

“Once the genuineness is proved and the interest is paid on the borrowing, it is not within the powers of the AO to disallow the deduction either on the ground that rate of interest is unreasonably high or that the Assessee had himself charged a lower rate of interest on the monies which he lent.”

[Case Brief] Taparia Tools Limited V. Joint Commissioner of Income Tax Special Range- I, Nasik

Case Name: Taparia Tools Limited V. Joint Commissioner of Income Tax Special Range- I, Nasik

Case Number: C.A. No.-006366-006368 / 2003

Court: The Hon'ble Supreme Court

Bench: A.K. SIKRI J., ROHINTON FALI NARIMAN J.

Decided on: 23/03/2015

Relevant Act/Sections: DIRECT TAXES MATTERS - DEDUCTIONS / EXEMPTIONS

BRIEF FACTS AND PROCEDURAL HISTORY:

1. The Appellant-Taparia Tools Limited (hereinafter referred to as the 'Assessee') came before the court having lost in the courts below.
2. There were six appeals between the same parties and the necessity of six appeals was because of the reason that the same dispute pertains to three assessment years, namely, assessment years 1996-97, 1997-98 and 1998-99.
3. The Assessee had claimed deduction of revenue expenditure on account of interest payment in the sum of 2,72,25,000 paid to one M/s. Maliram Makharia Stock Brokers Pvt. Ltd. and 55,00,000 on account of interest payment given to M/s. Sharp Knife Company Pvt. Ltd. This was on account of upfront payments of interest given to the aforesaid two debenture holders in the assessment years 1996-97 and 1997-98 respectively.
4. The Assessing Officer (for short, the 'AO'), however, treated it as the 'deferred revenue expenditure', to be written off over a period of five years and, therefore, in these assessment years he allowed only 1/5th of the payment made, though the entire payment was made in the assessment year 1996-97.
5. In the debenture issue of the Assessee two options as regards payment of interest there upon were given to the subscribers/debenture holders. They could either receive interest periodically, that is every half yearly @ 18% per annum over a period of five years, or else, the debenture holders could opt for one time upfront payment of 55 per debenture. In the second alternative, 55 per debenture was to be immediately paid as upfront on account

of interest. At the end of five years period, the debentures were to be redeemed at the face value of 100.

6. **On February 14, 1996**, M/s. Maliram Makharia Stock Brokers Pvt. Ltd. gave their letter of acceptance opting for upfront payment of interest. Likewise, vide letter of acceptance dated May 24, 1996, M/s. Sharp Knife Company Pvt. Ltd. exercised similar option. As these parties, mentioned at S. Nos. 1 and 6, had opted for one time upfront payment towards interest, they were paid interest in the sum of 2,72,25,000 and 55,00,000 respectively.
7. In the assessment orders passed by the AO, the Assessee's claim for deduction of upfront interest payment was denied. Instead, the AO chose to spread it over a period of five years thereby giving deduction only to the extent of 1/5th each in the respective assessment years. The order of the AO was challenged by the Assessee in appeals preferred before the Commissioner of Income Tax (Appeals). The Commissioner, however, dismissed the appeals thereby sustaining the orders passed by the AO. The assessee then approached the Income Tax Appellate Tribunal and thereafter the High Court of Bombay but was unsuccessful as the appeals preferred by him before the two fora have been dismissed maintaining the method of deduction adopted by the AO.

ISSUES:

1. Whether the liability of the assessee to pay the interest upfront to the debenture holder is allowable as a deduction in the first year itself or it is to be spread over a period of five years, being the life of the debentures?
2. Whether deduction of the entire amount of interest paid should be allowed or the stance of Revenue needs to be affirmed?
3. Whether the Assessee was estopped from claiming deduction for the entire interest paid in the year in which it was paid merely because it had spread over this interest in its books of account over a period of five years.

RATIO OF THE COURT:

1. The court observed that the Assessee follows mercantile system of accounting and one time upfront interest of an amount mentioned above was actually paid as well in the Accounting Years 1995-96 and 1996-97 respectively and clarified that insofar as the Assessee's claim for deduction of premium payable on redemption is concerned, the same was claimed in the return on a spread over basis covering a period of five years.
2. The court observed that there is no quarrel, in the present case, that the money raised on account of issuance of the debentures would be capital borrowed and the debentures were issued for the purpose of the business of the Assessee and opined that the Assessee would be entitled to deduction of full amount in the assessment year in which it is paid.
3. It later added that while examining the allowability of deduction of this nature, the AO is to consider the genuineness of business borrowing and that the borrowing was for the purpose of business and not an illusory and colourable transaction. **Once the genuineness is proved and the interest is paid on the borrowing, it is not within the powers of the AO to disallow the deduction either on the ground that rate of interest**

is unreasonably high or that the Assessee had himself charged a lower rate of interest on the monies which he lent.

4. The court explained, the AO did not dispute that the expenditure on account of interest was genuinely incurred observed that there is no dispute that interest has, in fact, been 'paid' during the year of accounting.
5. The court observed that Since the Assessee was following mercantile system of accounting, the amount of interest could be claimed as deduction even if it was not actually paid but simply 'incurred'.
6. The court observed that on exercise of the option of upfront payment of interest by the subscriber in the very first year, the Assessee paid that amount in terms of the debenture issue and by doing so he was simply discharging the interest liability in that year thereby saving the recurring liability of interest for the remaining life of the debentures because for the remaining period the Assessee was not required to pay interest on the borrowed amount.
7. The contention of the learned counsel for the Assessee was that assessment was to be made in accordance with the provisions of the Act and not on the basis of entries in the books of accounts to which the court opined that the High Court has taken into consideration the provisions of Section 36(1)(iii) of the Act and chose to decline the whole deduction in the year of payment, thereby affirming the orders of the authorities below, by invoking the 'Matching Concept'.
8. The court opined that the High Court has gone wrong and the approach of Matching Concept resulted in wrong application. The court also emphasized that as per the terms of issue, the interest could be paid in two modes. As per one mode, interest was payable every year and in that case it was to be paid on six monthly basis @ 18% per annum. However, in the second mode of payment of interest, which was at the option of the debenture holder, interest was payable upfront, which means insofar as interest liability is concerned, that was discharged in the first year of the issue itself.
9. The court stated that the moment second option was exercised by the debenture holder to receive the payment upfront, liability of the Assessee to make the payment in that very year, on exercising of this option, has arisen and this liability was to pay the interest @ 55 per debenture and not only the liability had arisen in the assessment year in question, it was even quantified and discharged as well in that very accounting year.
10. The court referred to the cases of -Kedarnath Jute Manufacturing Co. Ltd. v. Commissioner of Income Tax (Central), Madras v. Commissioner of Income Tax and stated that it has been held repeatedly by this Court that entries in the books of accounts are not determinative or conclusive and the matter is to be examined on the touchstone of provisions contained in the Act
11. The court stated that the income tax return filed by the Assessee, it chose to claim the entire expenditure in the year in which it was spent/paid by invoking the provisions of Section 36(1)(iii) of the Act and observed that once a return in that manner was filed, the AO was bound to carry out the assessment by applying the provisions of that Act and not to go beyond the said return. There is no estoppel against the Statute and the Act enables and entitles the Assessee to claim the entire expenditure in the manner it is claimed.

DECISION HELD BY COURT:

1. The court held that that the judgment and the orders of the High Court and the authorities below do not lay down correct position in law.
2. It was also held that The Assessee would be entitled to deduction of the entire expenditure of 2,72,25,000 and 55,00,000 respectively in the year in which amount was actually paid.
3. The appeals were allowed in the aforesaid terms with no orders as to costs.