this point of time, and at this stage of the development of the law, to survey the history of these decisions."

15. Our court, when faced with the problem as to whether the expenditure in question represented capital or revenue character, was very much aware that the problem has haunted the court from time and again. In fact, in making the above ringing observations, reliance is placed on the observations of the apex court in K.T.M.T.M. Abdul Kayoom and Another Vs. Commissioner of Income Tax,) , made by Justice Hidayatullah, which are also quoted immediately thereafter and they are to the following effect (120 ITR 200) :

" None of the tests is either exhaustive or universal. Each case depends on its own facts, and a close similarity between one case and another is not enough, because even a single significant detail may alter the entire aspect. In deciding such cases, one should avoid the temptation to decide cases (as said by Cardozo) by matching the colour of one case against the colour of another."

16. So much so that our court had occasion to observe to spare itself from the need and the responsibility of examining the aspect with reference to numerous other decisions, both English as well as Indian. This court has even referred to a passage at page 486-Kanga and Palkivala on Income Tax, Seventh edition, Volume I--to the effect that no test can be said to be of universal application. This court has also emphasised that the above observation is one from yet another decision of the apex court in Gotan Lime Syndicate Vs. Commissioner of

Income Tax, Rajasthan and Delhi, to the effect that it is not the law that, in every case if an enduring advantage is obtained, the expenditure for securing it must be treated as capital expenditure. In fact, the situation with reference to the case law on the subject has left this court to observe that the safe principle to be followed is that the decision must essentially depend upon the facts and circumstances disclosed by each individual case.

17. In our judgment, the above observation of our own court, which has spared itself created a situation of obligation upon us to follow the said course of sparing us even after the passage of nearly twenty years thereafter. We have already stated that the factual position is well laid.

18. Even then, learned senior tax counsel has taken efforts and put in labour to show us the view-points. We proceed to consider the three decisions. However, we must make it clear that the pathway has already been set out as stated earlier by our own court as a beaten track for us.

19. The Gujarat High Court in Vallabh Glass Works Ltd.'s case [1982] 137 ITR 389, dealt with the situation of the assessee having purchased machinery on deferred payment basis from a foreign supplier with regard to the assessment year 1966-67 and in regard thereto, paid Rs. 24,266 as the bank guarantee commission to the concerned banks, who had furnished the guarantee, guaranteeing regularity of the payment of instalments to the foreign party. The assessee also incurred an expenditure of Rs. 1,932 in obtaining letters of credit in favour of the parties from whom the machinery were purchased on deferred payment. Apparently, the question before the Gujarat High Court was as to whether the assessee was entitled to deduction of the said amount being bank guarantee commission. The Gujarat High Court has considered the relevant decisions of the apex court in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , and the decision of the other High Courts. On the basis of the decision of the apex court, it is observed that the question whether a particular expenditure is a revenue expenditure incurred for the purpose of the business 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, it may be regarded as an integral part of the profit-earning process and not for the acquisition of an asset or a right of a permanent character, the possession of which is a condition precedent to the carrying on of the business, the expenditure may be regarded as revenue expenditure. Thus, on the basis of the decision of the apex court, the profit earning process was considered to be the aspect or the factor taking the situation closer to the source of revenue.

20. The Gujarat High Court also considered its own decision in Commissioner of Income Tax, Gujarat Vs. Tensile Steel Ltd., , which was a case of a contract entered into by the assessee with a Japanese firm for the purpose of establishing and erecting a plant for high tension steel wires and for that purpose, a basic agreement was effected between the parties for providing financial collaboration,

supply of plant and machinery and technical know-how. It was under this basic agreement that 20 per cent, of the cost of the plant and machinery was to be paid at the time of signing the contract, 80 per cent, was to be paid in instalments spread over a period of five years and interest on such deferred payments. It is observed that the reasons for which the expenditure incurred for the interest payment was held to be of capital nature, would be appreciated. It is further observed that the expenditure incurred in the payment of bank guarantee commission and obtaining the letters of credit would have to be understood as the cost of acquisition of the machinery in question.

21. The decision of the Bombay High Court in Ballarpur Paper and Straw Board Mills Ltd. Vs. Commissioner of Income Tax, Vidarbha and Marathwada, Nagpur, was also considered by the Gujarat High Court. This was a case in regard to the purchase of new plant and machinery on the basis of the agreement entered into between a German company and a French company on payment of sale price in ten equal instalments. On the facts, a conclusion was reached with regard to the assessee capitalising the amount of interest, guarantee commission, stamp charges, etc., and treated it as part of the cost price of the machinery.

22. In the process of discussion, the Gujarat High Court has also considered the judgment of the Andhra Pradesh High Court in Addl. Commissioner of Income Tax Vs. Akkamba Textiles Ltd., . It appears that the Andhra Pradesh High Court dealt with the assessee which was a public limited company engaged in the manufacture of textiles and the question related to the machinery imported from two concerns in Japan and one from Textool Co, Ltd., Coimbatore, all on deferred payment basis. The Gujarat High Court has, in fact, quoted from the judgment of the Andhra Pradesh High Court with reference to certain observations therefrom at page 301. We have also gone through the decision of the Andhra Pradesh High Court and we find that the Andhra Pradesh High Court has drawn the principles governing the situation from three decisions of the apex court, BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., ; State of Madras Vs. G.J. Coelho, and India Cements Ltd. Vs. Commissioner of Income Tax, Madras, . It is specifically observed with reference to the factual matrix therein that on the facts, it was not a question of the assessee-company having borrowed money or entered into any agreement prior to the commencement of the business. It is specifically observed that the Andhra Pradesh High Court in Addl. Commissioner of Income Tax Vs. Akkamba Textiles Ltd., , in fact, did not lay down any new principle, but relied on the principles laid down by the decision of the Supreme Court in reaching the conclusions it did.

23. In fact, the Gujarat High Court has also considered the decision of the Madras High Court on which the Tribunal in the proceedings before us has relied upon. It is pertinent to observe that the Madras High Court held that payment of guarantee commission was unrelated to the working out of the cost of acquisition of any depreciable machinery, plant or other asset, but was an expenditure which was incurred in the course of carrying on the business. It is further observed that

such payment was so closely related to the business, that it could be viewed as an integral part of the conduct of the business and would be a revenue expenditure. It is further observed that the acquisition of the machinery on instalment terms was only a business exigency. These decisions have not been agreed upon.

24. Then, we take up the decision of the Patna High Court in *Chhabirani Agro Industrial Enterprises Ltd. Vs. Commissioner of Income Tax*, . The assessee was a company incorporated on November 7, 1969. For carrying on the business of manufacturing vanaspati products, ghee, etc., for purchasing, taking on lease or acquiring otherwise mines and quarry mineral rights and/or sale and deal in coal, etc., an agreement was entered into to purchase a complete vanaspati plant on turnkey basis for Rs. 54.69 lakhs. There was an agreement to obtain 10 per cent, interest on this amount which was to be paid in accordance with the agreement. The question before the Patna High Court was also with regard to payment of bank guarantee commission being Rs. 51,130 during the assessment year 1973-74. The facts found from the judgment show that the plant could not be commissioned during the relevant assessment year in question and the assessee-company also had to enter into a separate agreement to act as an agent of a colliery for a period of ten years. Reading the judgment, the factual matrix shows several points of differences. The Patna High Court, in such situation, had occasion to observe, that it is wholly irrelevant whether the asset was acquired prior to the commencement of the business or subsequent to the commencement of the business. The further observations are that it is fallacious to say that it is still at the option of the assessee to capitalise or not to capitalise the expenses directly incidental to the acquisition of such assets. We tried and we have not been able to appreciate that the expenses could be "directly incidental" to the acquisition of such assets. It will have to be observed that either there is direct relationship or there is incidental relationship and it cannot be a relationship which could be understood as directly incidental. We have carefully gone through the judgment of the Patna High Court. As stated at the outset, the strength is from the decision of the apex court in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, . There cannot be any dispute when the Patna High Court observes that in view of the law laid down by the Supreme Court in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, , laying down the mode of determining the cost of a capital asset, it is now no more open to evolve new principles in this regard.

25. In our judgment, there is no question of evolving any new principles and, as stated at the outset, there would not be any occasion to evolve new principles when the principles are already declared by the apex court by as many as four decisions referred to above by us. The question will be application of the above principles to the factual matrix which is more than well settled before us. It must be stated that in adopting and applying the new principles, the High Court, and it cannot be forgotten that it is the High Court that is applying the principles, has before it necessarily a meaningful attitude. Even purchasing luxury and

conspicuous goods, the established tendency is to run after available easy instalments or deferred payment schemes. The days of thinking about asking for loan in an inevitable situation of the person being in the nature of a broke do not hold water in the. present commercial society. It has now become more or less a business strategy or business exigency to embark upon the purchase activity not only of the capital assets but also of even other goods. The High Court in its approach cannot be a passive spectator to the changing ways of life and attitude of the commercial society. This would also be an additional indicator of the snapping of the connection of the amount in question with the capital asset in view of the fact that going in for easy instalments or deferred payments will have to be appreciated in its own way, rather than linking it with the capital asset in a pedantic attitude.

26. In our judgment, in view of the factual situations, it will have to be held that the amount has no connection with the capital asset as sought to be contended by the Revenue.

27. For the above reasons, we answer the question in the affirmative, in favour of the assessee and against the Revenue.

28. A copy of this judgment, under the seal of this court and the signature of the Registrar, shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench, as required by law.