

PETITIONER:
M/S MADRAS INDUSTRIAL INVESTMENT CORPORATION LTD.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME TAX, TAMIL NADU I, MADRAS

DATE OF JUDGMENT: 04/04/1997

BENCH:
S.C. AGRAWAL, SUJATA V. MANOHAR

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T

Mrs. Sujata V. Manohar, j.

The appellant is public limited company. The present appeal filed by it pertains to the accounting year ending June 30, 1967 relevant to the assessment year 1968-89.

On December 10, 1966 a public issue of the debentures of the appellant company was made. The total value of the debentures was Rs. 1.5 crores repayable with interest at the rate of 5-3/4% per annum. The debentures were issued at a discount of 2%, redeemable after 12 years. The issue price of a debenture of Rs. 100/- was Rs. 98/-. The total discount on the issue of Rs. 1.5 crores amounted to Rs. 3 lakhs. For the Rs. 10,000/- written off as discount on the previous issue.

The Income-tax officer by his assessment order dated January 31, 1969 disallowed the claim of the appellant for deduction of Rs. 22,500/- on the ground that discount on bonds and debentures was not allowable as an expenditure. On appeal, the Appellate Assistant Commissioner by his order dated July 4, 1969 held that the discount allowed at the time of the issue of debentures was to be treated as a part of the expenditure for such issue. He upheld the claim for deduction of Rs. 12,500/- But rejected the claim as regards Rs. 10,000/- on the ground that it related to discount on debentures issued in an earlier year and hence it did not pertain to the relevant previous year.

The assessee then preferred an appeal before the Appellate Tribunal. The assessee contended. Inter alia, that (1) The Appellate Assistant Commissioner had erred in sustaining the disallowance of Rs. 10,000/- on the ground that it related to an earlier year and (2) The Appellate Assistant Commissioner having held that discount allowed at the time of issue of debentures was to be treated as part of the expenditure incurred for such issue, should have further allowed a sum of Rs. 2,87,000/- being balance amount of the total discount of Rs. 3,00,000/- relating to the issue of debentures of Rs. crores. Before the Tribunal the department contended that the appellant-company had, for the first time, made a new claim before the Tribunal for deduction of Rs. 2,87,500/- and the Tribunal had no jurisdiction to

examine this claim. This objection was rejected by the Tribunal. The Tribunal held that the expenditure of Rs. 3,00,000/- was incurred during the relevant previous year although it was proportionately written off over a period of 12 years. The expenditure of Rs. 3,00,000/- was allowable as expenditure incurred for accountancy purposes this amount was spread over 12 year and only Rs. 12,500/- was written off, being the proportionate amount for 6 months ending with June 30, 1967, cannot make difference. Therefore, the Tribunal allowed a deduction of Rs. 2,87,500/- also. On the application of the Department, the Tribunal stated as case under Section 256(1) of the Income-tax Act, 1961 to be decided by the Madras High Court. The following two questions were referred to the Madras High Court:-

"(1) Whether on the facts and in the circumstances of the case, the Tribunal was justified in permitting the assessee to raise the contention that the entire amount of Rs. 3,00,000/- being the discount relating to the issue of debentures for Rs. 1.5 crores during the relevant previous year was to be allowed as a permissible deduction?

(2) Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee had incurred an expenditure of Rs. 3,00,000/- during the relevant previous year by way of discount paid to the persons who had subscribed to the debentures issued by it for Rs. 1.5 crores during the relevant previous year and the same was allowable as a revenue expenditure?"

The Madras High Court by its judgment and order dated November 5, 1987 (reported in 1980 124 ITR 454) answered the first question in favour of the appellant-assessee. The High Court reframed the second question as follows:

"Whether there was any expenditure in the sum of Rs. 2,87,500/- and whether it was revenue expenditure?"

It held that the discount of Rs. 3,00,000/- did not represent any payment made to any one so to constitute expenditure. It held that no expenditure was laid out or incurred by the assessee/appellant company which could be allowed as a deduction. It noted that out of the total discount of Rs. 3,00,000/- a discount of Rs. 12,500/- had been allowed by the Tribunal which the Department has not challenged. Hence the High Court was concerned only with the balance amount of Rs. 2,87,500/- which the High Court held could not be considered as expenditure. Therefore, the second part of the question whether it was revenue expenditure or not, did not require consideration.

The present appeal is filed by the appellant-company against the second question as reframed by the Madras High Court and answered as above. We have first to consider whether the discount of Rs. 3,00,000/- on debentures which were issued by the appellant company is expenditure incurred by the appellant company for the purposes of its business. The appellant-company actually received Rs. 1.47 crores as against which it incurred a liability to return a sum of

Rs. 1.50 crores with interest at the end of 12 years (the date of redemption). This liability which the assessee incurred to pay the amount of Rs. 3,00,000/- in addition to what it actually received, is being written off over the period of 12 years. Can it be treated as expenditure? In the case of Indian Molasses Co. (Private) Ltd. v. commissioner of Income-tax, West Bengal (1959 37 ITR 66) this Court considered the meaning of "expenditure" under Section 10(2) (xv) of the Income-tax Act 1922. The High court was concerned with sums which were transferred by the company to trustees to take out an annuity policy on the life of the managing director or the longest life policy in favour of the managing director and his wife. There was a provision in the policy for surrendering the annuity for a capital sum after giving notice. The payment by the company to the trustees was contingent and the liability itself was contingent. The Court said that expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time. Putting aside of money which may become expenditure on the happening of an event is not expenditure. Dealing with what is expenditure, this Court said (page 78) that "expenditure" is equal to "expense and "expense" is money laid out by calculation ad intention. The idea of spending in the sense of "paying out or away" money is the primary meaning. Expenditure is what is paid out or away, something that is gone irretrievably. In the case of Calcutta Co. Ltd. v. commissioner of Income-tax, West Bengal (1969 37 ITR 1) decided in the same month, the assessee bought lands and sold them in plots for building purposes. The assessee undertook to develop the plots by laying out roads, Providing a drainage system, installing lights etc. when the plots were sold the purchasers paid only a portion of the purchase price and undertook to pay the balance in instalments. The assessee undertook to carry out the development of these plots. In the relevant accounting year, the assessee who followed the mercantile system of accounting, actually received in cash only a sum of Rs. 29,392/- towards the sale price of lands; but it credited in its accounts the sum of Rs. 43,692/- representing the full sale price of land and at the same time it also debited an estimated sum of Rs. 24,809/- as expenditure for the development it had undertaken to carry out even though that amount was not actually spent. The Department disallowed this expenditure. Upholding the claim of the assessee to deduction, this Court said that the undertaking given by the assessee imported a liability on the assessee which accrued on the dates of the deeds of sale though that liability was to be discharged at a future date. It was thus an accrued liability and the estimated expenditure which would be incurred in discharging the same could be deducted from the profits and gains of business. The difficulty in the estimation of liability did not convert the accrued liability into a conditional one. This Court said that the expression 'profits or gains' in Section 10(1) of the Income-tax Act, 1922 had to be understood in its commercial sense; and there could be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipt is deducted therefrom, whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date.

Thus "expenditure" is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date.

However, a contingent liability which may have to be discharged in future cannot be considered as expenditure.

In the case of Commissioner of Income-tax, Bombay North v. Chandulal Keshawalal and Co. (1960 38 ITR 601) the assessee-firm was the managing agent of a company. In accordance with the managing agency agreement the commission for the relevant accounting year was a sum of Rs. 3,09,114/-. But at the request of the managed company the assessee agreed to accept a sum of rupees one lakh only as its commission. The Appellate Tribunal found that (i) the financial position of the managed company was rather unsatisfactory, (ii) that the assessee had been remitting a part of whole of its commission in that past whenever the profits of the managed company were unsatisfactory, (iii) that the waiver was neither a bounty nor mala fide and (iv) that the business of the assessee was so linked up with the managed company that if the latter was put on a sounder position the assessee would get a larger commission in the future. It held that the part of the commission remitted by the assessee was given up for reasons of commercial expediency and was business expenditure allowable under Section 10(2)(xv) of the Income-tax Act 1922. In deciding whether a payment of money is deductible expenditure, one has to take into consideration questions of commercial expediency and the principles of ordinary commercial trading. What is relevant to note in this case is that the assessee had not paid out any amount but had relinquished a part of its claim.

In the case of Commissioner of Income-tax, West Bengal v. Indian Jute Mills Association (1982 134 ITR 68), Sabyasachi Mukharji, J. as he then was, in the Calcutta High Court, considered the meaning of the expression "expenditure" and said that the expression must be understood in the context in which it is used. The Legislature has used the expression "allowances and depreciation" in several sections in the scheme in Chapter IV of the Income-tax Act, 1961. Section 37 of the Income-tax Act, 1961, enjoins that any expenditure not being expenditure of the nature described in Section 30 to 36 laid out or expended wholly and exclusively for the purpose of the business or profession should be allowed in computing the income chargeable under the head "Profits and gains of business or profession". In Sections 30 to 36 the expression "expenses incurred" as well as "allowances and depreciation" has been used. Therefore, the Legislature was using the expression "any expenditure" in Section 37 to cover both. He interpreted Section 44A and the term "expenditure incurred" occurring there in the light of Sections 30 to 36 (1). In that case, the Calcutta High Court was required to consider the claim of the assessee which was a non-trading association to depreciation on furniture, air-conditioner etc. which were debited in its account. The Department contended that the assessee could not claim depreciation since it was a non-trading association. The Calcutta High Court held that having regard to the purpose of Section 44A the depreciation claimed should be construed as "expenditure incurred" and the assessee would be entitled to the beneficial construction of the provision. The Calcutta High Court differed in that case from the view taken by the Madras High Court in the judgment which is under challenge before us.

Therefore, although expenditure primarily denotes the idea of spending or paying out, it may, in given circumstances, also cover an amount of loss which has not gone out of the assessee's pocket but which is all the same,

an amount which the assessee has had to give up. It also covers a liability which the assessee has incurred in present although it is payable in futuro. A contingent liability that may arise in future is, however, not "expenditure". It would also cover not just a one-time payment but a liability spread out over a number of years.

The question whether a discount on bonds should be treated as "expenditure", directly arose before the Madhya Pradesh High Court in the case of M.P. Financial Corporation v. Commission of Income-tax (1987 165 ITR 765. The Madhya Pradesh High Court was required to deal with a case where State Financial Corporation had issued bonds at a discount. The Court held that the expression "expenditure" as used in Section 37 of the Income-tax Act, 1961 may, in the circumstances of a particular case, cover an amount which is really loss and the said amount has not gone out from the pockets of the assessee. In the case of issue of bonds at a discount, it said that the same principles as are applicable in the case of issue of debentures at a discount, would be attracted. The amount of discount, in effect, represents deferred interest and an assessee would not be justified in claiming deduction of the entire amount of discount in the accounting year in question. But it would be entitled to proportionate deductions spread over the period for which the bonds remain outstanding. The High Court has relied upon a passage in Spicer and Pegler's "Book-Keeping and Accounts" (seventeenth edition) at page 240 which is as follows:-

"The discount on the issue is, in effect, deferred interest, and should accordingly be written off over the period having the use of the money raised by the debentures, unless a sinking fund is created to accumulate the full redemption price, including the discount."

It has also relied upon a paragraph in Batliboi's "Principles and Practice of Auditing" which is as follows:-

"When debentures are issued at discount, an account styled 'Discount on Debentures Account', will be debited with the discount allowed on the issue. The debentures account will be credited in the books at their nominal value and will appear at that value as a liability in the balance-sheet. The loss thus arising need not be completely written off in the year in which the debentures are issued, since the benefit to be derived from the amount borrowed will continue till the debentures are redeemed. Where the debentures are redeemable at the end of a fixed period, a proportionate amount of discount should be written off out of revenue every year during which the debentures are outstanding."

The Madhya Pradesh High Court also referred to the judgment of the Madras High Court which is under challenge before us and differed from it, preferring the decision of the Calcutta High Court in the case of Commissioner of Income Tax v. Indian Jute Mills Association (supra). The Madhya Pradesh High Court held that the assessee would not

be justified in claiming deduction of the entire amount of discount in the accounting year in question but it would nevertheless be entitled to proportionate deduction spread over the period for which the bonds would remain outstanding.

Therefore, when a company issues debentures at a discount, it incurs a liability to pay a larger amount than what it has borrowed, at a future date. We need not go into the question whether this additional liability equivalent to the discount, which is incurred in present but is payable in future, represents deferred interest or not. That may depend upon the totality of circumstances relating to the issue of debentures, including its terms. The liability, however, to pay the discounted amount over and above the amount received for the debentures, is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. The amounts so obtained by issue of debentures are used by the company for the purposes of its business. This would, therefore, be expenditure.

Section 37(1) further requires that the expenditures should not be of a capital nature. In the case of *India Cements Ltd. v. Commissioner of Income-tax, Madras* (1966 60 ITR 52) the appellant-company had obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection with this loan it spent a sum of Rs. 84,633/-, etc., and claimed this amount as business expenditure. This Court considered whether the expenditure so incurred was business expenditure or whether it was capital expenditure. This Court quoted with approval the observations of Shah, J. in *Bombay Steam Navigation Co. Ltd. v. Commissioner of Income-tax* (1965 56 ITR 52 at 59) that whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. The question 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, that it may be regarded as an integral part of the profit-making process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure. This Court went on to observe that the provisions of the English Income-tax Act in this regard are somewhat different from those of the Indian Income-tax Act. It referred to the English case of *Taxes Land and mortgage Co. v. William Holtham* (1894 3 Tax cases 255, 260) where a mortgage company had raised money by the issue of debentures and debentures stock and incurred expenses in this connection. The English High Court said that the expenses would not be deducted as trading expenses because the amount paid was for raising capital. Differing from the observations made therein, this Court observed that a loan is a liability and has to be repaid and in its opinion it is erroneous to consider a liability as an asset or an advantage. This Court disagreed with the English view that borrowing money by the issue of debentures was an acquisition of capital asset and that any commission or expenditure incurred in respect thereof was of a capital nature. It said; "we are of the opinion that (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. Consequently, in the circumstances of the case, the expenditure was revenue expenditure within Section 10(2)(xv)", The same ratio would apply here also.

Our attention was drawn to the case of Lomax (Inspector of Taxes) v. Peter Dixon and son, Ltd, a decision of the English Court of Appeal reported in (12 Suppl. ITR 513) where the English Court had treated discount or premium in the hands of the recipient as a receipt of a capital nature. But the character of payment in relation to the payer can be different from the character of that payment in the hands of the recipient. In the light of the ratio laid down by this Court in the case of India Cements Ltd. (supra) any liability incurred for the purpose or obtaining the loan would be revenue expenditure.

The Tribunal, however, held that since the entire liability to pay the discount had been incurred in the accounting year in question, the assessee was entitled to deduct the entire amount of Rs. 3,00,000/- in that accounting year. This conclusion does not appear to be justified looking to the nature of the liability. It is true that the liability has been incurred in the accounting year. But the liability is a continuing liability which stretches over a period of 12 years. It is, therefore, a liability spread over a period of 12 years. Ordinarily, revenue expenditure which is incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. It cannot be spread over a number of year even if the assessee has written it off in his books over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. In fact, allowing the entire expenditure in one year might give very distorted picture of the profits of a particular year. Thus in the case of Hindustan Aluminium Corporation Ltd. v. Commissioner of Income-tax, Calcutta-I (1983, 144 ITR 474) the Calcutta-High Court upheld the claim of the assessee to spread out a lump sum payment to secure technical assistance and training over a number of years and allowed a proportionate deduction in the accounting year in question.

Issuing debentures at a discount is another such instance where, although the assessee has incurred the liability to pay the discount in year of issue of debentures, the payment is to secure a benefit over a number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures.

The appellant, therefore, had, in its return, correctly claimed a deduction only in respect of the proportionate part of discount of Rs. 12,500/- over the relevant accounting period in question. In this connection, we agreed with the reasoning and conclusion of the Madhya Pradesh High Court in the case of M.P. Financial Corporation v. Commissioner of Income-tax (supra). The view that we have taken is also in conformity with accounting practice of showing the discount in "discount on debentures account" which is written off over the period of the debentures."

The appellant is, therefore, entitled to deduct a sum of Rs. 12,500/- out of the discount of Rs. 3,00,000/- in the relevant year. The balance expenditure of Rs. 2,87,500/- cannot be deducted in the assessment year in question. Question No. 2 (as reframed) therefore, which is the subject matter of appeal before us, is answered in the negative in so far as it related to the deduction of Rs. 2,87,500/- in the assessment year in question though for reasons entirely

different from those given by the High Court. The second part of the reframed question is answered in the affirmative. But only proportionate part of the discount can be deducted in the assessment year in question. Question No. (as reframed) therefore, which is the subject matter of appeal before us, is answered in the negative in so far as it relates to the deduction of Rs. 2,87,500/- in the assessment year in question though for reasons entirely different from those given by the High Court. The second part of the reframed question is answered in the affirmative. But only a proportionate part of the discount as set out earlier. The appeal is disposed of accordingly and the judgment of the High Court is set aside. There will be no order as to costs in the circumstances of the case.

JUDIS