Commissioner Of Income Tax, Delhi vs Delhi Safe Deposit Co. Ltd on 12 January, 1982

Equivalent citations: 1982 AIR 757, 1982 SCR (3) 1, AIR 1982 SUPREME COURT 757, 1982 (1) SCC 364, 1982 TAX. L. R. 311, (1982) 26 CURTAXREP 411, (1982) 64 TAXATION 201, 1982 SCC(TAX) 67, 1982 UPTC 493, (1982) 3 SCR 1 (SC), 1982 UJ(SC) 139, (1982) 133 ITR 756, (1982) 8 TAXMAN 1

Author: E.S. Venkataramiah

Bench: E.S. Venkataramiah, R.S. Pathak

PETITIONER:
COMMISSIONER OF INCOME TAX, DELHI

Vs.

RESPONDENT:
DELHI SAFE DEPOSIT CO. LTD.

DATE OF JUDGMENT12/01/1982

BENCH:
VENKATARAMIAH, E.S. (J)
BENCH:
VENKATARAMIAH, E.S. (J)
PATHAK, R.S.

CITATION:
1982 AIR 757 1982 SCR (3) 1
1982 SCC (1) 364 1982 SCALE (1)6

ACT:
Income Tax Act, 1961 -Section 37-Scope of-Assessee, partner of a managing agency firm-Managed company advanced loan to another firm at the instance of a partner of the firm-Loan turned out to be a bad debt-Loss of managed company partly made good by assessee-Reimbursed amount, if could be claimed as deduction under section 37.

HEADNOTE:
The assessee was a partner of a firm of managing agents. At the instance of one of the partners of the managing agency firm the managed company advanced to another firm a large sum of money as loan. Eventually by reason of the failure of the borrower to repay the loan the managed

company suffered loss which was made good partly by the assessee and partly by one of its partners. Later, the managing agency firm had been reconstituted.

When the assessee in its returns claimed as a deduction the sum paid by it in that year in partial discharge of its liability, the Income Tax Officer disallowed it holding that the assessee was not legally bound to make the payment and therefore it was not a business expenditure which could be allowed as a deduction.

The Appellate Assistant Commissioner affirmed the order of the Income Tax Officer on the grounds that (a) the loss was actually the loss of a firm which was no more in existence; (b) the loss had been borne by the assessee on personal considerations and (c) the loss was a loss of the managing agency and not of the partners concerned.

Accepting the assessee's appeal the Tribunal held that even if there was a change in the constitution of the managing agency firm the assessee's liability as a partner had not ceased, that the payment could not be treated as one made on personal considerations and that the assessee had made the payment in question purely on business considerations with the sole object of maintaining its business connection which was yielding profit.

The High Court answered the reference in favour of the assessee.

Dismissing the appeal,

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HELD : The true test of expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to its trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than of a trader. [6 D-E]

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In the instant case the expenditure was rightly held to be deductible under s. 37 of the Act. The assessee incurred the expenditure to avoid any adverse effect on its reputation, to protect the managing agency which was an income earning apparatus and for retaining it with the reconstituted firm in which the assessee's interest was the same as before. It was likely that but for the expenditure, the fair name of the assessee would have been tarnished and the managing agency would have been terminated. The expenditure incurred on the preservation of a profit earning asset of a business has always been held to be a deductible expenditure. The expenditure incurred by the assessee was neither gratuitous nor one incurred outside the trading activities of the assessee. [7 C-E]

Ushers's Wiltshire Brewery Ltd. v. Bruce, [1915] A. C. 433, British Insulated & Helsby Cables Ltd. v. Atherton, [1926] A. C. 205, Mitchell v. B. W. Noble Ltd. [1927] 1 K. B. 719, referred to.

Commissioner of Income tax, Kerala v. Malayalam Plantation Ltd., [1964] 7 S.C.R. 693, followed.

The fact that the firm has not claimed the expenditure as its own does not affect the right of the assessee to claim deduction in respect of the amount in question in its assessment proceedings. [7 H, 8 A]

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1235 of 1974.

Appeal by special leave from the judgment and order dated the 22nd March, 1973 of the Delhi High Court in Income Tax Reference No. 65 of 1968.

S.C. Manchanda, J. Ramamurthy and Miss A. Subhashini for the Appellant.

S.T. Desai and Bishambar Lal for the Respondent. The Judgment of the Court was delivered by VENKATARAMIAH, J. This appeal by special leave is directed against the judgment and order dated March 22, 1973 of the Delhi High Court in Income-tax Reference No. 65 of 1968 made by the Income-tax Appellate Tribunal, Delhi pursuant to an order made by the High Court under section 256(2) of the Indian Income-tax Act, 1961 (hereinafter referred to as 'the Act').

The facts of the case are these : The assessee (the respondent herein) is a public limited company. The assessee was a partner of a firm of managing agents known as M/s. Morari Lal Batra & Co.

(hereinafter referred to as 'the managing agency firm') which was managing another public limited company called M/s. Bharat Carbon & Ribbon Manufacturing Co. Ltd. (hereinafter referred to as 'the managed company'). There were in all three partners in the managing agency firm, the two other partners being V.K. Batra and Lal Balwant Roy who held 50% share and 25% share respectively in that firm. The assessee held the remaining 25% share. At the instance of V.K. Batra who held the major share in the managing agency firm, a large sum was advanced by the managed company to a firm known as M/s. H.K. Sinha & Sons at Calcutta. When a demand for repayment was made, M/s. H.K. Sinha & Sons repudiated the claim except to the extent of Rs. 11,409 and ultimately the managed company suffered a loss to the extent of Rs. 1,90,092 on account of the said transaction. Consequently it became necessary for the managing agency firm to make good the said loss. Thereupon the assessee and Lal Balwant Roy together undertook to pay to the managed company Rs. 95,092 out of which the share of the assessee was Rs. 47,500. The balance of the amount was undertaken to be paid by R.K. Batra, brother of V.K. Batra. The managing agency firm was also reconstituted with the assessee, Lal Balwant Roy and R.K. Batra as partners, R.K. Batra taking the place of V.K. Batra. During the previous year corresponding to the assessment year 1962-63, the assessee paid a sum of Rs. 9,500 to the managed company in partial discharge of its liability of Rs. 47,500 referred to above and claimed it by way of deduction in the assessment year in question in the assessment proceedings under the Act before the Income-tax Officer. The Income-tax Officer disallowed the said claim on the ground that the assessee was not legally bound to make the payment and hence it was not a business expense that could be allowed under the Act. The Appellate Assistant Commissioner of Income-tax before whom the order of assessment was

questioned by the assessee affirmed the order of assessment on the above question on three grounds : (a) the amount in question was actually the loss of a firm which was no more in existence; (b) the loss in question had been borne by the assessee on personal considerations, and (c) the loss was the loss of the managing agency firm and not of the partners concerned and since the managing agency firm had not claimed that loss in its return, none of its partners could claim it. When the matter was taken up in appeal before the Income-tax Appellate Tribunal, the claim of the assessee was accepted. The Tribunal held inter alia that even if there was a change in the constitution of the managing agency firm, the liability of the assessee as a partner had not ceased, the assessee being a company, the payment could not be treated as one made on personal considerations and that the assessee had made the payment in question purely on business considerations with the sole object of maintaining its business connection which was yielding profit. The Tribunal was also of the view that there was no bar to the assessee claiming the loss in question in its own assessment even though it could have been first claimed by the firm and then in the hands of the partner. An application under section 256(1) of the Act having been rejected by the Tribunal, the appellant moved the High Court under section 256(2) of the Act. The High Court thereupon passed an order directing the Tribunal to refer the following question for its consideration :

> "Whether, on the facts and in the circumstances of the case, the assessee was entitled to any allowance on account of the share of loss made good by it to the managed company ?"

After the reference was made to it, the High Court answered the question in the affirmative and in favour of the assessee. Dissatisfied with the judgment of the High Court, the appellant has come up in appeal to this Court by special leave, as stated above.

The first question which needs to be examined is whether the amount in question can be treated as an expenditure laid out or expended wholly and exclusively for the purposes of the business of the assessee which is admissible as a deduction under section 37 of the Act. It is no doubt true that the solution to a question of this nature sometimes is difficult to arrive at. But, however difficult the task may be, a decision on that question should be given having regard to the decisions bearing on the question and ordinary principles of commercial trading and of commercial expediency. The facts found in the present case are that the assessee was carrying on business as a partner of the managing agency firm and it also had other businesses. The managing agency agreement with the managed company was a profitable source of income and that the assessee had continuously earned income from that source. But on account of the negligence on the part of one of its partners, there arose a serious dispute which could have ordinarily resulted in a long drawn out litigation between the managing agency firm and the managed company affecting seriously the reputation of the assessee in addition to any pecuniary loss which the assessee as a partner was liable to bear on account of the joint and several liability arising under the law of partnership. The settlement arrived at between the parties prevented effectively the hazards involved in any litigation and also helped the assessee in continuing to enjoy the benefit of the managing agency which was a sound business proposition. It also assisted the assessee in retaining the business reputation unsullied which it had built up over a number of years. It is also material to notice here that it was not shown that the settlement was a gratuitous arrangement entered into by the assessee to benefit the defaulting

partner exclusively even though he might have been benefitted to some extent. It is no doubt true that it was voluntary in character but on the facts and in the circumstances of the case whether it would make any difference at all is the point for consideration.

Dealing with the question whether an expenditure incurred by a brewery in aid of their tenants of tied houses as a necessary incident of the profitable working of the brewery business was an admissible expenditure in the computation of the income-tax liability of the brewery, Lord Summer upholding the above claim observed in Usher's Wiltshire Brewery Ltd. v. Bruce thus :

> "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, say that of the publican, or that the brewer incidentally obtains some advantage, say in his character of landlord cannot in law defeat the effect of the finding as to the whole and exclusive purpose."

In British Insulated and Helsby Cables Ltd. v. Atherton Lord Cave observed.

> "It was made clear in the above cited cases of Usher's Wiltshire Brewery v. Bruce, [1915] A.C. 433 and Smith v. Incorporated Council of Law Reporting for England and Wales, [1914] 3 K.B. 674 that a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on the business, may yet be expended wholly and exclusively for the purposes of the trade."

Rowlatt, J. in Mitchell v. B.W. Noble Ltd. held that the money spent on getting rid of a director and saving the company from scandal was deductible. Affirming the above view, the Court of Appeal (whose judgment appears at page

731) held that as the payment was not made to secure an actual asset so as effectually to increase the capital of the company but was made in order to enable the directors to carry on the business of the company as they had done in the past unfettered by the presence of the retiring director, which might have had a bad effect on the credit of the company, it must be treated as the income and not as capital expenditure and was deductible as such for income-tax purposes.

The true test of an expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than of a trader. In Commissioner of Income-tax, Kerala v. Malayalam Plantation Ltd. Subba Rao, J. (as he then was) summarised the legal position at page 705 thus :-

> "The aforesaid discussion leads to the following result: 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 measure for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile titles; it may also comprehend payment of statutory dues and taxes imposed as a pre- condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business.
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> 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 carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business."

In the instant case, the assessee incurred the expenditure in question to avoid any adverse effect on its reputation, to protect the managing agency which was an income earning apparatus and for retaining it with the reconstituted firm in which the interest of the assessee was the same as before. It was likely that but for the expenditure, the fair name of the assessee would have been tarnished or rendered suspicious and the managing agency would have been terminated. The expenditure incurred on the preservation of a profit earning asset of a business has always been held to be a deductible expenditure by courts. In the circumstances, it is difficult to hold that the expenditure incurred by the assessee was either gratuitous or one incurred outside the trading activities of the assessee. The expenditure was, therefore, rightly held to be deductible under section 37. We, therefore, reject the contention of the Revenue that the amount in question could not be claimed as a deduction under section 37 of the Act.

The next contention of the Department is that the payment in question should have been first assessed as a loss in the assessment proceedings of the firm and in the absence of any claim made in the course of such proceedings by the firm, it was not possible to allow its deduction in the assessment of the assessee. Reliance is placed on sections 187 and 67 of the Act in support of this submission. It is seen that the expenditure in question had not been incurred by the firm. Even if the amount had been paid through the firm by the assessee, it would not be payment of the firm's funds. In the accounts of the firm, there would be a credit and debit entry cancelling each other showing a receipt from the assessee and a payment to the managed company, not in any way affecting the capital structure of the firm. If the amount had been paid by the assessee directly to the managed company which appears to be more probable then the expenditure is obviously one incurred by the assessee itself though on account of the firm. In any view of the matter, the fact that the firm has not claimed the expenditure as its own does not affect the right of the assessee to claim deduction in respect of the amount in question in its assessment proceedings which it is legitimately entitled to do. It is not shown how in the peculiar circumstances of the case there is any statutory bar to the claim made by the assessee.

We are satisfied that in the circumstances of the case the decision of the High Court does not call for interference.

For the foregoing reasons, the appeal is dismissed with costs.

P.B.R. Appeal dismissed.