

A **COMMISSIONER OF INCOME TAX, WEST BENGAL**

v.

B **BIRLA COTTON SPINNING & WEAVING MILLS LTD. & ORS.**

August 17, 1971

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

C *Indian Income-tax Act (11 of 1922), s. 10(2)(xv)—'For the purpose of business', scope of—Expenses incurred before Investigation Commission—Whether deductible.*

D The assessee, a public limited company, incurred legal expenses for representing its case before the Income-tax Investigation Commission. The proceeding before the Commission was a statutory proceeding with a view to collecting materials for more taxation. The expenses were claimed by the assessee as a deduction under s.10(2)(xv) of the Income tax Act, 1922. The Income tax Officer, Appellate Assistant Commissioner and the Tribunal disallowed the claim, but the High Court, on reference, held in favour of the assessee.

Dismissing the appeal to this Court,

E HELD: The expression 'for the purpose of the business' in s. 10(2)(xv) is wider than the expression 'for the purpose of earning profits'. The former covers, not only the running of the business or its administration but also measures for the preservation of the business and protection of its assets and property. The test under the section therefore is whether the expenses were actually and honestly incurred for the preservation and protection of the assessee's business from any process or proceedings which might have resulted in the reduction of its income and profits.

[286 G-H, 288D]

F The earning of profits and the payment of taxes are not isolated and independent activities of a business, but are continuous and take place from year to year during the whole period for which the business continues. If the assessee takes any steps for reducing its liability to tax which result in more funds being left for the purpose of carrying on the business there is always a possibility of higher profits. Therefore, expenditure which was incurred by the assessee in opposing a coercive governmental action, with the object of saving taxation and safeguarding business, was justified by commercial expediency and was, hence, allowable under s.10(2)(xv) of the Act. [288 E-H., 289A-F]

G *Travancore Titanium Product Ltd., v. Commissioner of Income-tax Kerala*, 60 I.T.R. 277(S.C.) and *Smith's Potato Estate Ltd. v. Bolland*, 30 T.C. 267, referred to.

H *C.I.T. Calcutta v. Calcutta Landing and Shipping Co.* 77 I.T.R. 575 and *Bansilal Abirchand Spinning and Weaving Mills v. C.I.T. Poona*, 81 I.T.R. 34, approved.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1351 to 1353, 1897 and 1241 of 1968. A

Appeals from the judgments and orders dated March, 3, 1967, February 9, 1968 and June 28, 1967 of the Calcutta High Court in Income-tax Reference Nos. 136 of 1962, 154 of 1964 and 54 of 1963 respectively. B

*Jagdish Swarup, Solicitor-General, S. T. Desai, S. K. Aiyar, R. N. Sachthey and B. D. Sharma*, for the appellant (in C. As. Nos. 1241 and 1351 to 1353 of 1968)

*B. B. Ahuja, R. N. Sachthey and B. D. Sharma* for the appellant in C. A. No. 1897 of 1968). C

*B. Sen, A. C. Mitra, N. R. Khaitan, O. P. Khaitan, B. P. Maheshwari and Krishna Sen*, for respondent (in C. As. Nos. 1351 to 1353 and 1897 of 1968).

*Krishna Sen, N. R. Khaitan, O. P. Khaitan and B. P. Maheshwari*, for respondent (in C.A. No. 1241 of 1968.) D

The Judgment of the Court was delivered by

**Grover, J.** These appeals from a judgment of the Calcutta High Court have been brought by certificate under s. 66A (2) of the Indian Income tax Act, 1922, hereinafter called the 'Act' and involve a common question, namely, whether the law charges incurred in connection with the proceedings before the Investigation Commission were an allowable deduction in computation of the profits of the business of the assessee. E

The facts in the first batch of appeals i.e. C. As. 1351-1353/68 may be stated. During the assessment years 1952-53, 1953-54 and 1954-55 the assessee, which is a public limited company, spent Rs. 3810/-, 1,42,377/- and Rs. 2,42,688/- for representing its case before the Investigation Commission relating to the past assessment years 1941-42 to 1947-48. These expenses which were termed as "general expenses" were claimed by the assessee as deduction under s. 10 (2) (xv) or in the alternative under s. 10 (1) of the Income tax Act 1922, hereinafter called the 'Act'. The Income tax Officer disallowed the claim. His order was upheld by the Appellate Assistant Commissioner and the F

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A Appellate Tribunal. Thereupon the assessee moved the Tribunal under s. 66 (1) of the Act to state the case and refer the question of law arising out of its order. The Tribunal submitted a common statement of the case and referred the following question to the High Court :—

B “Whether on the facts and in the circumstances  
 of the case the Tribunal was right in holding that  
 the law charges incurred in connection with the  
 proceedings before the Investigation Commission  
 were not allowable deductions in computation of the  
 C profits of the business either under s. 10 (1) or under  
 10 (2) (xv) of the Income tax Act, 1922?”

D The High Court held that the expenditure incurred by the assessee in opposing an illegal and coercive government action with the object of saving taxation and safeguarding the business was justified by commercial expediency and was an allowable expenditure.

E It is necessary at this stage to notice the purpose of the Taxation of Income (Investigation Commission) Act 1947, hereinafter called the ‘Investigation Commission Act’ as also some of its relevant provisions. That Act was enacted for the purpose of ascertaining whether the actual incidence of taxation on income was and had been in recent years in accordance with the provisions of law and the extent to which the existing law and procedure for  
 F the assessment and recovery of such taxation was adequate to prevent the evasion thereof and to make provision for investigation into such matters. Section 5 (1) conferred power on the Central Government to refer particular cases or points to the Commission for investigation and report if the Government was of the opinion that there had been  
 G substantial evasion of payment of income tax in such cases. If in the course of investigation the Commission had reasons to believe that some person other than the one whose case was being investigated had avoided payment of income tax the Commission was authorised under sub-s. (4) of s. 5 to report to the Central Government. The  
 H ultimate object of investigation was collection of material showing evasion of tax so that the avoided income could be subjected to taxation and penalties imposed for evasion.

Section 5 (1) of the Investigation Commission Act was struck down by this Court as unconstitutional in *Shree Meenakshi Mills Ltd., Madurai & Others v. Sri A. V. Visvanatha Sastri & Another*<sup>(1)</sup>. Similarly s. 5 (4) was declared to be void and unconstitutional in *Surajmal Mohta & Co. v. A. V. Visvanatha & Another*.<sup>(2)</sup>

As a result of investigation into the affairs of Birla group of concerns the case of the assessee was referred to the Commission while it was functioning for investigation. The assessee engaged eminent lawyers and incurred the expenses in question in conducting appropriate proceedings before the Commission as also in courts where the vires of the aforesaid Investigation Commission Act were challenged.

Sub-section (1) of s. 10 of the Act provides that tax shall be payable by the assessee under the head profits and gains of business, profession or vocation in respect of the profits and gains of any business, profession or vocation carried on by him. Among the allowances which are not to be included in the computation of such profits and gains it is provided by sub. s. (2) (xv) of s. 10 as follows :—

S. 10 (2) (xv) :

“any expenditure not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation”.

The expression “for the purpose of the business” is essentially wider than the expression “for the purpose of earning profits”. It covers not only the running of the business or its administration but also measures for the preservation of the business and protection of its assets and property. It may legitimately comprehend many other acts incidental to the carrying on of the business. In *Travancore Titanium Product Ltd. v. Commissioner of Income Tax, Kerala*<sup>(3)</sup> the position relating to expenditure

(1) 26 I.T.R. 713.

(2) 26 I.T.R. 1

(3) 60 I.T.R. 277, 282.

A which can be deducted under s. 10 (2) (xv) of the Act was summarised thus :

B “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, *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.”

D It is well settled by now that the deductibility of expenditure incurred in prosecuting the civil proceedings to resist the enforcement of a measure, legislative or executive, which means restriction on the carrying on of a business or to obtain a declaration that the measure is invalid, would, if other conditions are satisfied, be admissible as a deduction under s. 10 (2) (xv). Deductibility of such expenditure does not depend on the final outcome of those proceedings. However, wrong-headed, ill-advised, unduly optimistic or over confident in his conviction the assessee might appear in the light of the ultimate decision, expenditure in prosecuting a civil proceeding cannot be denied as a permissible deduction if it is reasonably and honestly incurred to promote the interest of the business. (See *Sree Meenakshi Mills Ltd. v. Commissioner of Income tax Madras.* <sup>(1)</sup>)

G The point which has presented some difficulty at least in the English courts is whether the expenditure incurred by the trader in fighting the Revenue's assessment can be regarded an allowable expenditure. In *Smith's Potato Estate Ltd. v. Bolland* <sup>(2)</sup> expenses had been incurred in filling an appeal against the decision of the Commissioners of Inland Revenue to the Board of Referees in the matter of certain expenditure which had been claimed by the assessee as an allowable deduction. It was held by the majority (Viscount Simon and Lord Oaksey dissenting)

(1) 63 I.T.R. 207.

(2) 30 T.C. 267.

that the expenditure was not an allowable deduction for income tax and excess profits tax purposes. The basis of the view of the majority was that the expenses on the litigation undertaken for the purpose of reducing the amount of tax payable was not incurred by a trader for the purpose of his trade but partly atleast for the purpose of his relationship to the crown as a tax-payer. Therefore the expenditure was not wholly and exclusively for the purpose of the trade. Viscount Simon and Lord Oaksey, who took the contrary view, considered that attention should be concentrated on the statutory words that litigation undertaken for the purpose of reducing the amount of tax payable was undertaken "wholly and exclusively" for the purpose of the trade in that the reduction in the amount of tax increased the traders' monetary resources and so promoted the carrying on of the trade and the earning of the trading profits. (See also Simon's Income tax, Second Edition, Vol. 2, pages 216-217). In *Commissioner of Income tax, Calcutta v. Calcutta Landing & Shipping Co. Ltd.* (A) the Calcutta High Court has sought to distinguish the language of s. 10 (2) (xv) from that of the provisions in the English Income tax law and has given weighty reasons for accepting the opinion of Viscount Simon and Lord Oaksey, particularly, because of the observations of this Court in the decisions which we have already noticed. The above case was followed by a Full Bench of the Bombay High Court in *R. B. Bansilal Abirchand Spinning & Weaving Mills v. Commissioner of Income tax, Poona*(<sup>2</sup>). (B) (C) (D) (E)

Learned counsel for the Revenue has relied upon the observations extracted at an earlier stage from the case of *Travancore Titanium Products Ltd*(<sup>3</sup>) and has argued that there must be a direct and intimate connection between the expenditure of the business, i.e. between the expenditure and the character of the assessee as a trader and not as an owner of assets. We are unable to appreciate how these observations which were made in the light of different facts in any way militate against the view of Viscount Simon and Lord Oaksey in *Smith Potato Estate* case(<sup>4</sup>) as also the decision of the Calcutta High Court in *Calcutta Landing & Shipping Co.* case(<sup>1</sup>). It may be pointed out that in the (F) (G) (H)

(1) 77 I.T.R. 575.

(2) 81 I.T.R. 34.

(3) 69 I.T.R. 277.

(4) 30 T.C. 267.

A decision relied upon by the Revenue the question was whether the tax imposed under the Wealth Tax Act on the owner of assets was a permissible deduction under s. 10 (2) (xv) of the Act. It was emphasised by this Court that the charge of the tax was the same whether the assets were part of or used in the trading organisation of the owner or were merely owned by him. The assets of the tax-payer whether incorporated or not became chargeable to tax because they were owned by him and not because they were used by him in the business. The position is quite different when it has to be decided whether an allowance contemplated in s. 10 (2) (xv) is deductible.

The essential test which has to be applied is whether the expenses were incurred for the preservation and protection of the assessee's business from any such process or proceedings which might have resulted in the reduction of its income and profits and whether the same were actually and honestly incurred. It is not possible to understand how the expenditure on the proceedings in respect of the Investigation Commission by the assessee will not fall within the above rule. Even otherwise the expenditure was incidental to the business and was necessitated or justified by commercial expediency. It must be remembered that the earning of profits and the payment of taxes are not isolated and independent activities of a business. These activities are continuous and take place from year to year during the whole period for which the business continues. If the assessee takes any steps for reducing its liability to tax which result in more funds being left for the purpose of carrying on the business there is always a possibility of higher profits. To give an illustration, if an assessee can, by an appropriate proceedings, succeed in getting its tax liability for gains and profits reduced by a sum of Rs. 1,00,000/- that amount will essentially become available for the purpose of business with a reasonable expectation of more profits. As was observed by Viscount Simon in *Smith Potato Estate* case<sup>(1)</sup> if the trader considers that the Revenue seeks to take too large a share and to leave him with too little the expenditure which the trader incurs in endeavouring to correct this mistake is a disbursement laid out for the purposes of his trade. If he succeeds he will have more money with which to earn profits next year.

(1) 30 T. C. 267.

The High Court in the judgment under appeal, after a discussion of the relevant case law, approached the matter in this way. The proceeding before the Investigation Commission is not a civil proceeding; but it is a statutory proceeding with a view to collecting materials for more taxation. Therefore if the proceeding touched the business of assessee the expenditure incurred by the assessee in safeguarding its interest before the Commission would be an allowable deduction. It was pointed out—and this was based on the material on the record—that the Commission was holding an investigation on a suspected escape-ment of income to the tune of about Rs. 4 crores. Taxes levied on that income and the penalties imposed would naturally have been very heavy for the business of the assessee and might have either crippled or annihilated it. To preserve the business from an investigation which, according to the assessee, was unlawful the assessee was justified in taking proper steps and spending monies therefor. Such an expenditure was not for earning profits but was aimed at preservation of business from the inroads of a piece of legislation which, it was maintained, was unconstitutional and was so held by this Court later in certain decisions that have already been mentioned. The expenditure which was incurred by the assessee in opposing a coercive governmental action with the object of saving taxation and safeguarding business was justified by commercial expediency and was, therefore, allowable under s. 10 (2) (xv) of the Act. We have no doubt that the above approach of the High Court and its ultimate decision were fully justified on principle and authority.

In the result all these appeals fail and are dismissed. But the respondent will be entitled to costs only in C. As. 1351-1353/68. One hearing fee.

V.P.S.

*Appeals dismissed.*