
(1997) 07 BOM CK 0101
In the Bombay High Court
Case No : IT Ref. No. 231 of 1995

Kinetic Engineering Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 23-07-1997

Acts Referred:

Income Tax Act, 1961 — Section 37(1)

Citation : (1997) 143 CTR 419 : (1998) 233 ITR 762

Hon'ble Judges : Pratibha Upasani, J;B.P. Saraf, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

B.P. Saraf, J.—By this reference under s. 256(1) of the IT Act, 1961, made at the instance of the assessee, the Tribunal has referred the following question of law to this Court for opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the entire guarantee commission paid to the Bankers for securing timely repayment of credit facility under bills discounting scheme for the purpose of machinery and equipment required by the running business is not a revenue expenditure".

2. This reference pertains to asst. yrs. 1985-86 and 1986-87. The assessee is a public limited company engaged in the business of manufacturing mopeds. It follows the accounting year ending on 30th June. During the asst. yrs. 1985-86 and 1986-87, the assessee paid guarantee commission to its bankers who issued guarantees on behalf of the assessee favouring IDBI/ICICI for securing timely repayment of the deferred credit obtained by it under the bills discounting scheme for the purpose of buying machinery in its running business. The assessee paid as guarantee commission Rs. 6,98,780 and Rs. 7,03,821 in the previous years relevant to the asst. yrs. 1985-86 and 1986-87, respectively. In its assessment for the above assessment years under the IT Act, 1961 ("Act"),

the assessee claimed deduction of the above amounts of guarantee commission in computation of its business income. The case of the assessee was that it was a revenue expenditure incurred for the purpose of business which was deductible under s. 37(1) of the Act. The above claim of the assessee was negated by the ITO. According to ITO, it was a capital expenditure. The assessee appealed to the CIT(A). The CIT(A) held that the entire amount of guarantee commission was not a capital expenditure but only the portion upto the date of installation of the asset was a capital expenditure and the balance was to be allowed as a revenue expenditure. He, therefore, directed the ITO to allow the guarantee commission till the date of installation or user of the plant and machinery to be capitalised and allow the guarantee commission relatable to and payable thereafter during any particular year as a revenue expenditure for that year. Both the assessee and the Revenue appealed to the Tribunal against the above order of the CIT(A). The contention of the assessee before the Tribunal was that the guarantee commission was a revenue expenditure and no part of it could be regarded as a capital expenditure, whereas the contention of the Revenue was that the whole of it was a capital expenditure as it was incurred for acquisition of capital asset. The Tribunal accepted the contention of the Revenue as it was also of the opinion that the guarantee commission was an expenditure relatable to the acquisition of capital asset and hence it was a capital expenditure and not a revenue expenditure. The Tribunal, therefore, held that no part of the guarantee commission was deductible under s. 37 of the Act. Hence this reference at the instance of the assessee.

3. We have heard Mr. S. N. Inamdar, learned counsel for the assessee, who submits that the Tribunal committed a manifest error of law in holding that the guarantee commission paid by the assessee to its bankers, who issued guarantees on its behalf favouring IDBI/ICICI for securing timely repayment of the deferred credit obtained by it from them under their bill discounting scheme for the purpose of buying machinery in its running business, was an expenditure relatable to the acquisition of capital asset and hence a capital expenditure. It was contended that the guarantee commission was relatable not to the acquisition of the capital asset but to the loan obtained by the assessee in its running business. According to the learned counsel, the guarantee commission paid by the assessee was an expenditure incurred for obtaining the loan which cannot be treated as a capital expenditure. It was urged that the guarantee commission was an expenditure related to the carrying on of the business and not for the acquisition of any asset and in that view of the matter, it was a revenue expenditure. Reliance was placed in support of this contention on the decision of the Supreme Court in *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, , Andhra Pradesh High Court in *Addl. Commissioner of Income Tax Vs. Akkamba Textiles Ltd.*, , Madras High Court in *Sivakami Mills Ltd. Vs. Commissioner of Income Tax*, , *Commissioner of Income Tax Vs. Gogte Minerals*, and the Calcutta High Court in *Commissioner of Income Tax Vs. Metal Corporation of India Ltd.*, .

4. In reply, Dr. Balasubramanian, learned counsel for the Revenue, submitted before us that the guarantee commission paid by the assessee cannot be held to be revenue expenditure because the loan obtained by the assessee had been used by it for purchasing capital assets i.e. plant and machinery. According to the learned counsel, the guarantee commission in this case was related to the acquisition of a capital asset and hence it was a capital expenditure. Reliance was placed in support of this contention on the decision of the Supreme Court in *Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad*, and the decision of the Gujarat High Court in *Commissioner of Income Tax, Gujarat Vs. Vallabh Glass Works Ltd.*. So far as the decision of the Supreme Court in *India Cements Ltd.* (supra) is concerned, it was contended that the ratio thereof was not applicable in view of the decision of the Supreme Court in *Challapalli Sugar Ltd.* (supra). So far as decisions of the Andhra Pradesh, Madras, Karnataka and Calcutta High Courts, in which guarantee commission has been held to be a revenue expenditure, are concerned, the submission of the learned counsel for the Revenue was that the law laid down in those cases was not in consonance with the decision of the Supreme Court in *Challapalli Sugars Ltd.* (supra). According to the learned counsel, the decision of the Gujarat High Court in *Vallabh Glass Works Ltd.* (supra) lays down the correct law and the same should be followed.

5. We have carefully considered the rival submissions. There is no dispute about the fact that an assessee is entitled to deduction of any expenditure laid out or expended wholly or exclusively for the purposes of its business in computing its income chargeable to Income Tax under the head "Profits and gains of business or profession" unless the expenditure is in the nature of capital expenditure or personal expenses of the assessee. There is also no controversy about the fact that the expenditure incurred by the assessee in the instant case by way of guarantee commission was wholly and exclusively for the purpose of its business. The only controversy is whether it is a revenue expenditure or an expenditure in the nature of capital expenditure. Law is well settled by the decision of the Supreme Court in *India Cements Ltd.* (supra) that any expenditure which is relatable to a loan obtained for the purpose of business cannot be termed as a capital expenditure on the ground that the amount of loan was used by the assessee for purchasing capital asset. The assessee claims that the present case is squarely covered by the above decision. According to the Revenue, the decision of the Supreme Court in *India Cements Ltd.* (supra) is not applicable in view of its later decision in *Challapalli Sugars Ltd.* (supra). The case of the Revenue, in other words, is that the ratio of the decision of the Supreme Court in *India Cements Ltd.* (supra) stands modified by its later decision in *Challapalli Sugars Ltd.* (supra).

6. We have carefully perused the decision of the Supreme Court in *India Cements Ltd.* (supra) and in *Challapalli Sugars Ltd.* (supra).

On a careful consideration of the same, we are of the clear opinion that the ratio

of the decision of the Supreme Court in India Cements Ltd. (supra) has in no way been effected by its later decision in Challapalli Sugars Ltd. (supra). On the other hand, in Challapalli Sugars Ltd. (supra) the Supreme Court has specifically referred its decision in India Cements Ltd. (supra) with approval. The only ground on which the expenditure in Challapalli Sugars Ltd. (supra) was held to be capital expenditure was that it was incurred before the commencement of the business of the assessee.

7. In India Cements Ltd. (supra), the assessee obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation by creating a charge on its fixed assets. In connection therewith, it paid Rs. 84,633 towards stamp duty, registration fees, lawyers' fees, etc., and claimed this amount as business expenditure. The ITO refused to allow deduction of the above amount as according to him, it was an item of capital expenditure. The order of the ITO was affirmed by the AAC on appeal. The assessee appealed to the Tribunal. The Tribunal reversed the finding of the ITO and the AAC and held that the expenditure being an expenditure incurred for obtaining the loan was an allowable expenditure. On reference, the High Court reversed the finding of the Tribunal as it was of the opinion that it was incurred for the purpose of bringing into existence an asset in the shape of borrowing Rs. 40 lakhs. On appeal of the assessee, the Supreme Court reversed the order of the High Court and held that the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was, therefore, allowable as a deduction. It was observed that the act of borrowing money was incidental to the carrying on business and the loan obtained was not an asset or an advantage of enduring nature. The Supreme Court expressed its opinion in this regard in the following terms :

"..... we are unable to agree that a loan obtained can be treated as an asset or advantage for the enduring benefit of the business of the assessee. A loan is a liability and has to be repaid and, in our opinion, it is erroneous to consider a liability as an asset or an advantage within the test laid down by Viscount Cave and approved and applied by this Court in many cases".

The Supreme Court referred to the decision of this Court in S.F. Engineer and Others (A Firm) Vs. Commissioner of Income Tax, Bombay City I, , where the nature and purpose of the loan was taken into account in considering the nature of the expenditure incurred in raising the loan and observed :

"..... we are not able to agree with the principle that the nature of the expenditure incurred in raising a loan would depend upon the nature and purpose of the loan".

The Supreme Court referred with approval the decision of the Nagpur Judicial Commissioner in Nagpur Electric Light & Power Co. vs. CIT (1931) 6 ITC 28 and observed :

"..... In our opinion, it was rightly held by the Nagpur Judicial Commissioner in

Nagpur Electric Light & Power Co. vs. CIT (supra) that the purpose for which the new loan was required was irrelevant to the consideration of the question whether the expenditure for obtaining the loan was revenue expenditure or capital expenditure".

The Supreme Court summarised its opinion in this regard as follows :

"(a) the loan obtained is not an asset or advantage of an enduring nature;

(b) that the expenditure was made for securing the use of money for a certain period; and

(c) that it is irrelevant to consider the object with which the loan was obtained".

In view of the above, the Supreme Court held that the expenditure of Rs. 84,633 incurred by the assessee in that case was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business.

8. In Challapalli Sugars Ltd. (supra), the controversy before the Supreme Court was whether interest paid on money borrowed for the acquisition and installation of the machinery of a plant accruing before the commencement of its business could be taken into account in considering the actual cost of the plant. The Supreme Court held that interest paid by the assessee before the commencement of its business on amounts borrowed by it for the acquisition and installation of plant and machinery formed part of the actual cost of the assets to the assessee. In other words, the Supreme Court treated the expenditure incurred by the assessee by way of interest upto the date of commencement of the business as a capital expenditure and not a revenue expenditure. The controversy before the Supreme court in Challapalli Sugars Ltd. (supra) was thus quite different from the controversy in India Cements Ltd. (supra) which is evident from the following passage in the decision in Challapalli Sugars Ltd. (supra) :

"..... what we are concerned with here is whether interest paid on money borrowed for the acquisition and installation of the machinery of a plant accruing before the commencement of production can be taken into account in considering the actual cost of the plant".

Referring to its earlier decision in India Cements Ltd. (supra), it was observed :

"The appellant company in that case at the time it raised the loan was a running concern.

Unlike the assessee in the present appeals, the loan raised by the appellant company in the cited case was not before the commencement of production but at a later stage. The question of including the interest paid on the loan before the commencement of business in the actual cost of the plant did not arise in that case.

9. It is thus clear that there is no inconsistency in the decision of the Supreme Court in *India Cements Ltd. (supra)* and *Challapalli Sugars Ltd. (supra)*. In *Challapalli Sugars Ltd. (supra)* the expenditure was held to be capital expenditure only because it was incurred before the commencement of business.

10. In the instant case, the uncontroverted factual position is that at the time the loan was raised, the assessee was a running concern. The guarantee commission was payable to the bankers who issued guarantee on behalf of the assessee for securing timely repayment of the loan. The act of borrowing money was incidental to the carrying on of the business and the loan obtained was not an asset or an advantage of enduring nature. In fact, the loan was a liability which cannot be considered as an asset or an advantage of enduring nature. The fact that the loan was obtained for purchasing capital asset would not effect this position. In fact, that is not a relevant consideration. In that view of the matter the ratio of the decision of the Supreme Court in *India Cements Ltd. (supra)* clearly applies and guarantee commission in the instant case has to be treated as a revenue expenditure.

11. We have also perused the decisions of the High Courts of Andhra Pradesh, Madras, Karnataka and Calcutta referred to above. The Andhra Pradesh High Court, in *Addl. CIT vs. Akkamba Textiles Ltd. (supra)* has held that the guarantee commission paid by the assessee in connection with the purchase of machinery was a revenue expenditure and not a capital expenditure. While arriving at this conclusion, the High Court followed the decision of the Supreme Court in *India Cements Ltd. (supra)*. In *Sivakashi Mills Ltd. vs. CIT (supra)* the Madras High Court also held that guarantee commission paid to a bank for obtaining a loan for acquisition of machinery was a revenue expenditure. While saying so, the High Court summed up the reasoning in support of its conclusion as follows :

"The expenditure incurred for the purchase of the machinery was undoubtedly capital expenditure, for it brought in an asset of enduring advantage. But the guarantee commission stands on a different footing. By itself, it does 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 installment terms was only a business exigency. If interest paid on a credit purchase of machinery could be held to be revenue expenditure, we fail to see how guarantee commission paid to a bank for obtaining easy terms for acquisition of the machinery could be regarded as capital payments".

12. To the same effect is the decision of the Karnataka High Court in *CIT vs. Gogte Minerals (supra)*. In that case also, the assessee purchased machinery on deferred payment scheme. The controversy was whether the guarantee commission paid by the assessee for securing the loan facility was a revenue expenditure. It was observed :

"In the present case, the assessee purchased machinery on deferred payment scheme. Payments made under the scheme should certainly be treated as capital

in nature. The guarantee agreement has been entered not for the purpose of acquiring the asset as such, but for securing a loan facility to pay the amount on deferred payment basis. Such an arrangement would only be a financial arrangement entered into by the assessee and if any commission had been paid towards the guarantee arising thereto, it would be revenue in nature because in the course of conduct of business such financial arrangement had been entered into.

13. We have also perused the decision of the Gujarat High Court in CIT vs. Vallabh Glass Works Ltd. (supra) wherein it was held :

"..... the payment of bank guarantee commission to the bank and the expenditure incurred in obtaining the letter of credit were necessary items of expenditure to bring the machineries, capital assets, into existence and to put them in working condition. These items of expenditure were incurred as an integral part of the payment of the cost price of the machineries and formed part of the cost of acquisition of the capital assets. Therefore, the expenditure must be regarded as capital expenditure irrespective of the time when the payment was made".

We have carefully considered the above conclusion. However, in view of the clear decision of the Supreme Court in India Cements Ltd. (supra), we find it difficult to agree with the reasoning and conclusion of the Gujarat High Court in the above decision.

14. In the light of the foregoing discussion, we are of the clear opinion that the bank guarantee commission paid by the assessee for securing timely repayment of the deferred credit facility for buying machinery in its running business is a revenue expenditure and not a capital expenditure. The Tribunal, in our opinion, committed a manifest error of law in holding it to be a capital expenditure. We accordingly answer the question referred to us in the negative, i.e., in favour of the assessee and against the Revenue.

15. This reference is disposed of accordingly with no order as to costs.