

Commissioner of Income-tax Vs. Gwalior Sugar Company Limited

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Court : Madhya Pradesh

Decided On : Sep-05-1983

Reported in : (1984)42CTR(MP)69; [1984]150ITR320(MP)

Judge : G.P. Singh, C.J. and ;Faizan-Ud-Din, J.

Acts : [Income Tax Act, 1961](#) - Sections 37(1) and 256(2); Indian Income Tax Act, 1922 - Sections 10(2); Sugarcane (Control) Order, 1955

Appeal No. : Miscellaneous Civil Case Nos. 85 and 467 of 1971, 726 and 727 of 1972 and 252 of 1982

Appellant : Commissioner of Income-tax

Respondent : Gwalior Sugar Company Limited

Advocate for Def. : K.P. Munshi, Adv.

Advocate for Pet/Ap. : B.K. Rawat, Adv.

Judgement :

Faizan-Ud-Din, J.

1. The judgment and order delivered in this reference will also govern the disposal of M.C.C. No. 85 of 1971 (Commissioner of Income-tax, M. P., Nagpur & Bhandara v. Gwalior Sugar Co. Ltd.); M.C.C. No. 467 of 1971 (Commissioner of Income-tax, M. P., Bhopal v. Gwalior Sugar Co. Ltd.); M.C.C. No. 726 of 1972 (Gwalior Sugar Co. Ltd. v. Commissioner of Income-tax, Bhopal) and M.C.C. No. 727 of 1972 (Addl. Commissioner of Income-tax, M. P., Bhopal v. Gwalior Sugar Co. Ltd.) as the assessee in all the references is the same and common questions are involved in all these five references, relating to the deductions and disallowances representing the extra cane price paid to Gwalior Agricultural Co. Ltd., and the forgone amounts of interest on advances made to the said agricultural company.

2. The reference in M.C.C. No. 252 of 1982 has been made by the Tribunal under the direction of this court in M.C.C. Nos. 95 and 625 of 1971 decided on July 26, 1976 under Section 256(2) of the I.T. Act, 1961. The reference relates to the assessment year 1957-58, the relevant previous year having ended on June 30, 1956. The reference in M.C.C. No. 85 of 1971 was made at the instance of the Commissioner of Income Tax, M. P., Nagpur and Bhandara, Nagpur, under Section 66(1) of the Indian I.T. Act, 1922, relating to the assessment year 1958-59, the corresponding financial year being the previous year. The reference in M.C.C. No. 467 of 1971 was also made at the instance of the Commissioner of Income-tax, Bhopal, under Section 66(1) of the Indian I.T. Act, 1922, relating to the assessment year 1959-60, the corresponding financial year being the previous year. The reference in M.C.C. No. 726 of 1972 was made at the instance of the assessee, M/s. Gwalior Sugar Co. Ltd., under Section 66(1) of the Indian I.T. Act, 1922, relating to the assessment years 1960-61 and 1961-62, the accounting periods being respectively the years ended on June 30, 1959, and June 30, 1960, Similarly the reference in M.C.C. No. 727 of 1972 was made at the instance of the Addl. Commissioner of

Income-tax-tax, M. P., Bhopal, relating to the assessment year 1964-65 corresponding to the previous year ended on June 30, 1963.

3. We shall now briefly state the facts and questions of each reference as set out by the Tribunal in its statement of case referred to this court for opinion.

4. The reference made in M.C.C. No. 252 of 1982 is the earliest case the facts of which as found by the Tribunal may 'be stated thus: The reference relates to the assessment year 1957-58, the relevant previous year having ended on June 30, 1956. The assessee 'Gwalior Sugar Co. Ltd.' (hereinafter referred to as 'sugar company') is a public limited company engaged in the manufacture and sale of sugar. Out of its seven directors, three are government nominees. The Gwalior Agricultural Company is an allied company, four directors of which are the same who are nominees of the sugar company. By an agreement dated December 30, 1950, the agricultural company undertook to sell its entire production of sugarcane every year to the assessee-company at the rate fixed by the Government of India as in the case of other cultivators. The agricultural company was also entitled to charge a premium for cane of better variety than that normally supplied by the small cultivators. The agricultural company, which is a subsidiary of the assessee-company, supplied sugarcane to the assessee-company besides various other cultivators and during the previous year, out of the total purchase of 27 lakhs maunds of sugarcane, 3.5 lakhs maunds were supplied by the agricultural company.

5. Besides the payment of price for cane purchased from the agricultural company, the assessee company made advances on interest from time to time to the agricultural company in all amounting to Rs. 10,00,000 (ten lakhs), the interest on which came to Rs. 50,000 during the relevant previous year which was forgone by the assessee-company in favour of the agricultural company. Besides giving up the aforesaid amount of interest, the assessee company also paid to the agricultural company a sum of Rs. 1,04,017 as additional price for the sugarcane supplied to it during the relevant previous year. At the time of the assessment proceedings of the assessee-company for 1957-58, the ITO required the assessee to explain as to on what account it had forgone the amount of interest of Rs. 50,000 in favour of agricultural company and paid additional price of Rs. 1,04,017. The assessee-company gave the explanation by its letter dated February 5, 1962, (annex. B) that the agricultural company was running in loss and as the assessee was interested in its welfare, the assessee appointed a sub-committee to go into its affairs and suggest ways and means to improve its condition. The assessee-company paid the extra price for sugarcane purchased from it and also gave up the amount of interest payable on the loans advanced on the recommendations (annex. D) of the said sub-committee as well as on the resolution (annex. E) of the board of directors of the assessee-company sanctioning the same.

6. The ITO took the view that the extra price had been paid by the assessee and the interest amount had been forgone for purposes other than business purposes. He, therefore, by his order dated March 30, 1962, disallowed the deductions of the said amount (Rs. 1,04,017 paid as extra price and Rs. 50,000 as interest (forgone) on loans advanced). This order was maintained by the AAC in first appeal. In second appeal by the assessee, the Tribunal maintained the orders of the ITO and AAC in so far as it related to the amount of extra payment of price but so far as the amount of interest was concerned, the Tribunal took the view that the interest was surrendered on considerations of business expediency and, therefore, deleted the addition of the amount of interest. Both the CIT as well as the assessee were dissatisfied with this order and as such both filed applications seeking reference to this court. But the Tribunal dismissed both the applications and declined to make a reference under Section 256(1) of the Act. However, this court by order dated July 26, 1976, passed under Section 256(2) of the Act in M.C.C. Nos. 95 and 625 of 1971, directed the Tribunal to refer to this court the following questions for consideration which the Tribunal referred accordingly:

'(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in allowing the claim for the deduction of the amount of interest of Rs. 50,000 on the ground of business expediency ?

(2) Whether it has been correctly held that the interest has not accrued up to the time it was surrendered by

resolution dated June 25, 1956, and was the Appellate Tribunal justified in allowing deduction on this ground ?

(3) Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,04,017 representing the extra cane price paid to Gwalior Agricultural Company Ltd., was admissible as an expenditure under Section 10(1) or under Section 10(2)(xv) of the Indian Income-tax Act, 1922 ?'

7. The reference in M.C.C. No. 85 of 1971 relates to the assessment year 1958-59, the corresponding financial year being the previous year. The question referred for our opinion is as under :

'Whether, on the facts and in the circumstances of the case, the Tribunal was, in law, justified in allowing the claim for the deduction of the amount of interest of Rs. 50,000 on the ground of business expediency ?'

8. The facts may be stated thus: As stated earlier, the assessee-company had advanced a sum of Rs. 10,00,000 to the agricultural company at a certain rate of interest charged every year. An amount of Rs. 50,000 had accrued as interest on the said amount for the relevant period which was surrendered by the assessee-company in favour of the agricultural company. The assessee-company claimed deduction of the said amount of interest in the assessment proceedings before the ITO who rejected the said deduction. The order was maintained by the AAC in first appeal. On further appeal before the Tribunal (Bench of Delhi Tribunal), it reversed the orders of the ITO and AAC following its earlier order dated September 6, 1968, passed in the earlier assessment proceedings relating to the assessment year 1957-58 in Income-tax Appeal No. 15702 of 1966-67, wherein it was held that the assessee was entitled to claim the allowance for interest surrendered by it. On the application by the CIT, the Tribunal referred the question reproduced above for our answer.

9. The reference in M.C.C.No. 67 of 1971 relates to the assessment year 1959-60, the corresponding financial year being the previous year in which the following question has been referred for our answer:

'Whether, on the facts and in the circumstances of the case, the Tribunal was, in law, justified in deleting the addition of the amount of interest of Rs. 50,000 made in the assessment ?'

10. In this case also during the assessment year the interest amount of Rs. 50,000 was surrendered by the assessee-company in favour of the agricultural company for the same reasons as stated earlier. In the assessment proceedings, the ITO took the view that the interest was forgone not for business considerations but for extra-commercial considerations, and, therefore, added Rs. 50,000 to the income of the assessee-company. The said order was maintained in appeal by the AAC. However, on further appeal, the Tribunal held that the addition of Rs. 50,000 to the income of the assessee was uncalled for and, therefore, the said addition was deleted by the Tribunal. The reference was, therefore, made on the application of the CIT referring to our answer the question reproduced above in this para.

11. M.C.C. No. 726 of 1972 relates to the assessment years 1960-61 and 1961-62, the accounting periods being respectively the years ending on June 30, 1959, and June 30, 1960, in which the questions referred for our answer are as follows:

'1. Whether, on the facts and in the circumstances of the case, the sums of Rs. 65,806 (Rs. 1,03,806--Rs. 38,000) and of Rs. 1,35,668 (Rs. 1,73,668--Rs. 38,000) representing the extra price paid to the Gwalior Agricultural Company Ltd. during the previous years relevant to the assessment years 1960-61 and 1961-62 are admissible as an expenditure under Section 10(1) or under Section (10)(2)(xv) of the Indian Income-tax Act, 1922, for the assessment year 1960-61 and under Section 28, read with Section 37 of the Income-tax Act, 1961, for the assessment year 1961-62 ?

2. Whether, on the facts and in the circumstances of the case, the sum of Rs. 10,57,462 and Rs. 2,35,130 being the additional price payable to the cane-growers under Clause 34 of the Sugarcane (Control) Order, 1955, represented ascertained liabilities and have to be deducted in computing the total income of the assessee for the assessment years 1960-61 and 1961-62, respectively?'

12. On representation made by the agricultural company, the board of directors of the assessee-company, after taking into consideration the overall factors, agreed for the modifications and changes in the terms and conditions for supply of sugarcane under the agreement dated December 30, 1950, and agreed for an overpayment of Rs. 1/12 per maund on all cane supplied by the agricultural company during the session 1958-59. On the basis of the aforesaid decision, the assessee paid a sum of Rs. 1,03,806 over and above the minimum price fixed by the Government during the assessment year 1960-61 and a sum of Rs. 1,73,667.56 during the assessment year 1961-62. In the assessment proceedings, the ITO disallowed these claims on the ground that this extra payment over the minimum price fixed by the Government was made for extra-commercial considerations, the object of which was to divert part of the income of the company to its subsidiary company. The assessee-company went in appeal before the AAC, who, relying on a Government notification dated December 24, 1964, allowed only Rs. 73,669 over and above the minimum price for 1960-61 and Rs. 1,46,039 for 1961-62. The assessee-company as well as the ITO challenged this order of the AAC before the Tribunal. The Tribunal partly allowed the Department's appeals to the extent that it allowed only a sum of Rs. 38,000 instead of Rs. 73,669 for 1960-61 and also a sum of Rs. 38,000 for 1961-62 as the premium for better recoveries of sugar for supplying cane of better quality on the basis of average of last three assessment years during which such payment had been made and allowed by the Department. The Tribunal dismissed the appeals filed by the assessee-company and referred the first question in M.C.C. No. 726 of 1972 reproduced above in this para.

13. The facts giving rise to the question No. 2 referred to for our opinion in M.C.C. No. 726 of 1972 are that the Central Govt. had made the Sugarcane (Control) Order, 1955, Clause 3 of which empowered the Central Govt. to fix from time to time the minimum price of sugarcane payable by a producer. Clause 34(1) thereof made a provision for payment of additional price to the sugarcane grower in addition to the price fixed if found due in accordance with the provisions of the Schedule during the four successive years beginning on November 1, 1958. The authority appointed by the Central Govt. determined the price for which a notification dated December 24, 1964, was issued in which it was notified that for 1958-59 season, i.e., from November 1, 1958, additional price of 0.22 paise per maund was payable and in respect of the cane purchased from November 1, 1959, to October 31, 1960, the additional price of 0.37 paise per maund was payable. It was on the basis of this notification that the assessee-company had made revised claim to the deduction referred to in the para hereinafter while computing the profits for the accounting year ending on June 30, 1959, relevant for the assessment year 1960-61 as well as for the accounting year ending on June 30, 1960, relevant for the assessment year 1961-62.

14. The additional price of the sugarcane worked out at 0.22 paise per maund for the assessment year 1958-59, came to Rs. 46,1,890 which was reduced to Rs. 1,57,462 on appeal to the Central Government. It was this amount which was claimed by the assessee as a deduction before the Tribunal for the assessment year 1960-61. Similarly, the additional price of the sugar-cane worked out at 0.37 paise per maund for the assessment year 1959-60, came to Rs. 11,59,979 which was reduced to Rs. 2,35,130 on appeal to the Central Government. It was this amount which was claimed by the assessee as a deduction before the Tribunal for the assessment year 1961-62. The Tribunal rejected the said deductions by holding that no liability arose on the part of the assessee before the end of the relevant year of account. It took the view that by virtue of the notification dated December 24, 1964, the payment became due to the cultivators only after the issue of the notification and the additional price was allowable in the year of payment only as on date the account books of the assessee under appeal were closed and there was no liability which could be considered. It was under these facts and circumstances that the Tribunal had referred the second question reproduced in para 9 above.

15. This brings us to the fifth and last reference in M.C.C. No. 727 of 1972 which relates to the assessment year 1964-65 corresponding to the previous year which ended on June 30, 1963, The question referred for our opinion in this reference is as follows :

'Whether, on the facts and in the circumstances of the case, the Tribunal was, in law, justified in deleting the addition of amount of interest of Rs. 10,000 made in the assessment for the assessment year 1964-65 ?'

16. In this case also the assessee-company did not charge any interest on the amount due from the agricultural company in the accounting year. The amount of interest was Rs. 10,000. In the assessment proceedings, the ITO did not allow the said deduction and added the amount of interest of Rs. 10,000 to the income of the assessee. The assessee preferred an appeal before the AAC, who allowed the appeal and deleted the addition following the earlier decision of the Tribunal on the same point. The Department preferred an appeal before the Appellate Tribunal. The Appellate Tribunal, following its earlier decision on the point, maintained the order of the AAC. The reference was, however, made on the application of the CIT referring to our answer the question reproduced above.

17. The crux of the matter in all these references is in the determination of the question whether the payment of the extra price for sugarcane over and above the rate fixed by the Government and the amount of interest forgone by the assessee-company in favour of the agricultural company can be treated as a commercial consideration of business expediency which is allowable as business expense.

18. The relevant provision which deals with the allowable expenditure as business or professional expense is contained in Section 10(2)(xv) of the Indian I.T. Act, 1922 or Sub-section (1) of Section 37 of the I.T. Act, 1961, which are almost identical. Section 37(1) of the I.T. Act, 1961, which alone may be quoted, reads:

'Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and Section 80VV and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.'

19. While construing the provisions of Section 37(1) of the Act and dealing with the question as to what expenditure can be treated as commercial considerations of business expediency, a Full Bench of this court in CIT (Addl.) v. Kuber Singh Bhagwandas : [1979]118ITR379(MP) , in which one of us (Chief Justice) was a party, has laid down the law on the point in controversy by holding as under (headnote):

'For an expenditure to fall within Section 37(1) of the I.T. Act, 1961, it is not necessary that it should have been incurred 'necessarily'. An expenditure can be allowed under Section 37(1) if it fulfils the necessary conditions even though it is incurred voluntarily and without any necessity. The expression 'for the purpose of business' as it occurs in the section is wider in scope than the expression 'for the purposes of earning profits'. It may take in not only the day-to-day running of a business but also many other acts incidental to the carrying on of a business. So, to decide whether a payment of money or incurring of expenditure is for the purposes of business and an allowable expenditure, the test applied is of commercial expediency and principles of ordinary commercial trading.' If the payment or expenditure is incurred to facilitate the carrying on of the business of the assessee and is supported by commercial expediency, it does not matter that the payment is voluntary or that it also enures to the benefit of a third party. If the sole object is business promotion, the expenditure would be one incurred wholly and exclusively for the purposes of the assessee's business even though some other object necessarily results, being . inherent in the nature and quality of the expenditure.'

20. The Full Bench further observed as under :

'The expression 'commercial expediency' is not limited to an existing practice prevailing in any particular trade or business. Even if the incurring of a particular expenditure may not be supported by any prevailing practice, yet, if, at the time when the expenditure is incurred, commercial expediency justifies it, the expenditure would be taken to be for the purposes of the business.'

21. From the observations made by the Full Bench of this court, it is now distinctly clear that the test to treat an expense in the nature of expenditure incurred wholly and exclusively for the purpose of the business of the assessee, in order to qualify for the deductions under Section 37(1) of the Act, is that the expenses incurred should have a direct bearing and nexus with the business of the assessee, or, in other words, should have been incurred to facilitate the carrying on of the business of the assessee or on considerations of

business expediency. Having regard to the tests laid down, we shall now proceed to examine the facts and circumstances of the present case to determine whether the expenses incurred in payment of extra price for cane and the amount of interest forgone by the assessee-company fulfil the requirements so as to qualify as allowable deductions.

22. It is an admitted fact that there was an agreement dated December 30, 1950 (annex. A) entered into between the assessee-company and the agricultural company which stipulated advancement of loans to the agricultural company. According to the terms of agreement, the agricultural company had to utilize the whole of its land and farms for growing sugarcane which were in close proximity to the sugar factory of the assessee-company and the agricultural company was bound to sell its entire production of cane to the assessee, to further develop its land and farms with a view to augment the production of cane to the maximum quantities of a better variety to meet the requirements of the sugar factory of the assessee-company. There was also a term in the agreement to charge a premium for cane of better variety than what was normally supplied by the other small growers of cane which was capable of giving higher percentage of recovery of sugar.

23. A successful cane cultivation in its very nature requires a dependable and assured system of irrigation and unless there are adequate means of irrigation, there can neither be grown sufficient quantity nor a better quality of cane. The facts on record go to show that due to inadequate means of irrigation and other financial stringencies, the agricultural company was craving for assistance and the assessee-company was naturally interested in the well being of the agricultural company which was the largest supplier of cane and almost an asset. For these reasons the assessee appointed a sub-committee to go into the affairs of agricultural company and suggest ways and means for uplifting its affairs and to improve its overall condition. The said sub-committee after due consideration recommended financial assistance to the agricultural company. It was in pursuance of this recommendation that the assessee-company took a decision for payment of extra price for cane on consideration that the price fixed by the Government was not economical and for the same reasons it gave up the amount of interest accrued on the loans advanced. These facts are clearly borne out from the extracts of proceedings of the board of directors of the assessee-company (annexes. C to F). It was because of the assurance and assistance of the assessee that the agricultural company continued to grow cane and it did not divert its land and farms to other crops which were more profitable. It may be pointed out here that the AAC himself while allowing the deletion of interest amount was of the view that the agricultural company was in an embarrassed financial condition. The fact that the agricultural company had taken a loan of Rs. 10,00,000 further indicated that its financial position was not sound and if the interest was not forgone and extra payments were not made, it may possibly have reached a halting stage which situation was bound to be avoided by the assessee by all possible means in its own interest.

24. There can be no justification for disallowance of the extra payment of price and interest simply because no extra amounts were paid to any other suppliers and cultivators except the agricultural company whose supplies are quite distinguishable and stand on a different footing inasmuch as the agricultural company was bound by an agreement to utilize the whole of its land for growing cane and to supply the entire production to the assessee-company only. The agricultural company supplied cane from 13 to 20 per cent. of the requirements of the assessee and thus at least to that extent the supply of cane was assured to carry on the sugar manufacturing business. The lands of the agricultural company growing cane were in close proximity to the sugar factory and, therefore, it could supply the cane at the convenience of the sugar factory as and when it required the same, while in the case of other growers there was neither any facility nor they were so bound for the supply and that too at the convenience of the factory. Thus in the case of the agricultural company, the supply of cane could be regulated according to the suitability and convenience of the sugar factory of the assessee. Similarly, it is also settled law that where the whole and exclusive purpose of the expenditure is the purpose of the expender's trade, and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure enures to a third party's benefit, cannot in law defeat the effect of the finding as to the whole and exclusive purpose. (See CIT v. Delhi Safe Deposit Co. Ltd. : [1982]133ITR756(SC) as well as

the Full Bench decision in CIT (Addl.) v. Kuber Singh Bhagwandas : [1979]118ITR379(MP) .

25. The Appellate Tribunal disallowed the extra payment of price mainly on the ground that in spite of financial help rendered by the assessee, it did not result in any benefits to the assessee as the agricultural company could not step up the production. We are unable to agree to this view as the stepping up or going down of production is not the test to see whether the extra payment was a commercial consideration. The test is whether the expenditure was incurred for business purposes or incidental thereto, which is carried on in the accounting year. A normal businessman would also incur expenditure to ensure at least adequate supply of raw material for keeping the trade going on in the expectation of better future prospects in the business by preserving a profit earning asset and an apparatus like the agricultural company.

26. In CIT v. Delhi Safe Deposit Co. Ltd. : [1982]133ITR756(SC) , the Supreme Court took the view that the expenditure incurred on the preservation of a profit earning asset of a business is always a deductible expenditure. After examining the entire facts and circumstances of the case before us, we are of the view that the assessee incurred the expenditure in question to avoid any adverse effect on its sugar manufacturing business due to any untimely or short supply of cane needed for its sugar factory by protecting the agricultural company from ruin, in its own interest as the same was an income earning source. The expenditure was incidental to the assessee's trade, purely on considerations of business expedience and entirely for the purpose of keeping the assessee's trade going on and for making it profitable. The expenditure thus had a direct connection with the successful carrying on of business of sugar manufacturing by the assessee. The object behind the payment of extra price and giving up the interest was to improve the condition and capacity of the agricultural company to grow more cane of better quality to subserve the interest of the assessee and to promote its own business. The expenditure incurred on the preservation of a profit earning asset of a business has always been regarded as deductible expenditure by the courts.

27. The Government under the Sugarcane (Control) Order, 1955, had only fixed the minimum price to be paid to the cane-growers but it did not, in any way, prevent the purchaser from making the payment at a higher rate or even additional price voluntarily, in order to safeguard its own business interests and on consideration of future prospects of its business to ensure timely and adequate supply of raw material to the factory which was engaged in the manufacture of sugar, as the agricultural company was the largest supplier of cane up to about 20% of the requirements of the assessee-company. In the circumstances stated above, it is difficult to assume that the expenditure incurred by the assessee was one incurred outside its trading activities. The expenditure in question, therefore, in our opinion, was deductible under Section 10(2)(xv) of the Indian I.T. Act, 1922, or Section 37(1) of the I.T. Act, 1961.

28. For the reasons stated above, we answer all the questions referred to us by the Tribunal in all the aforementioned five references in the affirmative and in favour of the assessee-company. There shall be no order as to costs.

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