
(1985) 03 MAD CK 0032
In the Madras High Court
Case No : T.C.P. No. 455 of 1984

K. Sampath Kumar

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 14-03-1985

Acts Referred:

Income Tax Act, 1961 — Section 144A, 256(1), 256(2), 36(1)

Citation : (1986) 51 CTR 380 : (1986) 158 ITR 25

Hon'ble Judges : N.A. Sathar Sayeed, J;G. Ramanujam, J

Bench : Division Bench

Advocate : A.K. Lakshmi Narayanan, for the Appellant; Nalini Chidambaram and C.V. Rajan, for the Respondent

Judgement

Ramanujam, J.—The assessee is a partner in M/s. Sam Engineering Company, Coimbatore, and he was being assessed to Income Tax on

his share of the income as a partner of the firm. On July 24, 1978, he started his own separate business, namely, manufacture and sale of Sam

pumps. For this purpose, he purchased machinery out of the monies borrowed and the machinery was installed during the year 1979-80. The

entire amount of interest paid on the capital borrowed came to Rs. 35,526 which has been charged to the profit and loss account along with other

expenses. The assessee's case was that the interest payment should be treated as a revenue expenditure and, therefore, it should be charged to the

profit and loss account. The assessee also filed an application u/s 144A to the Inspecting Assistant Commissioner who by his order dated April 7,

1980, directed the apportionment of the portion of the interest relating to the borrowals for the purchase and erection of the machinery and plant

and allowed the same to be capitalised. The Income Tax Officer, however,

rejected the assessee's claim and held that the entire interest of Rs.

35,526 is to be added to the cost of the machinery.

2. There was an appeal by the assessee before the Appellate Assistant Commissioner who allowed the assessee's claim and directed the Income

Tax Officer to grant deduction u/s 36(1)(iii) of the Act. The Revenue took the matter in appeal to the Income Tax Appellate Tribunal questioning

the decision of the Appellate Assistant Commissioner upholding the assessee's claim for deduction of the sum of Rs. 35,526 as a revenue

expenditure. The Tribunal took the view that any interest paid before the commencement of the production on amounts borrowed by the assessee

for the acquisition and installation of the plant and machinery forms part of the actual cost of the assessee and, therefore, the assessee will be

entitled only to depreciation allowance and development rebate with reference to such interest also, but he will not be entitled to claim deduction as

revenue expenditure. In that view, the Tribunal rejected the claim of the assessee for the allowance of the said revenue expenditure.

3. Aggrieved by the decision of the Tribunal, the assessee applied u/s 256(1) of the Act to refer the following four questions for the opinion of this

court :

1. Whether the Appellate Tribunal was justified in upholding the disallowance of interest of Rs. 35,526 as capital in nature ?

2. Whether the Appellate Tribunal was justified in ignoring the fact the appellant's business was indeed set up while disallowing interest of Rs.

35,526 ?

3. Whether the Appellate Tribunal misdirected itself in applying the decision of the Gujarat High Court in the case of Commissioner of Income Tax,

Gujarat II Vs. Alembic Glass Industries Ltd., to the facts of the appellant's case in disallowing interest claim of Rs. 35,526 ?

4. Whether the Appellate Tribunal while disallowing interest claim erred in ignoring the fact that the appellant was already engaged in business as a

partner in M/s. Sam Engineering Co. and the proprietary business is only a continuation and extension of this business ?

4. That petition having been rejected, the assessee has now filed this application u/s 256(2) of the Act seeking a direction to refer the said

questions for the opinion of this court.

5. We find that questions Nos. 2 to 4 referred to above are comprised in the first question as to whether the Tribunal is justified in upholding the disallowance of interest of Rs. 35,526 as capital in nature. Thus, the main question to be considered is whether the Tribunal is right in holding that the interest paid on the capital borrowed for the purchase of plant and machinery can be allowed as a revenue expenditure as claimed by the assessee. The Tribunal has found as a fact that during the assessment year 1979-80, the assessee has not commenced his business, though there was the purchase and erection of the machinery. The Tribunal took note of the fact that interest is chargeable against the profit and loss account only after the business has been commenced and that there is no question of interest being charged to the profit and loss account when the business has not been commenced. Before the Tribunal, the assessee relied on the decision of the Karnataka High Court in Gopal Films Vs. Income Tax Officer, Assessment-5, (Addl.) Circle-I, wherein the Karnataka High Court has held that the expenditure incurred prior to the commencement of the business is clearly attributable to the business and, as such, it is allowable as business expenditure. However, the Tribunal referred to certain tests laid down by the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Alembic Glass Industries Ltd., for determining the nature of the expenditure, whether capital or revenue, and applying those principles to the facts on hand, the Tribunal came to the conclusion that since the capital has been borrowed for the purchase of the machinery and plant, the interest paid on the said borrowing cannot be claimed as revenue expenditure in the assessment year, when the plant and machinery have been installed but the production has not commenced. According to the Tribunal, the new business started by the assessee has nothing to do with the business in which he was a partner and, therefore, so long as the machinery and the plant have not gone into production but only installed during the assessment year, the interest paid on such borrowing during the assessment year cannot be charged to the profit and loss account. The learned counsel appearing for the assessee relies on the decision of the Karnataka High Court in Addl. Commissioner of Income Tax, Karnataka Vs. Southern Founders, wherein a Division Bench of that court has held that where for the purpose of carrying on its business the assessee had constructed certain buildings and for the purpose of meeting certain

expenses incurred for constructing such buildings, the assessee borrowed monies and on such borrowings paid some interest, the interest paid was deductible as revenue expenditure irrespective of the fact that the buildings had not been actually put to use for carrying on the business during the relevant accounting year by the assessee. We do not see how that decision will come to the aid of the assessee in this case. That decision does not refer to the facts in detail and the decision appears to proceed on the basis that the assessee was carrying on the business and it is only in the course of the business the assessee found the necessity for construction of a new factory and for that purpose capital was borrowed and with the borrowed capital the construction of building was undertaken. Where there is an existing business and in the course of that business, the construction of a building was undertaken with borrowed capital, the interest paid on that borrowed capital will clearly be revenue expenditure, for, it is an expenditure incurred in the course of carrying on of the business. The objection taken by the Revenue in that case was that since the building was not put to use during the assessment year, the interest paid on the capital borrowed cannot be allowed as a revenue expenditure. The court, in our view, very rightly pointed out that the user of the building during the assessment year may not be quite relevant for the allowance of the interest as a revenue expenditure, though the user may be relevant for the purpose of the allowance of depreciation. In this case, the undisputed facts are that the assessee purchased the plant and machinery with borrowed capital and installed the same during the assessment year. Apart from the assessee being a partner of a firm which carries on some other business, the assessee has not started the business of manufacturing Sam pumps which he had proposed to start. The mere purchase and erection of the machinery will not amount to the starting of the business, though they may be essential preliminary steps for starting the business. The assessee can be taken to have started the business only when his plant and machinery go into production and, in this case, the Tribunal finds that during the assessment year, the Sam pumps had not been produced and that except for the erection of the plant with the machinery, nothing else took place. Therefore, only when the business is commenced, the interest paid on the capital borrowed for the purchase of machinery and plant can be charged to the profit and loss account. Before the business is commenced, there

is no question of the interest payment being charged to that account. Thus, in whatever manner the matter is looked at, the assessee's claim that he is entitled to charge interest on borrowed capital to the profit and loss account cannot be legally sustained. In this view of the matter, we do not think that there is any justification for directing the Tribunal to refer the questions referred to above. The petition is, therefore, dismissed. There will, however, be no order as to costs.