
(1993) 05 RAJ CK 0011

In the Rajasthan High Court

Case No : Income Tax Reference No. 150 of 1981

Commissioner of Income Tax

APPELLANT

Vs

Mohan Enterprises

RESPONDENT

Date of Decision : 19-05-1993

Acts Referred:

Income Tax Act, 1961 — Section 28, 37

Citation : (1993) 1 RLW 474 : (1993) 3 WLC 27

Hon'ble Judges : K.C. Agrawal, C.J;V.K. Singhal, J

Bench : Division Bench

Advocate : G.S. Bapna, for the Appellant;

Judgement

V.K. Singhal, J.—The Income Tax Appellate Tribunal has referred the following three questions of law arising out of its order dated February 11, 1981, in respect of the assessment year 1978-79 :

"(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the assessee is entitled to claim deduction of bank charges, legal fees and interest amounting to Rs. 9,075, Rs. 10,000 and Rs. 30,787, respectively, as revenue expenditure?

(2) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the travelling and other expenses incurred on Shri Sunil Kumar Sah, director of the company, and Smt. Kum Kum Sah, w/o. Shri Sunil Kumar Sah, director, for undertaking training in production methods of costume jewellery for the new project which was proposed to be set up was capital expenditure ?

(3) Whether, on the facts and in the circumstances, the Tribunal has rightly held that the assessee is not entitled to depreciation with reference to travelling expenses incurred on Shri Sunil Kumar Sah, director, in connection with his visit to Austria ?"

2. Question No. 1 has been referred on the application of the Commissioner of Income Tax while questions Nos. 2 and 3 have been referred on the application of the assessee filed u/s 256(1) of the Income Tax Act, 1961.

3. No one has appeared on behalf of the assessee in spite of due service of notice. It appears that the assessee is not interested in agitating the grievance raised in questions Nos. 2 and 3 and, therefore, these questions are returned unanswered.

4. So far as question No. 1 is concerned, the relevant facts are that the assessee-company was running a cinema at Kota and wanted to set up a factory for manufacture of costume artificial jewellery. Expenses of Rs. 9,075 were incurred as bank charges which were paid to the bank as commission for guarantee given by it to the Government of India for import of machinery. Rs. 30,787 were incurred as interest paid on money borrowed for the purpose of machinery. Rs. 10,000 were paid as fees of the advocate for attending the case pertaining to acquisition proceedings in respect of the land purchased by the assessee for the aforesaid project. The assessee claimed these expenses as revenue expenditure. The Income Tax Officer came to the conclusion that the bank charges cannot be allowed as it has nothing to do with the assessee's previous business and the claim in respect of legal fee was disallowed on the ground that the expenditure related to agricultural land income from which is not taxable and cannot be allowed as business expenditure and in respect of the claim of interest since it is attributable to the capital borrowed for starting a new project, the interest cannot be allowed. In the appeal preferred to the Commissioner of Income Tax, it was held that the expenses are allowable only in respect of the business which was actually carried on by the assessee during the relevant previous year and expenses incurred in connection with a business which was yet to be set up during the relevant previous year cannot be allowed. It was further held that for different businesses, separate "previous years" can be opted for by the assessee and as such in respect of the new business the previous year starts only from the date of setting up of the new business. The appeal was dismissed.

5. In the second appeal before the Income Tax Appellate Tribunal, relying on the decision of Produce Exchange Corporation Ltd. Vs. Commissioner of Income Tax (Central), Calcutta, it was held that the different ventures constitute a single business when the unity of control of business is at one place and as such these expenses are allowable.

6. Section 36(1)(iii) of the Act provides that the amount of interest paid in respect of capital borrowed for the purposes of business shall be allowed as deduction while computing the income u/s 28.

7. In the case of Commissioner of Income Tax Vs. Shah Theatres (P.) Ltd., this court has held that the business of exhibition of motion pictures and that of starting construction of the cinema theatre is the same. The interest paid on such borrowing was held allowable as it was incurred in connection with the

extension of the existing business and not for setting up a new business.

8. In order to determine as to whether the bank charges, legal fees and interest could be claimed as revenue expenditure the nature of the payment has to be examined. As a general proposition, there cannot be any rule of thumb to determine as to whether a particular expenditure is capital or revenue. The nature of the business, the nature of expenditure, nature of rights acquired and their relation inter se are to be examined with reference to the particular case. Normally, the word "capital expenditure" connotes an expenditure which is having permanency, securing tangible or intangible corporeal or incorporeal rights having lasting or enduring benefit. In the words of Viscount Cave L.C. in *Atherton v. British Insulated and Helsby Cables Ltd.* [1925] 10 TC 155 (HL) "when an expenditure is made, not only once and for all, but with a view to bring into existence an asset or an advantage for the enduring benefit of the trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital." The matter has been considered by the apex court in various decisions and the expenditure for acquisition of a capital asset, expenditure incurred once for all (in contrast to recurring expenditure), expenditure for acquiring an enduring benefit and expenditure relating to fixed capital (in contrast to circulating capital) were considered as capital expenditure. Still none of these principles could be said to be of universal application or the conclusive test.

9. The amount of bank charges was in respect of commission charges paid to the Canara Bank for the guarantee given for the purpose of import of machinery concerning the costume artificial jewellery business. The Income Tax Appellate Tribunal has proceeded on the assumption that the different ventures constitute a single business as the unity and control of the business is at one place. In the present case, the previous business of cinema and the venture regarding setting up of a factory for manufacture of costume jewellery were considered as the same business. It was on this account that the legal fees were also allowed as revenue expenditure. It is undisputed that the commercial charges of the bank are in connection with the guarantee given by the bank to the Government of India for the import of machinery for the new unit which had not been imported during the accounting period relevant to the assessment year. Similarly, the interest on borrowed money is for the purpose of purchase of machinery which was neither installed nor put to use during the accounting period relevant to the assessment year.

10. An expenditure made under a transaction which is closely related to the business could be viewed as an integral part of the conduct of the business and can be considered as revenue expenditure if it is laid out wholly or exclusively for the purpose of business. The expenditure has to be considered in the larger context of business necessity or expediency.

11. In *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P.*,

Hyderabad, the amount of interest expended for acquiring a capital asset prior to the commencement of business was held to be capital expenditure.

12. In *K. Sampath Kumar Vs. Commissioner of Income Tax*, the assessee purchased machinery out of moneys borrowed and installed the machinery and paid the interest on such borrowed capital which was claimed as revenue expenditure. It was held that mere purchase and erection of the machinery would not amount to starting of the business, though they may be essential preliminary steps for starting the business. The assessee could be taken to have started the business only when his plant and machinery went into production.

13. In *Commissioner of Income Tax, Gujarat II Vs. Alembic Glass Industries Ltd.*, where the business organisation, administration and funds of the two units of the assessee were common and the control and administration of both the units was under one company which supplied the staff to both the units and managed the whole of the business administration of both the units and there was complete inter-connection, interlacing and interdependence and unity of both the units, it was held that the two lines of business constituted the same business. The decision of the apex court in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, referred to above and the decision of *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, were considered and the following principles were laid down (at page 727) :

(1) Where a borrowing is made for the purposes of a business, the interest paid on such a borrowing becomes eligible to deduction contemplated by Section 10(2)(iii) of the Act of 1922 or Section 36(1)(iii) of the Act of 1961 ;

(2) This would be so, even if the capital is invested in order to acquire a revenue asset or a capital asset, because the act of borrowing capital is distinct from the act of investment of that capital to acquire an asset ;

(3) However, the business for which an asset of enduring nature is purchased with borrowed capital should not be separate or distinct from the business for the purposes of which the capital is borrowed if deduction u/s 10(2)(iii) is to be allowed ; and

(4) If there is no existing business with reference to which the capital is borrowed and the borrowed capital is invested to purchase a new asset of enduring nature, then the interest paid on such borrowing till the asset so purchased goes into production, increases the cost of the installation of the said asset, and hence should be treated as capital expenditure not covered by Section 10(2)(iii) of the Act of 1922 or Section 36(1)(iii) of the Act of 1961.

14. The decision of the apex court in *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, was with reference to the borrowings made for the purpose of a running business whereas the decision in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, was with reference to the borrowings which were considered in respect of a situation where the business

had not yet commenced.

15. So far as the payment of legal fees for defending the acquisition proceedings in respect of the agricultural land purchased by the assessee is concerned, we are of the view that an expenditure which is made for creating/completing title is a capital expenditure. It is only when an expenditure is made for preservation, protection, defending or maintaining an existing title that it can be considered to be a revenue expenditure. The Income Tax Appellate Tribunal has not gone in detail with regard to the nature of the expenditure and has simply proceeded on the assumption that the two businesses are the same.

16. In Commissioner of Income Tax, Madras Vs. Prithvi Insurance Co. Ltd., the following tests were laid down by the apex court (at page 637) :

"A fairly adequate test for determining whether the two constitute the same business is furnished by what Rowlatt J. said in Scales v. George Thompson and Co. Ltd. [1927] 13 TC 83 (KB), "Was there any interconnection, any interlacing, any inter-dependence, any unity at all embracing those two businesses ?"

That inter-connection, inter-lacing, inter-dependence and unity are furnished in this case by the existence of common management, common business organisation, common administration, common fund and a common place of business." .

17. In Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna, it was held by the apex court that where the litigation expenses were incurred by the assessee for the purpose of creating, curing or completing the assessee's title to the capital must be considered as capital expenditure. If the litigation expenses are incurred to protect the business of the assessee, they must be considered as revenue expenditure. Since neither the business was in existence nor it could be said that the litigation expenses were to protect the business of the assessee, the expenditure incurred by the assessee cannot be considered to be a revenue expenditure.

18. In MESSRS. HIRALAL KALYANMAL AND ANOTHER Vs. RE., Beaumont C.J. has observed : "It is obvious that mere common ownership of the businesses does not mean that they are merely branches of the same business. It is also I think obvious that the mere fact that the two businesses are of a distinct nature does not necessarily mean that they are distinct businesses. You can have two branches of a multiple store, one selling drugs and the other selling cloth. Nobody would suggest that these two departments constitute two different businesses."

19. In Scales v. George Thompson and Co. Ltd. [1927] 13 TC 83 (KB), the observations of Rowlatt J. were as under ;

"Is there an inter-connection, an inter-lacing, an inter-dependence between, and a unity embracing, the businesses ? The inter-dependence may be financial, the unity may be unity of management and control."

20. It was held in Commissioner of Income Tax, Madras Vs. Prithvi Insurance Co. Ltd., by the apex court :

"If there was common management, common business organisation, common administration, common fund and a common place of business, then one could come to the conclusion that there was inter-connection, inter-lacing and inter-dependence which would mean that it was the same business."

21. The observation of Rowlatt J, in the case of Scales v. George Thompson and Co. Ltd, [1927] 13 TC 83 (KB) were also taken into consideration where on the facts it was found :

"That inter-connection, inter-lacing, inter-dependence and unity are furnished in this case by the existence of common management, common business, common administration, common fund and a common place of business."

22. In Produce Exchange Corporation Ltd. Vs. Commissioner of Income Tax (Central), Calcutta, relied on by the Tribunal, the matter was with regard to the loss in the sale of shares which was carried forward and set off against the profit of subsequent years from transactions in other commodities. The Tribunal found that there was no element of diversity or distinction or separateness about the transaction in shares. The High Court held that the essential matter to be considered was the nature of the two lines of business and not merely their unity of control. The apex court reversed the decision of the High Court and came to the conclusion that the decisive test was unity of control and not the nature of the two lines of business.

23. In The Standard Refinery and Distillery Ltd. Vs. Commissioner of Income Tax, Calcutta, it was held by the apex court (sic) :

"It was for the appellants to establish that different ventures constitute parts of the same business. There is in this case no evidence about unity of control and management, or inter-relation of the business, or employment of the same staff to run the business or the possibility of one theatre being closed without affecting the rest of the business."

24. From the various decisions of the apex court, it would be evident that for the purpose that the burden is on the assessee to establish as to whether the different ventures constitute part of the same business. Sufficient evidence is to be produced about the unity of control and management and inter-relation of the business or employment of the same staff to run the business or the possibility of one after being closed affecting the other business. None of the factors have been taken into consideration and the Tribunal has proceeded simply on the basis of the observation of the Supreme Court without going into the facts of the case.

25. In these circumstances, the reference is returned unanswered and the Tribunal is directed to either take into consideration the evidence at its level or send the case back to the assessing authority to take evidence and then record a finding as to whether the business of film exhibition and that of manufacturing of

artificial jewellery was the same business. It will also take into consideration whether before establishment of the business of manufacture of artificial jewellery it could be said that any expenditure in relation thereto could be considered as business expenditure allowable u/s 37. The reference is returned unanswered. Costs made easy.