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INDIAN ALUMINIUM CO. LTD.

v.

COMMISSIONER OF INCOME TAX, WEST BENGAL

January 12, 1971

B [K. S. HEGDE AND A. N. GROVER, JJ.]

Income Tax Act, 1922, s. 10(2)(xi) and 10(2)(xv)—Fee paid to foreign collaborator for technical know-how—No provision in contract for payment of tax on fee by Indian Company—Assessee held in default and tax recovered from it—If allowable as business expenditure and deductible.

C The appellant Company which was engaged in the manufacture of aluminium products, entered into a contract with another company in Montreal, Canada, for the supply of technical know-how etc. for the development of its production. This agreement provided for payment of a retainer fee by the appellant on an annual basis and there was no condition or stipulation that the fee would be payable by the assessee without deduction of income tax. In 1951 the Income Tax Officer treated the assessee as being in default under section 18(7) of the Income Tax D Act, 1922 in respect of a sum of Rs. 1,24,199 which the appellant was liable to deduct from the payments made to the Montreal Company under the provisions of sections 18(3-A), 18(3-B) and 18(3-C). The appellant was required to pay this amount and the Montreal Company refused to accept its claim for reimbursement. The appellant claimed the amount as a deduction from its business income under S. 10(1) or 10(2)(xi) or 10(2)(xv) of the Act. Although this claim was allowed by the Appellate Assistant Commissioner, the Tribunal, in appeal, held that the amount in E question was neither expenditure incidental to the business nor was it wholly and exclusively laid out for that purpose; and nor was it claimable as a bad debt in view of the fact that it had not been incurred as a trade debt in the course of the business.

The High Court, upon a reference made to it, held against the assessee. On appeal to this Court,

F HELD : Dismissing the appeal,

(i) It is well settled that a business or trading debt should spring directly from the carrying on of a business or trade and should be incidental to it and it cannot be just any loss sustained by the assessee even if it has some connection with his business. [355 E]

Although the retainer fees were paid by the assessee to the Montreal G Company for technical assistance which had a connection with the business of the assessee it was not possible to regard the amount which the assessee was bound to deduct from the payment made to the Montreal Company under s. 18(3-B) of the Act and which it failed to recover from that company, as a debt which could be deducted under s. 10(2)(xi). The debt was not incidental to the business because it arose out of non-compliance with the provisions of the Act. The payment which the assessee made to the income tax authorities and which it failed to recover H from the Montreal Company was more a matter of commercial expediency and proceeded out of motives of business relationship, because the assessee was anxious not to annoy or offend the Montreal Company so as to avail of its continued technical assistance and advice. [355 G]

A. V. Thomas & Co. Ltd. v. *Commissioner of Income Tax*, 48 I.T.R. 67 at p. 75, referred to. A

(ii) The assessee was presumed to know the relevant provisions of the Act at the time when it entered into an agreement with the Montreal Company. There was no provision in the agreement with the Montreal Company which created a contractual obligation on the assessee to make payment of the taxes deductible under s. 18(3-B). A payment made under a statutory obligation, because the assessee was in default, could not constitute expenditure laid out for the purpose of the assessee's business and was not therefore deductible under s. 10(2)(xv). [356 E] B

Commissioner of Income Tax, Bombay v. *M/s. Pannalal Narotamdas & Co. Bombay*, 1969 1 I.T.J. 32, distinguished.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 24 of 1967. C

Appeal by special leave from the judgment and order dated April 27, 1966 of the Calcutta High Court in Income-tax Reference No. 90 of 1962.

M. C. Chagla, S. R. Banerjee, N. N. Goswami and *S. N. Mukherjee*, for the appellants. D

Jagadish Swarup, Solicitor-General, Ram Panjavani and *R. N. Sachthey*, for the respondent.

The Judgment of the Court was delivered by

Grover, J. This is an appeal by special leave from a judgment of the Calcutta High Court answering the following question referred to it under s. 66(1) of the Indian Income-tax Act, 1922, hereinafter called the "Act" in the negative and against the assessee :— E

> "Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,24,199/- was deductible from the business income of the assessee either under Section 10(1) or 10(2) (xi) or 10(2)(xv) of the Income-tax Act ?" F

The assessee is a public limited company having its registered office at Calcutta. Its principal business consists of manufacturing aluminium ingots, sheets and such other products from aluminium. There is another company known by the name of Aluminium Laboratories Limited, Montreal, in Canada, hereinafter called the "Montreal Company", which provided the assessee with technical know-how, engineering services etc. regarding development of a production of the goods. An agreement was entered into on January 31, 1947 between the Montreal Company and the assessee. The agreement provided for payment of a retainer fee on an annual basis. There was no condition or stipulation G H

A that the fee would be payable by the assessee without deduction of tax under the provisions of the Act. The assessee credited a total fee of Rs. 2,50,808/- in favour of the Montreal Company for a period of seven years between the accounting year ending September 30, 1944 and September 30, 1950.

B In 1951 the Income-tax Officer treated the assessee as being in default under s. 18(7) of the Act in respect of the amount of tax which the assessee was liable to deduct from the payments made to the Montreal Company under the provisions of ss, 18(3-A), 18(3-B) and 18(3-C) of the Act. The amount of tax C which was found to be payable by the assessee came to a toal sum of Rs. 1,24,199/-. The assessee wrote to the Montreal Company asking for reimbursement of the said amount. The Montreal Company, however, refused to accept the assessee's claim for reimbursement by means of a letter dated August 3, 1954. The assessee wrote off the amount of Rs. 1,24,199/- during the relevant previous year ending on December 31, 1954. The assessee D appealed to the Appellate Assistant Commissioner who allowed its claim. The department preferred an appeal to the Tribunal which held that the amount in question was neither expenditure incidental to the business nor was it wholly and exclusively laid out for that purpose nor was it claimable as a bad debt in view of the fact that it had not been incurred as a trade debt in the E course of the business. The departmental appeal was therefore allowed and the order of the Income-tax Officer was restored. The High Court was of the view that there was a nexus between payment and the business of the assessee inasmuch as it had an indirect bearing upon the technical aid which the assessee had obtained from the Montreal Company but was of the opinion F that even if the payment had some connection with the business it could not be said to be incidental to it as the liability could have been avoided by the assessee if it had deducted at the source the required amount of income-tax from the retainer fee which was payable to the Montreal Company. The High Court also considered the question whether the amount paid to the Montreal G Company could be treated as a bad debt within the meaning of s. 10(2) (xi) but came to the conclusion that as it had not been advanced as a trading debt in the course of business it was not deductible as a bad debt. According to the High Court the provisions of s. 18(3-B) had not been complied with and since the statutory provisions had been disobeyed and as a result thereof H the assessee had incurred a liability it could not be construed as a part of business expense within the meaning of s. 10(2)(xv) nor could it be said that such an expense was wholly and exclusively laid out for the purpose of the business.

In order to decide the contentions raised before us it is necessary to refer only to ss. 18(3-B) and 18(7) of the Act as they stood at the material time :—

> S. 18(3-B)—"Any person responsible for paying to a person not resident in the territories any interest not being "interest on securities" or any other sum chargeable under the provisions of this Act shall, at the time of payment, unless he is himself liable to pay any income-tax and super-tax thereon as an agent, deduct income-tax at the maximum rate and super-tax at the rate applicable to a company or in accordance with the provisions of sub-clause (b) of sub section (1) of section 17, as the case may be :
>
> Provided that where the person not resident is not a company, the proviso to sub-section (2B) shall apply to the deduction of income-tax and super-tax under this sub-section as it applies to the deduction of income-tax and super-tax under sub-section (2B) :
>
> Provided further that nothing in this section shall apply to any payment made in the course of transactions in respect of which a person responsible for the payment is deemed under the first proviso to section 43 to be an agent of the payee."
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> S. 18(7)—"If any such person does not deduct or after deducting fails to pay the tax as required by or under this section, he, and in the cases specified in sub-section (3D) the company of which he is the principal officer shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default in respect of the tax."
>
> Provided that ....."

Now the Act contains provisions for collecting taxes in two modes; one is by direct levy and the other by means of deduction at the source. Section 18 provides for deduction in cases *inter alia* of "Salaries" "Interest on securities", "Dividends", interest and other sums chargeable under the Act and paid to non-residents. There is no dispute that in the present case the assessee was bound under sub-section (3-B) to deduct the sum chargeable under the provisions of the Act at the time of payment of the retainer fees to the Montreal Company. Under sub-section (7) if the assessee did not deduct the amount of tax as required under the section it was to be deemed to be in default in respect of the tax. The argument raised on behalf of the appellant is that the Montreal Company refused to reimburse it for the payment of the

A amount in question for the reasons stated in the letter dated August 3, 1954. It was stated in this letter that the Montreal Company was not contractually bound to meet the obligation of Indian tax liability. The concluding portion of the letter was as follows :—

B "Again, this involves a question of principle for us. If every State to which we have to render technical assistance, based on the researches carried on by us in our plant and laboratories, starts demanding income-tax and super-tax on our charges, no such State could ever receive any technical assistance at all and we our-
C selves could hardly afford to render such technical assistance and the expensive taxes involved. We have given this matter our serious consideration and cannot bring ourselves on any score, equitable, legal contractual, or moral to reimburse to you any monies you may have to pay to the Indian-taxing Authorities."

D The claim of the assessee principally is two fold. It is maintained firstly that after the refusal of the Montreal Company in the matter of reimbursement the amount of Rs. 1,24,199/- was written off as a bad and irrecoverable debt. It was, therefore, deductible under s. 10(2)(xi) of the Act. In the section the debt certainly means something more than a mere advance. It
E is something which is related to business or results from it. To be claimable as a bad and irrecoverable debt it must first be shown as aproper debt. (vide *A. V. Thomas & Co. Ltd.* v. *Commissioner of Income-tax*(1). It is well settled that a business or trading debt should spring directly from the carrying on of a business or trade and should be incidental to it and it cannot be just any loss sustained by the assessee even if it has some
F connection with his business.

Although it is true that the retainer fees were paid by the assessee to the Montreal Company for technical assistance which had a connection with the business of the assessee but it is not possible to regard the amount which the assessee was bound to
G deduct from the total payment made to the Montreal Company under s. 18(3-B) of the Act and which it failed to recover from that company as a debt which could be deducted under s. 10(2)(xi). The debt was not incidental to the business because it arose out of non-compliance with the provisions of the Act. The payment which the assessee made to the income-tax authorities and which it failed to recover from the Montreal Company was
H more a matter of commercial expediency and proceeded out of motives of business relation-ship because the assessee was anxious

(1) 48 I.T.R. 67 at p. 75.

not to annoy or offend the Montreal Company so as to avail of its continued technical assistance and advice. Indeed the argument on behalf of the appellant has rested a great deal on this aspect of the matter and it has been urged strenuously that the assessee could not afford to displease the Montreal Company as it stood greatly in need of the latter's technical assistance.

Secondly the question is whether the assessee could claim deduction under s. 10(2)(xv) of the Act. For that purpose the assessee had to establish that the amount in question had been wholly and exclusively laid out for the purpose of its business. Our attention has been invited to a decision of the Bombay High Court in *Commissioner of Income-tax, Bombay* v. *M/s. Pannalal Narotamdas & Co. Bombay*(1) in which it was held that the amount of penalty imposed not for the fault of the assessee but because he had to pay the same for the purpose of getting the goods released from the Customs Authorities could be regarded as wholly and exclusively incurred for the purpose of hise business. We consider it unnecessary to pronounce on the correctness of this decision. The point which came up for consideration there was altogether different and it can afford no assistance to us in determining whether an amount which an assessee had to pay by virtue of the provisions of the Act could be regarded as an expense incurred wholly and exclusively for the purpose of the business. The assessee was presumed to know the relevant provisions of the Act at the time when it entered into an agreement with the Montreal Company. There was no provision in the agreement with the Montreal Company which created a contractual obligation on the assessee to make payment of the taxes deductible under s. 18(3-B). At any rate it is difficult to understand how a payment made under a statutory obligation because the assessee was in default, could constitute expenditure laid out for the purpose of the assessee's business.

We find no reason or justification to interfere with the answer returned by the High Court with the result that the appeal fails and it is dismissed with costs.

R.K.P.S. *Appeal dismissed.*

(1) [1969] 1 L.T.J. 32.