Travancore Titanium Products Ltd vs Commissioner Of Income-Tax, Kerala on 17 January, 1966

Equivalent citations: 1966 AIR 1250, 1966 SCR (3) 321, AIR 1966 SUPREME COURT 1250

Author: J.C. Shah

Bench: J.C. Shah, S.M. Sikri

PETITIONER:
TRAVANCORE TITANIUM PRODUCTS LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, KERALA

DATE OF JUDGMENT:
17/01/1966

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
SUBBARAO, K.
SIKRI, S.M.

CITATION:
1966 AIR 1250 1966 SCR (3) 321
CITATOR INFO :
D 1972 SC 19 (6,8)
O 1972 SC1880 (1,2,3,23,28,38,40,51)
D 1972 SC2674 (2)
RF 1973 SC1344 (2,3)
RF 1975 SC 97 (22)
RF 1975 SC 657 (7,8)

ACT:
Income Tax Act, 1922 (11 of 1922), s. 10(2)(xv)-Wealth-tax paid on assets owned for purpose of business-Whether a permissible deduction.

HEADNOTE:
In computing the total earned income of the appellant company for the calendar year 1959, the Income Tax Officer

disallowed a claim for deduction of Rs. 80,255 in respect of liability for payment of tax under the Wealth Tax Act, 27 of 1957 incurred by the company. The order of the Income Tax Officer was confirmed in appeal by the Appellate Assistant Commissioner, the Tribunal and, on a reference, by the High Court.

It was contended by the appellant company that since the company held the assets on which tax was levied for the purpose of its business and profits were earned by the use of those assets, tax paid in respect of those assets was expenditure laid out wholly and exclusively for the purpose of the business and on that account was a permissible allowance under s. 10(2)(xv) of the Income-tax Act, 1922,

HELD:The amount of tax paid on the net wealth of an assesses under Wealth Tax Act is not a permissible deduction under s. 10(2) (xv) of the Income-tax Act, for tax is imposed under the Wealth Tax Act on the owner of the assets and not on any commercial activity. The charge of tax is the same, whether the asset are part of or used in the trading organization of the owner or are merely owned by him. [326 G-H]

For expenditure to be regarded as being for the purpose of the assessee's business within the meaning of s. 10 (2) (xv), the nature of the expenditure of outgoing must be adjudged in the light of accepted commercial practice and trading principles. The expenditure must be incidental to the business and must be necessitated or justified by commercial expediency. It must be directly and intimately connected with the business and be laid out by the tax payer in his character as a trader. To be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business i.e. between the expenditure and the character of the assessee as a trader, and not as owner of assets, even if they are assets of the business. [326 F]

Case law discussed.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 235 of 1963 Appeal by special leave from the judgment and order dated August 26, 1963 of the Kerala High Court in Income-tax Referred Case No. 29 of 1962.

G.B. Pai, T. A. Ramachandran and O. C. Mathur, for the appellant.

A. V. Viswanatha Sastri, N. D. Karkhanis, R. H. Dhebar and R. N. Sachthey, for the respondent.

The Judgment of the Court was delivered by Shah, J. In computing the total earned income of the appellant Company for the calendar year 1959, the Income-tax Officer, Trivandrum, disallowed a claim for deduction of Rs. 80,255/- in respect of liability for payment of tax under the Wealth Tax

Act 27 of 1957 incurred by the Company for the calendar years 1957 and 1958. The order was confirmed by the Appellate Assistant Commissioner and by the Appellate Tribunal. On the following question referred by the Wealth Tax Appellate Tribunal, "Whether on the facts and circumstances of the case, the assessee Company is entitled to a deduction of Rs. 12,873/- being the wealth tax paid during the account year ended 29-2-1960. against the profits and gains of its business for the assessment year 1960-61 under Sec. 10 (2)(xv) of the Indian Income-tax Act ?"

the High Court of Kerala recorded an answer in the negative. The Company has appealed to this Court with special leave. The Company claims that wealth-tax paid by it represented expenditure laid out wholly and exclusively for the purpose of its business, and on that account is a permissible allowance under s. 10(2)(xv) of the Income-tax Act. In determining the admissibility of this claim, it is necessary to ascertain the true character of the liability for payment of tax under the Wealth Tax Act. Tax is charged under S. 3 of the Wealth Tax Act, 1957, for every financial year in respect of the net wealth of every individual, Hindu undivided family and Company at the rate or rates specified in the Schedule to the Act; and 'net wealth' under the Act means the amount by which the aggregate value computed in accordance with the provisions of the Act of all the assets belonging to the assessee on the valuation date is in excess of the aggregate value of all the debts owed by the assessee on that date other than the debts specified. The tax under the Act is payable by all individuals, Hindu undivided families ,and Companies on the value of taxable assets belonging to the taxpayer: it is charged on the net value of the assets, and not on the business or trading activity carried on by the taxpayer. The rates of tax for companies as well as individuals and Hindu undivided families are prescribed by the Second Schedule. The slabs on which the rate of tax is nil are not uniform in the case of different taxable entities and a special exemption is given to a Company which has incurred in any year loss computed in accordance with ss. 8, 9, 1 0 and 12 of the Income-tax Act without referring to depreciation allowances and development rebates and without taking into account the losses brought forward from the earlier years, and which has not declared any dividend on its equity capital in respect of that year. It is also provided by r. 5 of the Schedule that where the profits of a company in respect of any year, before deducting any 32 3 of the allowances referred to in the second paragraph of Part 11, are less than the amount of wealth-tax payable by it in respect of the relevant assessment year, the wealth- tax payable by the company for such assessment year shall be limited to the amount of such profits provided that the company has not declared any dividend on its equity capital in respect of that year. But by relating the quantum of liability of a company to wealth-tax in these special cases to the profits earned, the character of the tax is not altered. It is and remains a tax charged upon the net wealth, and it is not made a tax related to or incidental to the carrying on of a business. The rules in the Schedule merely extend the exemption which is primarily declared in favour of a Company of which the net wealth does not exceed Rs. 5 lakhs, to a company which has in the previous year made a loss, and grant a partial exemption if the company has made profits which are inadequate to meet the wealth-tax liability at the prescribed rate.

> In computing the profits or gains of an assessee who carried on business, certain allowances are permitted under s. 10(2) from the business profits, and one such head is:
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> "(xv) any expenditure not being an allowance of the nature described in any of the clauses
>
> (i) to (xiv) inclusive, and not being in the nature of capital expenditure for personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

An allowance permissible under cl. (xv) in the computation of taxable income is therefore expenditure incurred in the year of account in respect of a business carried on by the assessee: the expenditure must not be in the nature of capital expenditure or personal expenses of the assessee and it must have been laid out or expended wholly and exclusively for the purpose of the business. The argument for the Company in this case turns upon the meaning of the expression "for the purpose of such business." On behalf of the Company it is urged that for the purpose of its business, it holds assets and by the use of those assets profits are earned and therefore tax paid in respect of those assets is expenditure laid out for the purpose of the business. Whether an item of expenditure falls within that description has of necessity to be determined having regard to the nature of the business, the nature of the expenditure and the relation between the business and the expenditure. In adjudicating upon the claim that an outgoing is a permissible deduction under s. 10(2)(xv) of the Income-tax Act, the primary question is whether in the light of accepted commercial practice, trading principles and the relation between the business and the outgoing,the outgoing can be said to arise out of the carrying on of the business and to be incidental to that business. In the context of a variety of trading transactions and the relation between the transactions and the expenditure claimed as a permissible deduction, in the decisions of the courts under the Indian Income-tax Act and of the courts in the United Kingdom under the English taxing statutes, different tests are suggested. Those tests, though adequate for the specific problem under discussion, cannot be regarded as exhaustive or necessarily applicable to other problems. When Rowlatt, J., in The Commissioners of Inland Revenue v. The Anglo Brewing Company Ltd.(1) said that the expression "for the purpose of the trade" meant for the purpose of keeping the trade going, and of making it pay, he was making that statement in relation to the facts of the case, and he did not intend to suggest a universal test. Similarly when because of the special nature of the business, expenditure incurred for payment of rates, taxes and duties was held a permissible allowance in the computation of taxable income, it was not intended and could not be intended to be laid down that expenditure incurred for payment of rates, taxes or duties in respect of another business would be regarded necessarily as a permissible allowance. Illustrations of this class are to be found in Smith v. Lion Brewery Company Ltd.(2) Usher's Wiltshire Brewery Ltd. v. Bruce(3) and Harrods (Buenos Aires) Ltd. v. Taylor-Gooby.(4) In the Lion Brewery Company's case(2) a Brewery Company who were owners or lessees of licensed premises acquired as part of their business as brewers and as a necessary incident to profitable exploitation were held entitled to the allowance in the computation of their income under Sch. D of Compensation Fund Charges imposed under the Licensing Act upon their tenants and which the tenants after paying recouped themselves by deduction from the rents

payable to the Company. In Usher's Wiltshire Brewery Ltd.'s case(3) the claim of a Brewery Company as owners or lessees of licensed premises acquired in the course of and for the purpose of their business as brewers and as a necessary incident to the more profitable conduct of their business of certain expenses in connection with those licensed houses was allow- ed in the computation of their profits. In Harrods (Buenos Aires) Ltd's case(4)-Harrods (Buenos Aires)Ltd-a company incorporated in the United Kingdom-carried on business of a retail store in Argentina and was liable to pay a tax known as "substitute tax" which was levied on joint stock companies incorporated in Argentina and on companies incorporated outside but which carried on business in Argentina through an "empresa estable" (a "commercial establishment"). In proceedings for assessment of income- tax of the business the claim of the Company to deduct the "substitute tax" paid to the Argentina Government was accepted, for it was an expenditure without paying which the assessee Company could not carry on its business at all. In all the three cases the expenditure was directly related to the business Organisation of the taxpayer. (1) 12 T.C. 803. (2)) 5 T.C. 568.

(3) 6 T.C. 399. 41 T.C. 450.

But every item of expenditure merely because it is connected with the trade may not necessarily be treated as a permissible deduction. A fairly reliable approach for determining what may be regarded normally as expenditure laid out or expended wholly and exclusively for the purpose of the business was suggested in Strong and Company of Romsey Ltd. v. Woodifield.(1) That was a case of a Brewery Company owning a licensed house in which it carried on the business of inn-keepers. The Company had to pay damages to a customer who was, when sleeping in the inn, injured by a falling chimney, the fall of the chimney being due to the negligence of the Company's servants. The Company was held disentitled to deduct the expenditure in computing its profits for income-tax purposes. Lord Loreburne, L. C., observed, in disallowing the claim as a permissible expenditure under the head expenditure laid out wholly and exclusively for the purpose of the business:

> "A deduction cannot be allowed on account of loss not connected with or arising out of such trade. That is one indication. And no sum can be deducted unless it be money wholly and exclusively laid out or expended for the purposes of such trade. That is another indication . .
>
> connected with the trade, it must always be allowed as a deduction: for it may be only remotely connected with the trade or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trader."

In the same case Lord Davey observed:

> "These words..... appear tome to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the

> course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade."

In Badridas Daga v. Commissioner of Income- tax,(2) Venkatarama Aiyar, J., observed that whether the expenditure is admissible or not will depend upon whether it can be said to arise out of the carrying on of the business and be incidental to it, and this was reaffirmed by this Court in a later judgment in Commissioner of Income-tax, Bombay v.

Abdullabhai Abdulkadar.(3) (1) 5 T.C. 215 (2) [1959] S.C.R. 690=34 I.T.R. 10 (3) [1961] 2 S. C. R. 949=41 1. T.R. 545.

In a recent judgment of this Court Commissioner of Income-tax, Kerala v.

Malayalam Plantations Ltd.(1) certain amounts paid as estate duty under s. 84 of the Estate Duty Act, 1953, by a resident company incorporated outside India on the death of shareholders not domiciled in India, were sought to be deducted under S. 10(2) (xv) as expenditure laid out or expended wholly and exclusively for the purposes of the business. Subba Rao, J., speaking for the Court observed at p. 705:

> "The expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits." Its range is wide: it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business."

The position may therefore be summarised thus: the nature of the expenditure or outgoing must be adjudged in the light of accepted commercial practice and trading principles. The expenditure must be incidental to the business and must be necessitated or justified by commercial expediency. It must be directly and intimately connected with the business and be laid out by the taxpayer in his character as a trader. To be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business ie. between the expenditure and the character of the assessee as a trader, and not as owner of assets, even if they are assets of the business.

In the light of the principles the amount of tax paid on the net wealth of an assessee under the Wealth Tax Act is not a permissible deduction under s. 10(2)(xv) of the Indian Income-tax Act in his assessment to income-tax, for tax is imposed under the Wealth Tax Act on the owner of assets and not on any commercial activity. The charge of the tax is the same, whether the assets are" part of or

(1) (1964] 7 S.C.R. 693=53 I.T.R. 140.

used in the trading Organisation of the owner or are merely owned by him. The assets of the taxpayer-incorporated or not-become chargeable to tax because they are owned by him, and not because they are used by him in the business. The appeal therefore fails and is dismissed with costs. Appeal dismissed.

10 Sup.C.I./66-8