
(1991) 04 BOM CK 0039

In the Bombay High Court

Case No : Income-tax Reference No. 227 of 1977

Shree Ram Mills Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 20-04-1991

Acts Referred:

Income Tax Act, 1961 — Section 37, 41(1)

Citation : (1992) 195 ITR 215

Hon'ble Judges : T.D. Sugla, J;D.R. Dhanuka, J

Bench : Division Bench

Advocate : J.D. Mistry, for the Appellant; Dr. V. Balasubramanian, for the Respondent

Judgement

T.D. Sugla, J.—This is a reference at the instance of the assessee company. The assessment year involved is 1969-70. The Income Tax Appellate Tribunal has referred to this court the following question of law for opinion u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the Tribunal erred in law in holding that the assessee is not entitled to deduction in respect of the sum of Rs. 3,05,981 being expenditure incurred on the issue of prospectus, etc. for raising working capital by way of replenishment ?"

2. The assessee-company carries on business in the manufacture of textile and engineering goods. Up to August 15, 1965, it was being managed by the managing agents, Messrs. Bhogilal Menghraj and Co. Ltd. The interest in the managing agency firm was held by two group known as Shri Bhogilal Laherchand group and Shri Lalchand Menghraj group. There developed a rift between the two group in the year 1965 when the Government of India announced the policy of gradual abolition of the managing agency system. Shri Pratap Bhogilal was appointed managing director with effect from August 16, 1965, with the approval of the Central Government as a result of which there were serious disturbances in the proper functioning of the day-to-day business of the company. There was

litigation in this court which ended in a consent decree dated September 4, 1968. In terms of the consent decree, the assessee-company was required to purchase 30,975 equity shares of the face value of Rs. 100 each relating to the minority group at a price of Rs. 206.50 per share and effect suitable reduction in capital. The assessee-company was, thus, required to pay a sum of Rs. 63,96,337 in installments as per our court's order dated September 4, 1968, to the minority group of shareholders. As a consequence, the assessee company's working funds were affected adversely.

3. In order to get over the situation, the board of directors of the assessee-company decided some time in November/December, 1968, to issue 62,750 fresh equity shares of Rs. 100 each at par. Prospectus was to purchase the shares. A sum of Rs. 32 lakhs odd was received during the calendar year 1968 itself as share application money. The shares were issued subsequently. The profit and loss account for the calendar year 1968 relevant for the year under reference disclosed a sum of Rs. 3,05,981 as share-issue expenses.

4. The assessee claimed the above expenditure as deduction on revenue account. The claim was rejected by the Income Tax Officer who relied on the Supreme Court decision in *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, . The Appellate Assistant Commissioner agreed with the Income Tax Officer. The Tribunal, inter alia, referred to the Bombay High Court decision in the case of *Tata Iron and Steel Co. Ltd., in re [1921] 1 ITC 125* , and the Supreme Court decision in *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, and agreed with the departmental authorities that the expenditure was incurred on the floating of capital by additional issue and was, therefore, capital in nature.

5. Shri Mistry, learned counsel for the assessee, submitted that, by raising additional capital, the assessee was in any way benefited. The additional capital raised was Rs. 62,75,000 which was almost equal to the amount of Rs. 63,96,337 the assessee was to pay to the minority group of shareholders for purchasing their 30,975 shares in terms of the consent decree. It is not quite correct to say that, by raising the capital by issue of additional shares, the assessee got any advantage, far less an advantage of enduring nature. The Tribunal was, therefore, not correct in confirming the disallowance of the expenditure as revenue expenditure. Shri Mistry stated that our court, in the case of *Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV*, , and in the case of *Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd.*, , considered this issue. In *Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV*, , our court held, following the Supreme Court decision in *India Cements Ltd. Vs. Commissioner of Income Tax, Madras*, , that it was not every item of expenditure incurred in connection with the raising of the additional capital that required disallowance. Expenditure such as legal expenses, printing expenses, etc., which a trader is expected to incur in the ordinary course of its capacity as a trader have to be allowed as revenue expenditure even though a part of it might relate

to the issue of the raising of the additional capital. In particular, Shri Mistry placed strong reliance on our court's judgment in Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd., . It was stated that, in more or less similar circumstances, the expenditure incurred on the raising of capital by additional issue of shares was held to be a revenue expenditure. This case, according to him, was squarely applicable in the facts of this case and, therefore, it must be held that the expenditure incurred herein is also a revenue expenditure.

6. Dr. Balasubramanian, learned counsel for the Revenue, on the other hand, strongly relied upon the Tribunal's order. In particular, he stated that the Supreme court decision in the case of BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY,, , was applicable and was against the assessee and that our court's judgment in Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd., was distinguishable.

7. We have carefully considered the Supreme court decision in India Cements Ltd. Vs. Commissioner of Income Tax, Madras, , and our High Court's decisions in Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV, and Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd., . In order to appreciate the facts of the case in the light of the decisions relied upon, it is desirable to mention that, in the present case, the dispute was between the two constituents of the managing agency firm. The dispute was no doubt settled in terms of a consent decree. However, the fact cannot be overlooked that the dispute has no direct nexus with the assessee company's carrying on of its business. In normal circumstances, the dispute between the two constituents could and should have been settled by one group buying out the other group. In the present case, the disputing groups compromised and obtained a consent decree in terms of which the assessee-company had to purchase the shares of the minority group which is generally not done. In the circumstances, we do not think it is quite correct to say that the depletion of the assessee-company's funds for the purpose of buying out one of the constituents of the managing agency firm has a direct nexus with the assessee's carrying on of the business or of the assessee-company's raising of the additional capital.

8. The prospectus issued on December 2, 1968, inviting the public to purchase the assessee-company's shares indicates the purpose of the issue of the shares as under :

"Purpose of the present issue :

The company intends to issue to the public 62,750 equity shares for the following purposes :

(a) The company desires to have its shares listed on the Bombay Stock Exchange and, accordingly, the issue covered by this prospectus is offered to the public.

(b) The company requires additional finance for investment in the Reishaure Chucks Project at Udhna in the State of Gujarat referred to above.

(c) The company has, pursuant to an order and decree dated September 4, 1968, passed by the Hon'ble High Court of Judicature at Bombay in Company Petition No. 102 of 1967 of Lalchand Menghraj v. Shree Ram Mills Ltd., purchased 30,975 equity shares of the face value of Rs. 100 each of the company at price of Rs. 206.50 per share and consequential reduction of the capital by 30,975 shares. Under the said decree, as adjusted by an order passed by the Hon'ble High Court of Judicature at Bombay on September 5, 1968, the purchase price of shares is to be paid by ten equal monthly instalments, commencing from September 21, 1968. The company has paid instalments due till date and it now requires funds partly to pay off the balance of the installments as and when due. The total amount paid so far is Rs. 19,18,901."

9. Evidently, the purpose of the issue of additional shares is two-fold. To the extent the purpose is to raise additional capital for the project at Udhna in Gujarat, the expenditure incurred cannot but be held to be on capital account. The other purpose is to meet a situation that was caused due to dispute between the two groups in the managing agency firm which resulted in a consent decree. To say the least, second purpose does not have a direct nexus with the assessee's carrying on of the business.

10. We will refer to our court's judgment in Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV, , a little later. In the Supreme Court decision in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , the expenditure was incurred for raising a loan. Observing that a loan is a liability and not an asset, it was held that a loan, i.e. a liability, cannot be an advantage, far less an advantage of enduring nature. The expenditure was treated to be of revenue nature primarily for the reason. The facts in our court's judgment in Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd., were that the assessee manufactured pharmaceutical products and had, for the purpose, entered into an agreement of technical collaboration with its parent company in the U.K. 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 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. The Government, however, informed the assessee that it would grant permission to enter into a fresh technical collaboration 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. It was in these circumstances that the assessee-company raise capital to the extent of 25% to be subscribe by the Indian public in order to dilute the capital contribution of the parent company. A question arose as to whether the expenditure in connection with the raising of such capital would be revenue expenditure. Our court held that the expenditure incurred was a revenue expenditure.

11. Comparing the facts of the case before us with those of the Commissioner of Income Tax Vs. Glaxo Laboratories (India) Ltd., , we find that the facts are materially different. In that case, our court has observed that (at p. 65) : "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." There was, thus, a direct nexus between the assessee's business and the raising of the capital. As against that case, in the case before us, it is the admitted position that the assessee needed funds for a project in Gujarat and for making payment to buy out the minority shareholders in the managing agency firm. Under the circumstances, the facts in the present case are more akin to our court's decision in Tata Iron and Steel Co Ltd., In re [1921] 1 ITC 125.

12. As regards our court's decision in Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV, , we have only to mention that there are no details available on record of the expenditure of Rs. 3,05,981. In the profit and loss account, the expenditure is shown as share issue expenses. It is true that the Tribunal has described this expenditure in paragraph 8 of its judgment as being expenditure incurred on the issue of prospectus, legal and other expenses for the new issue of capital. However, in the absence of details, it is not possible to hold whether and to what extent the decision in Bombay Burmah Trading Corporation Ltd. Vs. Commissioner of Income Tax, Bombay City-IV, will at all apply.

13. Having regard to the above discussion, we hold that the expenditure incurred herein is not of revenue nature. Accordingly, we answer the question in the negative and in favour of the Revenue. Before concluding we would like to observe that the expression used in the question "for raising working capital by way of replenishment" is not quite correct. However, we need not pursue this aspect of the matter further.

14. There will be no order to costs.