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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Decided on 19.01.2017

+ **ITA Nos.709/2004, 37/2005 & 636/2004**

COMMISSIONER OF INCOME TAX VI Appellant
Through: Mr. Zoheb Hossain, Sr. Standing
Counsel in both appeals.

versus

M/S VIRAT INVESTMENT & MERCANTILE CO. Respondent
Through: Mr. Shashwat Bajpai with Mr. Sharad
Agarwal, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

S.RAVINDRA BHAT, J.(ORAL)

1. Learned counsel for the parties submit that another appeal, i.e., ITA 636/2004 has to be heard together with these two appeals as the question of law framed is identical.
2. With consent of counsel for the parties, that appeal - ITA 636/2004 was listed and heard for final disposal along with the other appeals.
3. The following questions of law arise for consideration in these appeals: -

“Whether the assessee was entitled to deduction of interest/service charges paid on funds raised to subscribe to

the rights issue and for retaining control of 28% of its holding in M/s Shreyans Industries Limited?."

4. The brief facts are that the assessee, an investment company had reported for the assessment years 1992-93, a loan transaction to fund its subscription to the tune of ₹1,50,00,000/- in Shreyans Industries Ltd. The assessee was a shareholder in that company and wished to subscribe to certain debentures which had both convertible and non-convertible elements. The assessee was an existing shareholder with 28% equity holding in the company. The LIC Mutual Funds which financed these debentures, through an agreement, required the assessee to ensure that the debentures were subscribed in its name; the advance carried an interest of 19.5% annually. Upon the repayment of the principal and liquidation of all liabilities, the converted shares (being part of the convertible portion) were to be registered and made over to the assessee. It is not in dispute that during the first assessment year 1992-93, after allotment of the debentures to the assessee, it ensured the sale of the non-convertible portion of the debentures at 11% discount. Concededly, the AO accepted this transaction - as is evidenced by the acceptance of the capital loss reported in that regard. The assessment was finalized under Section 143 (3) for AY 1992-93 as well as later years. On 07.04.1997, during the course of regular assessment, the AO was of the opinion that the interest component should not have been allowed and, therefore, not only proceeded to bring that to tax for the concerned period/year but also issued notice for reassessment. In the reassessment proceedings, the AO disallowed the interest paid to the

creditor, i.e., LIC Mutual Funds Corporation on the ground that the assessee had wrongly claimed it and that it was inadmissible by virtue of Section 57 (iii) of the Income Tax Act, 1961 (hereafter referred to as “Act”). The assessee’s appeals were accepted by the CIT (A) for all the years in which the reassessments were concluded. The Revenue’s appeal was rejected by the ITAT by different orders. In these circumstances, the Revenue had approached this Court by filing different appeals - two of them being ITA 147/2005 (relating to AY 1992-93) and ITA 675/2004 (relating to AY 1995-96) were rejected by this Court on 19.04.2011 on the ground that the tax effect was lower than the stipulated amounts at that period of time. It is, in these circumstances, that the surviving appeals for AY 1993-94 (ITA 709/2004); for AY 1996-97 (ITA 37/2005) and for AY 1994-95 (ITA 636/2004) are listed for disposal. The amounts disallowed in these three cases are ₹10 lacs (for AY 1993-94), ₹15 lacs (AY 1994-95) and ₹23 lacs (AY 1996-97).

5. The Revenue contends that object of the expenditure ultimately was to retain control of the 28% share holding and in that sense it had to be treated on the capital side. Learned counsel relies upon the judgment of the Bombay High Court in *Commissioner of Income Tax v. Amritaben R. Shah*, (1999) 238 ITR 777 (Bom) and submits that under similar circumstances where the Revenue had to deal with interest on loans borrowings by the assessee for acquiring shares with the intention to retain or acquire control, the Court had categorically ruled that the expenditure lay properly in the capital side and,

therefore, had to be disallowed under Section 57 (iii). He also relied upon Bombay High Court's judgment in *Chinai and Co. Pvt. Ltd. v. CIT* (1994) 206 ITR 616 (Bom). Learned counsel further relied upon the judgment of the Supreme Court reported as *Brooke Bond India Ltd. v. Commissioner of Income Tax, W.B.III, Calcutta*, (1997) 10 SCC 362 as well as *Punjab State Industrial Development Corpn. Ltd. v. CIT* (1997) 10 SCC 184.

6. Counsel for the assessee relied upon the findings of the CIT (A) and also contended that the Revenue in effect accepted the nature of the transaction irrespective of the fact that the debentures were nominally allotted to LIC Mutual Funds - which was the rationale for allowing the capital loans reported in the year of commencement in the stream of expenditure, i.e., 1992-93. In these circumstances, for the later years, there could have been no question for different treatment. Counsel relied upon the judgment of the Madras High Court reported as *CIT v. M Ethurajan* (2005) 273 ITR 95 (Mad.); *CIT v. Model Manufacturing Company*, (1990) 122 ITR 767 (Cal.) and *India Cements Ltd. v. CIT*, (1966) 60 ITR 52 (SC).

7. In the present case, shorn of complexities which followed the transaction, LIC Mutual Funds financed the assessee's acquisition of the debentures which it invested in. No doubt, in the first instance, the LIC Mutual Funds was an allottee. This appears to be one of the important consideration which weighed with the Revenue in disallowing the interest expenditure apart from others. On this aspect, the CIT (A) found as follows: -

“5.3 It is also seen that whatever service charges were paid by the appellant were debited to interest expenditure account after reducing interest/dividend received from debentures/shares. This fact was duly mentioned by the auditors in the audited statement of accounts for the financial years 1991-92 to 1994-95. A copy of these accounts has been filed by the appellant company and this has been verified. Thus, it would be seen that the treatment given in the accounts both by the buyers (appellant company) and the subscribers (LIC Mutual Fund) suggests clearly that for all practical purposes the appellant company was the de-facto buyer of these debentures.

5.4 To view the matter in its proper perspective it would be necessary to examine what have been the effect in accountancy terms, had the appellant company raised a normal loan from some other source to make the said investment. It is very clear that in such a case interest paid on such borrowings would have been allowable straightway as a revenue expenditure. Therefore, the allowability of the interest paid to LIC Mutual Fund cannot be disputed merely because the LIC had subscribed to the shares under a buy back agreement. In fact, by entering into such an agreement the LIC Mutual Fund has only protected its interest by subscribing to these debentures/shares instead of giving a loan to the appellant company to invest in the said debentures. Thus the substance of the contract makes it clear that the LIC Mutual Fund did not wish to advance a straight loan to the appellant company but intended to give it in an indirect manner with checks and balances, as per the terms of the agreement.

5.5 It is very clear that had the appellant company not subscribed through LIC Mutual Fund to the right offer the holdings of the promoters would have fallen below 28% in M/s

Shreyans Industries Limited. Therefore, the business exigencies demanded that the promoters, including the appellant company, get the right offer subscribed and this compulsion became the genesis of the said buy back agreement, which was necessary because the appellant-company was facing a paucity of funds.”

In light of the above findings, the CIT (A) granted relief for AY 1995-96 which appears to be the main order that was followed in all other years. The ITAT had the following to say on the subject: -

“16. After examining the rival contentions, we are of the view that there is no merit in the submissions made by the ld. DR on behalf of the Revenue. The CIT (A) has aptly set out relevant facts of the case and has relied on relevant case law to initially come to the conclusion that it is the substance of the agreement with the LIC Mutual Fund, which is to be examined in proper perspective rather than its form. He has thereafter referred to relevant causes of the agreement to ultimately come to the conclusion that for all practical purposes, the Respondent company was the de-facto buyer of the debentures. The treatment given in their respective accounts by the Respondent company and the LIC Mutual Fund has also been taken into account to reach the same conclusions.”

8. The Revenue’s contention essentially is reflected in *Amritaben R. Shah (supra)* in the following submission of law by the Bombay High Court: -

“3. We are supported in our opinion by the decision of the Gujarat High Court in the case of Sarabhai Sons (P.) Ltd v. CIT [1993] 201 ITR 464. In that case, it was held that if the dominant purpose for which the expenditure was incurred was not to earn the income, the expenditure incurred in that behalf

would fall outside the purview of Section 57(iii) of the Act. We are also supported in our above conclusion by the decision of this court in *Chinai and Co. Pvt. Ltd. v. CIT* [1994] 206 ITR 616. In that case, there was a dispute in regard to deduction of expenditure under Section 37 of the Act. The expenditure was incurred by the assessee in fighting another group of shareholders to protect the investment in the erstwhile managed company. The court held that such an expenditure was not a business expenditure. It was observed that Section 37 of the Act dealt with deductions, inter alia, of any expenditure laid out or expended wholly and exclusively for the purposes of business or profession. Such deduction has to be in respect of any expenditure for business which was carried on by the assessee at any time during the previous year. It was held that expenditure incurred in proxy war should not be deducted as business expenditure.

4. It may be pertinent to mention the distinction in the language used by the Legislature in Sections 37(1) of the Act and 57(iii) of the Act. Section 37 provides for deduction of expenditure incurred wholly and exclusively "for the purpose of business" whereas Section 57(iii) provides for deduction only of expenditure incurred wholly and exclusively "for the purpose of making or earning such income". "Such income" refers to "income from other sources". The expression "for the purpose of business" is narrower than the expression "for the purpose of making or earning such income". In order that an expenditure may be admissible under Section 57(iii) it is necessary that the primary motive of incurring it is directly to earn income falling under the head "Income from other sources". That is not so under Section 37 which allows deduction of expenditure "incurred wholly and exclusively for the purposes of the business". Under Section 57(iii), deduction will not be allowed if the expenditure is not incurred for the purpose of earning income falling under the head "Income from other sources".

9. The other case cited by the Revenue is *Sarabhai Sons (P.) Ltd. v. Commissioner of Income Tax*, (1993) 201 ITR 464 (Guj), where too identical reasoning was applied. This Court is of the opinion that the Revenue's argument is fallacious. First and foremost the acceptance of the assessee's contentions that it suffered a capital loss in the first year, i.e., 1992-93 has gone uncontested; in fact that was given the treatment that it reported. This meant that the expenditure was treated as capital, even though the debentures were not allotted in the name of the assessee. In this regard, the CIT (A) and the ITAT's findings that the assessee's status as the beneficiary or de facto owner of the debentures remains undisputed. Such being the case, the question of the essential nature of the transaction not reflecting as such in the hands of the assessee for later years, does not arise.

10. Consequently and more fundamentally the interest expenditure in the present case is not of the kind that went into capital stream. In *Brooke Bond (supra)* as well as *Punjab State Industrial Development Corporation (supra)* - both cited by the Revenue, the expenditure was not towards interest but rather towards expenses which was the integral part of the capital raising activity. In both cases, the assessee had issued offers to the public and expenditure laid out was towards such capital generation. The conclusions of the Court that such expenditure could not be allowed since they were capital in nature was logical. However, in this case, the expenditure clearly is not towards acquisition of the capital nor is it an integral part of it, it is only the service alone. It is of a similar kind that would otherwise

have been permitted under Section 37 of the Income Tax Act. Since this expenditure does not pertain to the stream of income covered by Section 37 and is not excluded by Section 57 (3), it had to be and was correctly allowed.

11. In view of the above conclusions, the question of law framed is answered against the Revenue and in favour of the assessee. The appeals are accordingly dismissed.

JANUARY 19, 2017
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S. RAVINDRA BHAT
(JUDGE)

NAJMI WAZIRI
(JUDGE)