

Echjay Industries Ltd. Vs. Dy. Cit

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Court : Mumbai

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Appeal No. : ITA No. 3103/Mum/1996 24 April 2002 A.Y. 1992-93

Appellant : Echjay Industries Ltd.

Respondent : Dy. Cit

Judgement :

ORDER

J.P. Bengra, V.P.

These two cross appeals, against the order of the Commissioner (Appeals)-VI, Mumbai (S.K. Dasgupta) pertaining to assessment year 1992-93, are being disposed of by this consolidated order, for the sake of convenience.

2. We shall first take up the appeal filed by the revenue, in which the first ground urged reads as under :

'On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in holding that the incidental expenses connected to tour should not be included while computing the disallowance under rule 6D of the Income Tax Rules and thereby erred in deleting the addition of Rs. 1,17,475 made by the assessing officer.'

The learned Departmental Representative submitted that the conveyance, telephone and miscellaneous expenses incurred have to be disallowed under rule 6D of the Income Tax Rules, 1962. On the other hand, the learned counsel for the assessee relied on the decision of the Calcutta High Court in the case of CIT v. Vidyut Metallics Ltd. : [1993]203ITR779(Cal) We have considered the rival submissions and have gone through the material available on record. We find that the Commissioner (Appeals), in his elaborate discussions in paras 5 and 6 of his order, has mentioned that the issue of disallowance under rule 6D of the Income Tax Rules has been considered by the Hon'ble Calcutta High Court in the case of Vidyut Metallics Ltd. (supra), wherein it was held that the restriction under rule 6D should be confined only to expenses on stay and would not cover other expenses provided they are not personal in nature, and following that decision he deleted the addition. The learned Departmental Representative could not place any material to take a different view in the matter. We, therefore, agree with the view taken by the Commissioner (Appeals) on this issue. This ground of the revenue is accordingly rejected.

3. The second ground raised by the revenue reads as under :

'On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in holding that the allocation of electricity expenses amounting to Rs. 4,33,630 for reducing the profit of the 80-I unit made by the assessing officer should be restricted to Rs. 2 lakhs, disregarding the fact that the part of the electricity cost pertaining to machinery involved in the product was allocated by the assessing officer. ' The assessing officer, while computing the deduction under section 80-I of the Act, reduced the profit of the unit qualifying for deduction under section 80-I by an amount of Rs. 11,78,696 by allocating electricity expenses, out of overhead expenses, of Rs. 4,33,630 and the portion of interest on unsecured loans of Rs. 7,45,976. He has given detailed reasons in para 8 of the assessment order. Before the Commissioner (Appeals), the assessee made following submissions :

'48. On behalf of the appellant it was submitted that the company had worked out machine-wise electricity consumption taking into account total consumption of the

unit and on average rate per unit, the expenses were booked in the profit and loss account of the unit. It was submitted that no further electricity cost was allowable to the unit and profits reduced for the purposes of working out deduction under section 80-I. The assessing officer on the other hand was of the opinion that the electricity cost, lighting and fixtures of the office and even a part of the corporate head office electricity expenses are to be allocated on turnover basis as the head office has a role in various activities connected with 80-I unit.'

Considering the above submissions, the Commissioner (Appeals) was of the view that the allocation made by the assessing officer in respect of electricity expenses although was on reasonable basis, but had been on a very high side. Therefore, he restricted the allocation of electricity expenses to Rs. 2,00,000 for computation of deduction under section 80-1 of the Act.

4. Before us, the learned Departmental Representative heavily relied on the order of the assessing officer and submitted that the Commissioner (Appeals) should not have reduced the same to Rs. 2,00,000. On the other hand, the learned counsel for the assessee relied on the order of the Commissioner (Appeals) and reiterated the submissions made before the Commissioner (Appeals).

5. We have considered the rival submissions and have gone through the material available on record, as also the submissions made by the assessee before the Commissioner (Appeals). In our considered view, the Commissioner (Appeals) was justified in restricting the allocation of electricity expenses to Rs. 2,00,000. We, therefore, find no reason to take a different view in the matter. Accordingly, the order of the Commissioner (Appeals) on this issue is upheld and the revenue's ground is rejected.

6. The last ground in the revenue's appeal reads as under :

'On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in deleting the addition to the closing stock amounting to Rs. 33,79,025 made by the assessing officer on account of Modvat credit.'

Having heard both the parties, we find that this issue stands covered in favour of the assessee by the decision of the Hon'ble Bombay High Court in the case of CIT v. Indo Nippon Chemical Co. Ltd. : [2000]245ITR384(Bom) Respectfully following the said decision of the jurisdictional High Court, we do not find any justification to interfere with the order of the Commissioner (Appeals) on this issue. Accordingly, this ground of the revenue is rejected.

7. We shall now take up the appeal filed by the assessee. In this appeal, the assessee has filed revised grounds of appeal and the first ground relates to the disallowance of guest house expenses. The assessee- company maintains two rented accommodation as transit house at Rajkot, which were admittedly guest-houses. The assessee- company incurred an expenditure for the maintenance of the guest-house, as it was having its work place a Rajkot. The assessing officer disallowed the claim of guest-house expenses by invoking the provisions of section 37(4) read with section 37(5) of the Act. In the first appeal, the Commissioner (Appeals) concurred with the view taken by the assessing officer.

8. Before us, the learned counsel for the assessee admitted that the assessee was maintaining a guest-house at Rajkot. However, it was submitted that the expenses incurred were allowable under the specific provisions of sections 30 to 36 of the Act. In this connection, reliance was placed on the following decisions :

1. Mahindra & Mahindra Ltd. v. Dy. CIT (1997) 58 TTJ (Mumbai) 567 : (1997) 61 ITD 129 (Mumbai)
2. Hindustan Lever Ltd. v. IAC (1996) 56 TTJ (Mumbai) 598 : (1996) 58 ITD 555 (Mumbai)
3. Bhilai Engg. Corpn. Ltd. v. Dy. CIT (1997) 63 171D 223 (Nag)
4. International Computers Indian . v. Dy. CIT (1999) 63 ITD 195 (Mumbai)
5. Garware Marine Industries Ltd. v. Income Tax Officer (1989) 33 TTJ (Mumbai) 630
6. CIT v. Chase Bright Steel Ltd. : [1989]177ITR128(Bom)

7. Century Spinning & Weaving Mfg. Co. Ltd. v. CIT : [1991]189ITR660(Bom)

8. CIT v. Ahmedabad Mfg. & Calico Printing Co. Ltd. : [1992]197ITR538(Guj)

On the other hand, the learned Departmental Representative relied on the decisions of the Bombay High Court in the case of CIT v. Ocean Carriers (P) Ltd. (1995) 211 ITR 357 and in the case of Raj Bahadur Motilal Poona Mills Ltd. v. CIT : [1995]212ITR175(Bom) and also on the decision of Karnataka High Court in the case of United Catalyst India Ltd. v. CIT : [1998]229ITR233(Ker) Lastly reliance was placed on the latest order of the Tribunal, to which one of us was a party, in the case of Dy. CIT v. Murply (I) Ltd. in ITA No. 4709/Bom/1993 dated 5-2-2002. It was submitted that after considering the earlier decisions of the Tribunal as well as the latest decisions on the issue, the Tribunal has confirmed the disallowance made under section 37(4) of the Act.

9. We have considered the rival submissions and have gone through the material available on record. We find that this issue was discussed by the Tribunal elaborately in the latest order in the case of M/s Murply (I) Ltd., in which all the earlier decisions of the Tribunal as well as the High Courts were considered at length and for the reasons stated therein came to the conclusion that the expenditure incurred for the maintenance of a guest-house was not allowable under the provisions of section 37(4) of the Act. Respectfully following the said decision, to which one of us was a party, we do not find any justification to interfere with the order of the Commissioner (Appeals) on this issue. Accordingly the order of the Commissioner (Appeals) on this issue is upheld and the assessee's ground is rejected.

10. The next grievance of the assessee in its appeal relates to the disallowance of sundry expenses of Rs. 2,90,400. An amount of Rs. 2,90,400 was paid by the assessee- company to various employees, leaders and trade unions in and outside the company. The case of the assessee was that, in order to maintain best of relationship, discipline and tranquility in the work force, these expenses were incurred by the management of the assessee- company in order to control 1200 labour force and in order to get better output in the interest of the company. It was submitted that these payments were made in cash and there was no evidence in

the form of bill or voucher to substantiate the claim of payment of Rs. 2,90,400. The assessing officer observed that there has been no discontent among the workers or union so as to necessitate such payments. Moreover, there was no bill or voucher or name of the employees to whom these payments were made. As such, the sum of Rs. 2,90,400 was disallowed. This was confirmed by the Commissioner (Appeals) for the detailed reasons given in para 16 of his order.

11. The learned counsel for the assessee very vehemently argued that the assessee- company is having a wrong force of 1200 labourers, who are managed by the union in the factory. In order to maintain peace and tranquility in the factory premises, cash payments were made to the employees, leaders and union in the exigency and interest of the company. As such, the payment should be allowed. He admitted that there is no evidence in the form of name of the employees, bills or vouchers and also admitted that in assessment year 1989-90 such expenditure was not allowed even by the Tribunal. The learned Departmental Representative, on the other hand, relied on the order of the Commissioner (Appeals) as also of the Tribunal in the case of the assessee for assessment year 1989-90 and submitted that when on similar facts, identical expenditure was not allowed in assessment year 1989-90, in the absence of bills, vouchers, names of employees, etc., the expenditure cannot be allowed in this year also. It was pointed out that in the case of CIT v. Goodlass Nerolac Paints Ltd. : [1991]188ITR1(Bom) the jurisdictional High Court has observed that such expenditure cannot be allowed.

12. We have considered the rival submissions and have gone through the material available on record. We find that in the assessment year under consideration also the assessee- company failed to furnish information regarding the name and address of the recipients of such payments, so much so it has not maintained any details of such expenditure. In the absence of these details, it is difficult to believe that the payments were made to employees or union in order to maintain peace and tranquility in the factory premises. In the assessment year 1989-90, on similar facts, the Tribunal had confirmed the addition. There is no additional material before us to take a different view in the matter. Therefore, we agree with the view taken by the revenue authorities on this issue.

13. The next grievance of the assessee in its appeal is as under :

'On the facts and in the circumstances of the case, the learned Commissioner (Appeals) erred in confirming the disallowance of Rs. 1,28,496 made under section 43-B of the Act. He ought to have appreciated that in view of the fact that the payments in respect of the same being made before the due date for furnishing the return, the same was not disallowable under section 43B.

At the time of hearing, the learned counsel for the assessee did not press the above ground. Therefore, the same is rejected.

14. Ground No. 5 in the assessee's appeal relates to deduction under section 80HHC of the Act. The assessee while claiming deduction under section 80HHC of the Act excluded packing, freight, inspection, testing charges and octroi from its total turnover. In the course of assessment proceedings, the assessee submitted that the receipts were on account of reimbursement of insurance, packing, inspection and testing charges incurred by the company. Hence, though the receipts were credited to the profit and loss account, they were in the nature of reimbursement and should not be included in the total turnover. However, the assessing officer did not agree with the submissions of the assessee. According to him, an agreement between the parties or mere mutual consent of the parties as regards terms would not change the nature of the income, He has discussed this issue in detail in para 7 of the assessment order. He held that all the expenses, which were incidental to the business and were necessary for the sale to be effected, constituted part of the turnover. He held that since the sale could not be effected unless inspection and certification by the relevant authorities are not produced, the receipt in respect of such inspection and certification is in the nature of trading receipts. As such, these receipts formed part of the total turnover. Regarding octroi also, he held the same view. He, therefore, recomputed the deduction claimed by the assessee under section 80HHC of the Act.

15. Before the Commissioner (Appeals) it was pointed out that in the past, the department had accepted the claim of the assessee based in the same lines as the claim made for the year under appeal. It was, therefore, submitted that there was no reason to tinker with the claim of the assessee.. However, the

Commissioner (Appeals) did not agree with the submissions of the assessee. He also referred to the decision of the Supreme Court in the case of McDowell & Co. Ltd. v. CTO : [1985]154ITR148(SC) and then confirmed the addition.

16. The learned counsel for the assessee submitted that the assessing officer while working out the export profits, has taken into account packing collections, freights collected from customers, inspection charges collected, testing charges and octroi duty charged/recovered as part of turnover. It was pointed out that the assessee was incurring such expenses on account of and on behalf of its consistent clients and on their instructions. These expenses were in the nature of reimbursement. They were not part of sales turnover. Reliance was placed on the decision of the Bombay High Court in the case of CIT v. Pink Star : [2000]245ITR757(Bom) He clarified that the receipt and expenses incurred under these heads were separately shown in the accounts. He relied on the observations of the Bombay High Court in the case of CIT v. Sudarshan Chemicals Industries Ltd. : [2000]245ITR769(Bom) to submit that the receipts on these heads do not give rise to any profit and such items not generating profit, should not form part of turnover under the provisions of section 80HHC of the Act. Alternatively, he submitted that if those receipts are considered as part of turnover, the expenses incurred by the assessee under the same heads should be reduced from such receipts. The learned counsel for the assessee submitted that the observations of their Lordships in the case of Sudarshan Chemicals Industries (supra) were in different context. The activities performed against which the assessee has received payments are part and parcel of the sales activities. On the other hand, the learned Departmental Representative pointed out that here is a case of a company in which the business is not a hundred per cent export. There are local sales also. The situation will not change even if the assessee had an arrangement under an agreement with the constituents for reimbursement. So the amount was rightly taken into consideration while computing the total turnover for the purpose of section 80HHC of the Act. In this connection, reliance was placed on the decision of the Bombay High Court in the case of CIT v. Sudarshan Chemicals Industries Ltd. (supra) and it was pointed out that the decision in the case of CIT v. Pink Star (supra) relied upon by the learned counsel for the assessee is on different facts.

17. We have considered the rival submissions and have gone through the material available on record. We have also considered the decisions cited by the parties. In the present case, we find that the details of the expenditure incurred in India, which were reimbursed by the foreign parties, have not been furnished. Besides this, if the assessee is claiming that reimbursement was part of profit and not turnover, the claim would be erroneous. Otherwise, if the assessee is not crediting in P&L; a/c, then, it should be part of turnover. If the assessee has included the reimbursement, in profit and not in the turnover, claim under section 80HHC is not justified. But if it has not included in the profit and also not included in the turnover, its claim may be justified. Since the assessee has not furnished the details of the expenditure incurred in India, which were reimbursed by the foreign parties, and the bills, it is not possible for us to deliberate upon this issue at this stage. We do not know whether the bills, which were sent to the foreign parties, include packing, freight, inspection and testing charges or not. We also do not know whether the assessee has included the bill amount as part of export turnover and if so, what amount of these bills has been realised in foreign exchange and whether there was any foreign exchange as part of export turnover or not. Since no details have been given of miscellaneous income also, which includes all these disputed items of expenses, we are handicapped in deciding this issue at this stage. We are, therefore, of the opinion that the matter should go back to the file of the assessing officer for making inquiry in the light of the above observations and after giving full opportunity of being heard to the assessee to decide the issue afresh in accordance with law and also in the light of the latest decisions on the issue. We direct accordingly.

18. Ground No. 6 in the assessee's appeal reads as under :

'On the facts and in the circumstances of the case, the learned Commissioner (Appeals) erred in confirming the reduction in the amount of deduction under section 80-I made by the assessing officer by attributing certain unrelated expenses (i) being a part of interest on unsecured loan allocated on turnover basis and (ii) estimated electricity expenses aggregating to Rs. 7,46,976 to the new unit.'

We have discussed the factual position while dealing with ground No. 2 in the departmental appeal. Regarding the allocation of interest, the assessing officer was of the opinion that a portion of the interest paid by the assessee-company should be allocated to the unit qualifying for deduction under section 80-I of the Act. On the basis of sale ratio, he allocated Rs. 7,45,976 out of the total interest on unsecured loans of Rs. 78,55,479. Before the Commissioner (Appeals), it was pointed out that for setting up of 80-I unit, no other loan had been taken except the loan from IDBI and, therefore, no interest forming part of interest on unsecured loans was to be allocated to the profit of this unit. In this connection, reliance was placed on the decision of the Tribunal in the case of Usha Rectifier Corpn. (I) Ltd. v. IAC in ITA No. 2194/Del/1986. However, the Commissioner (Appeals) did not accept these arguments and concurred with the findings given by the assessing officer on this issue, for the reasons given in para 52 of his order.

19. Before us, the learned counsel for the assessee submitted that the assessee-company had set up a gear cutting division as a new industrial undertaking, manufacturing the products at Rajkot in the year relevant to the assessment year 1991-92 where it has invested certain amount for installation of plant and machinery. The assessee availed term loans under IDBI Deferred Payment Scheme only in respect of three machineries installed in the new industrial unit. Accordingly interest incurred during the year was debited to the P/L a/c. In respect of cost of acquisition and installation of other machineries, the same was borne out of the internal generations and reserves of the company and no part of the interest which the assessee-company has incurred in the other units could be allocated to the new industrial unit. However, the assessing officer allocated a sum of Rs. 7,45,976 unreasonably. It was pointed out that the assessee-company has two distinct industrial units, one is the old unit manufacturing steel and alloy forging products, whereas the new industrial unit was established in 1989-90 for gear cutting. The assessee-company maintains accounts for both the units. It follows scientific allocation of all expenses to each of the unit, which is clear from the paper book filed before us, which were also placed before the assessing officer. It was pointed out that investment has been made out of its self-generation reserves and profits. The assessee invested Rs. 52,97,288 till 31-3-1992, investing Rs. 33,79,376 till 31-3-1991 and Rs. 19,17,912 in 1991-92. Reserve and surplus of the

assessee- company as on 31-3-1990, was Rs. 547.89 lakhs and as on 31-3-1991 it was Rs. 997.70 lakhs, apart from depreciation fund and profit of the year. These were more than sufficient to fund the acquisition of the balance of gear cutting unit. Except for these three machines, the assessee did not avail of any loan and did not incur any interest. Reliance was placed on the decision of the Tribunal in the case of Usha Rectifier Corpn. (I) Ltd. v. IAC (supra). On the other hand, the learned Departmental Representative relied on the orders of the revenue authorities.

20. We have considered the rival submissions and have gone through the material available on record. It is an admitted position that the assessee is maintaining separate books of account, which have been audited by an Authorised Chartered Accountant. These books have also been accepted by the department. Thus the assessee could correctly work out the capital employed by taking the figure recorded in the books. Under these circumstances, unless there is evidence to indicate that borrowings were intended or were taken for the purpose of installation of plant and machinery in the new industrial unit, there is no reason on the basis of which the capital employed could be reduced. The assessee has pointed out that except for three machineries installed in the new industrial unit, no other interest part has been incurred. The entire cost has been borne out of industrial generation and reserves of the company and no part of the interest has been incurred in the other units. Therefore, it cannot be allocated to the new industrial unit. As such, we relying on the decision of the Tribunal in the case of Usha Rectifier Corpn. (I) Ltd. (supra) hold that the Commissioner (Appeals) was not justified in confirming the reduction in the amount of deduction under section 80-I of the Act, being the part of interest in unsecured loans. We, therefore, set aside the order of the Commissioner (Appeals) on this issue and direct the assessing officer to allow the claim of the assessee in this respect.

21. The remaining ground, viz. ground No. 4 in the assessee's appeal relates to the disallowance of Rs. 9,21,23,100 in respect of payments made to buy out certain recalcitrant shareholders in terms of the decree of High Court under section 402 of the Companies Act, ignoring the fact that the said payments were wholly and exclusively laid out for the purposes of the assessee's business; laid

out during the course of carrying on the business and to ensure growth of the business by removing inhibitions.

22. The assessee- company was constituted as a private limited company. At the relevant period, four brothers and their family members, viz. Shri Maganlal H. Doshi, Shri Manharlal H. Doshi, Shri Hasmukhlal H. Doshi and Shri Vinodchandra H. Doshi were the directors and shareholders of the assessee-company, holding almost equal shares. In or about 1985-86, serious disputes broke out between the shareholders, with the result that the functioning of the company and its growth was impeded so much so the matter was carried to the Court. Therefore, there was total diversion of the directors from the business of the company. The company's functioning could not be smooth and the management had to pass through great hardship and harassments arising out of the legal actions. As a result of arbitrations, court orders by way of injunctions and for compliances intervened the functioning of the company. Two of the directions, namely Shri Hasmukhlal H. Doshi and Shri Manharlal H. Doshi filed petitions before the Bombay High Court under the provisions of section 397 and 398 of the Companies Act, 1956, alleging mismanagement and oppression of minority and seeking Court's intervention for winding up of the company or passing such order as it may deem fit in the interests of the company. The company's management apprehensive of winding up of the company by the court order started working under scare. After a period of over six years, good sense prevailed between the two warring groups and a consent terms were drawn by the shareholders and the Bombay High Court in its orders passed on 2-5-1991, decreed approving the consent terms, inter alia giving the direction that the company would purchase the shares of the family members of Shri Maganlal H. Doshi, Shri Hasmukhlal H. Doshi and Shri Manharlal H. Doshi, who were the shareholders of the company and to pay a sum of Rs. 1,000 per share of which Rs. 100 per share was return of its capital value and the balance of Rs. 900 as by way of premia. The total payment accordingly came to Rs. 1,02,35,900 by way of repayment of the capital sum and an amount of Rs. 9,21,23,100 by way of premia. The consequential reduction in share capital were approved by the High Court.

23. The assessee-company debited the premia amount paid to the P&L; a/c for the year and has claimed the same as deductible in computing its total income. The assessee, while claiming that the payments were to be made to the shareholders to secure smooth running of the company and avoiding its possible winding up under the provisions of section 397 and 398 read with section 402 of the Companies Act, 1956, relied upon the decision of the Mumbai Bench of the Tribunal in the case of Atul Chemicals Industries Ltd. v. ITO in ITA No. 1395/Bom/1980, order dated 5-8-1981. In that case, the Bench has held that the payment having been made to secure peace and harmony and smooth management of the company, the interest of the business had been served and that was the whole purpose of such payment and, therefore, the amount paid was deductible as a revenue expenditure. It was pointed out that the case of the assessee is similar to the case of Atul Chemicals Industries Ltd. (supra). However, the assessing officer, for the detailed reasons given in para 6 of his order, held that the assets of the company had been distributed to the majority shareholders by way of consent terms i.e., the deal struck among the members after the filing of the liquidation petition. Therefore, he held that it is not a simple case of liquidation. Hence, the expenditure incurred was not treated as a business expenditure. When the matter was carried in appeal before the Commissioner (Appeals), he concurred with the view taken by the assessing officer, for the detailed discussions given in paras 21 to 36 of his order.

24. The learned counsel for the assessee pointed out that because the minority shareholders, Shri Manharlal H. Doshi and Shri Hasmukhlal H. Doshi had filed the petition under sections 397 and 398 of the Companies Act, the assessee-company could not steer through its activities and its business earnings. The apprehension of winding up was hanging and, therefore, the company's activities were affected. The management learning from the past history of the company, thought it proper to pay to the members belonging to the three groups so that the company is managed by one group and is avoided the harassment of recurrence of any impediments in its working. It was pointed out that the reason for payment has remained the same, i.e., in the interest of ensuring smooth carrying on of the assessee's business. It was a prudent business decision in the interest of its smooth running to have the company an uninhibited mind at work for the better

and efficient working. Our attention was invited to the court decree appearing at pages 57 to 69 of the paper book and the relevant clauses, viz. 1, 2, 3, 4 and 5 were brought to our notice to contend that the court passed this compromise decree between these two warring groups keeping in view the interests of the company as supermost. In this connection, our attention was invited to the Commentary of Ramaiah on Company Law, Part VI, Management and administration, page 2292 given on section 402, wherein it is mentioned that where a compromise or settlement is shown to have been arrived at between the parties to a proceedings under sections 397 and 398 of the Companies Act, 1956, the court has to consider whether the said settlement was in the interests of the company as well as in public interest and if it is not so, the court is not bound to accept and record the same. It was also mentioned that the proceedings under sections 397 and 398 are of representative nature. No individual rights can be ascertained nor can a personal relief granted to any member. The reliefs contemplated under both the sections concern the affairs of the company. The court will not accept any compromise or adjustment between the parties without also notifying the Government under section 400 nor will permit any party e.g. commission agents, etc., to draw away the whole amount available with the company. It was thus submitted that while granting the decree, the Hon'ble High Court had taken into consideration the above aspects of the matter. So the allegation of the revenue authorities that the payments amounted to allocation of family holding among the members and is a distribution of assets by the company upon filing liquidation petition is wrong. Qua the assessee-company why the amounts were paid off was for the simple reason for avoiding and removing inhibitions and impediments in carrying out the business of the company smoothly. It is wrong to say that the assessee- company had distributed any of its assets. The consent term approved by the High Court does not envisage any such distribution of assets in specie or otherwise to its members. There was no event which gave rise to any such distribution of assets. Distribution of assets is not permissible under the Company Law, except in cases of winding up or liquidation. It cannot be gain said that the assessee- company had distributed the assets while it paid the settled payment under section 402 of the Companies Act, keeping in view the interests of the business of the company. The payments had been made

out of the current year's profits and not out of the reserves and assets of the company. In this connection, our attention was invited to the annual reports of the company at pages 18 to 36 of the paper book. Our attention was also invited to the comparative chart of income and expenditure right from financial year ending 31-12-1986 to 31-12-1998, and also the balance sheet for these periods and it was pointed out that during the period when there were disputes amongst the various warring groups, the profits were going down and could not make as much as it could earn due to problems created by the directors. But after the troubleshooters went out, the company expanded and prospered. This is clear from these details. It was further submitted that the decision of the Tribunal in the case of Atul Chemical Industries Ltd. v. ITO (supra) referred to above, is applicable with full force to the facts of the present case. It was pointed out that the case of the assessee stands on a better footing. The position will not affect merely because a Reference Application is pending before the High Court. Reliance was also placed on the decision of the Allahabad High Court in the case of CIT v. Muir Mills Co. Ltd. : [1984]148ITR418(All) . It was also submitted that the decision relied upon by the Commissioner (Appeals) in the case of Albert David Ltd. v. CIT : [1981]131ITR192(Cal) is distinguishable on facts. In that case, the personal rights and title of certain shareholders in third party was the subject-matter of appeal, which is not the case here. Therefore, this decision is not applicable to the facts of the present case.

25. On the other hand, the learned Departmental Representative heavily relied on the order of the Commissioner (Appeals) and pointed out that the two warring groups of the shareholders desired to hold the administration of the assessee-company and accordingly they filed the petition before the High Court. In this way they have distributed the assets of the company by a compromise decree. So the decision of the Tribunal in the case of Atul Chemicals Industries Ltd. v. Income Tax Officer (supra) is not applicable to the facts of the present case. The learned Departmental Representative very vehemently argued that this was a domestic quarrel where ultimately a settlement has been arrived at in which the assets were distributed and if in such a situation the company has incurred an expenditure, it will serve the purpose of one of the warring groups against the other. So the amount in question cannot be held to be a business expenditure. In this

connection, reliance was placed on the following decisions :

1. Punjab State Industrial Development Corporation Ltd. v. CIT : [1997]225ITR792(SC)

2. Brooke Bond India Ltd. v. CIT : [1997]225ITR798(SC)

3. CIT v. Kodak India Ltd. : [2002]253ITR445(SC)

4. Premier Construction Co. Ltd. v. CIT : [1966]62ITR176(Bom)

5. Dalmia Dadri Cement Ltd. v. CIT (1980) 126 ITR 851
In fact, the learned Departmental Representative took us through the observations of the Commissioner (Appeals) in his order and submitted that the analysis shows that it was a domestic and family dispute, which has resulted into compromise decree and they have distributed the assets and no interest has been served by that.²⁶ In reply, the learned counsel for the assessee submitted that because of the decree passed by the High Court in the interests of the company, the capital structure is reduced. The reduction of the capital is mere causa causans and not the object.²⁷ We have considered the rival submissions and have gone through the material available on record. The main question which arises for determination is whether the impugned expenditure is allowable on revenue account being expenditure of business in nature or whether the said item of expenditure was rightly disallowed by the revenue authorities on capital account. In this context, we are of the opinion that the purpose of the expenditure for which it was incurred is determinative of the issue. The second limb of the issue is how the said expenditure was incurred. However, the first limb of the controversy, viz. whether the expenditure was incurred for the purpose of the business, is determinative and secondly if the said expenditure was incurred for the purpose of the business, whether such expenditure brought into existence any benefit or advantage which could be treated as an advantage on capital account. The facts in this case are not in dispute, viz. there were serious disputes between the two warring groups of the shareholders with the result that the functioning of the company and its growth was impeded so much so that the matter was carried to the Court. Therefore, naturally there was diversion of directors from the business of the company to the

litigation. Naturally the company's functioning in such circumstances could not be smooth and the management had to pass through a great deal of hardships. After a period of over six years, good sense prevailed between the two warring groups and a consent term was drawn by the shareholders, which was approved by the Hon'ble Bombay High Court by way of decree dated 2-5-1991, inter alia, giving the direction that the company would purchase the shares of the family members of Shri Maganlal H. Doshi, Shri Hasmukhlal H. Doshi and Shri Manharlal H. Doshi who were the shareholders of the company and to pay a sum of Rs. 1,000 per share of which Rs. 100 per share was return of its capital value and the balance of Rs. 900 per share was by way of premia. This resulted into reduction in the share capital of the company which was approved by the High Court. The reduction in the share capital as a result of the settlement, according to the revenue authorities, has affected the capital structure of the assessee-company and, therefore, the impugned expenditure was to be disallowed on capital account. It was also emphasised by the department that the company got enduring benefit. So far as the question of enduring benefit is concerned, the Hon'ble Supreme Court, in the case of *Empire Jute Co. Ltd. v. CIT* : [1980]124ITR1(SC) has observed that 'There may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, none-the-less, be an revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principles laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on the application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue accounts'.²⁸ If we go through the facts of the present case, it will be clear that the assessee- company incurred the impugned expenditure in the larger interest of the business necessity or expediency because it was necessary for it to get rid of the minority shareholders, who were undisputedly creating hurdles in the smooth working of the company. Therefore, the payments were made to the shareholders to secure

smooth running of the company and avoiding its possible winding up under the provisions of section 397 and section 398 read with section 402 of the Companies Act, 1956. Now the question arises whether such settlement or compromise between the two warring groups was in the interests of the company as well as of public or it was only in the interest of the warring groups. In the commentary of Ramaiah on Company Law it is clearly mentioned with reference to case-laws that where a compromise or settlement is shown to have been arrived at between the parties to the proceedings under section 397 and 398 of the Companies Act, as is in the present case, the court has to consider whether such settlement was in the interests of the company as well as in public interest and if it is not so, the court is not bound to accept and record the same (*Shanti Prasad Jain v. Union of India* (1973) 75 Bom LR 778 and *Syed Mohd. Ali v. R. Sundaramurthi* (supra)). While considering such compromise it was held in the case of *Syed Mohd. Ali v. Sundaramurthi* (supra) that proceedings under section 397 and 398 of the Companies Act are not like a suit between private parties which may be compromised in any manner they choose. The interests of the company are of paramount importance and the proceedings should not be conceived as a mere dispute between individuals. The commentary further mentions that the court may accept a compromise which is in the larger interest of the company or in public interest even though it may not be in the interest of the majority shareholders. It is further observed that a notice had to be issued to the Government to ensure the prime interest of the company and public. Therefore, the Rajasthan High Court in the case of *Sadul Textiles Ltd. v. Raja Textiles Ltd.* (1978) Tax LR 2119 held that the court will not accept any compromise or adjustment between the parties without also notifying the Government under section 400.29. From the case-laws referred to in the said commentary, it is amply clear that while accepting the compromise or settlement between the two warring groups, for a proceeding under sections 397 and 398 of the Companies Act, 1956, the court will keep in mind the prime interest of the company as well as public interest. Therefore, to say that the interest of only two warring groups has been kept in mind is not correct. It is difficult to contribute or accept the view canvassed by the revenue that the assessee has obtained any right or advantage which would affect its capital structure. The settlement in this regard, as pointed out earlier, was that as a result

of the compromise the assessee acquired the shares and the share capital was reduced. Now this aspect of the matter, as we have stated earlier, merely represented the mode of settlement and it cannot, therefore, be the test to be applied to determine the question whether the assessee derived any benefit on capital account. In fact, the assessee had got rid of the disadvantageous relationship which resulted as a result of disputes between the two warring groups of shareholders. The Supreme Court had occasion to consider similar controversy in the case of CIT v. Ashok Leyland Ltd. : [1972]86ITR549(SC) in which the Apex Court has held that the principles which flow from the above cited decisions clearly suggest firstly that the enduring benefit in itself is not a conclusive test. Secondly, it is necessary to consider whether the enduring advantage consisted merely in facilitating the assessee's operation or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, then such expenditure would be on revenue account. Thirdly, the question must be viewed in a larger context or business necessity or expediency. Having regard to the above test in the case of Empire Jute Co. Ltd. (supra), the point which would arise for consideration would be whether the expenditure incurred for getting rid of the minority shareholders, who were creating difficulties, would be an expenditure on revenue account. The authorities relied upon by the learned counsel for the assessee show that payment made to secure peace and harmony and smooth management of the company, the interest of business would serve and that is the whole purpose of such payment. Therefore, the amount paid for this purpose was on revenue account. Applying those principles, the position to our mind is clear that by getting rid of the minority shareholders, the company could not be said to have acquired any enduring benefit. Secondly, even if it is assumed that an enduring benefit has been obtained, even then such enduring benefit is not relatable to fixed capital structure of the company because it has neither increased the assessee's assets nor the company could be said to have acquired any right of income yielding nature. The act of writing off of share capital by way of reduction, may, on the first blush, suggest that the capital structure of the company has been affected, but it is not so if the facts are examined a little more closely. The reduction of the share capital was merely a consequence of the agreement which has to be given effect

to, that too by an order of the court where the interest of the company as well as of the public has to be necessarily kept in mind. Thus writing off of share capital by way of reduction as per the terms of consent decree merely was a consequential action and did not itself represent any effect on the capital structure or the acquisition of any right yielding income or advantage on capital account. Therefore, we have no hesitation in holding that the impugned expenditure, which was incurred in order to facilitate the smooth running of the business by getting rid of the recalcitrant group of shareholders, was an expenditure incurred out of business expediency and, therefore, wholly and exclusively incurred in the course of carrying on of the business. Similar issue came up for consideration before the Tribunal in the case of Atul Chemicals Industries Ltd. (supra) wherein the Tribunal considering the earlier decision in the case of Inland revenue v. Carron Co. 45 Tax Cases 18 and other cases, came to the same conclusion. The learned Departmental Representative has pointed out that a reference has been granted against the said decision. Therefore, it was pleaded that it has not reached finality. So far as this contention of the learned Departmental Representative is concerned, we are of the opinion that merely granting a reference of the question will not show that the decision is wrong. Unless it is disturbed, it is a sound decision, especially keeping in view the purpose of sections 397 and 398 of the Companies Act, 1956.³⁰ The learned Departmental Representative has relied on several decisions to contend that if the expenditure incurred is for domestic quarrel, where ultimately a settlement has been arrived at in which assets were distributed, in such situation the expenditure cannot be treated as a business expenditure. The decisions relied upon are

(1) Punjab State Industrial Development Corporation Ltd. v. CIT (supra);

(2) Broke Bond India Ltd. v. CIT (supra); CIT v. Kodak India Ltd. (supra); Premier Construction Co. Ltd. v. CIT (supra) and Dalmia Dadri Cement Ltd. v. CIT (supra). We have given our careful consideration to the ratio laid down in those cases. In the case of Punjab State Industrial Development Corporation Ltd. (supra) the question was the allowability of the fees paid to the Registrar of Companies for expansion of the company's capital base and the same was held to be directly related to the capital expenditure incurred by the company. In the case of Brooke

Bond India Ltd. and Kodak India Ltd. (supra), similar expenditure incurred in connection with the issue of shares with a view to increase the share capital relating to the expansion of the capital base, was the issue before the Hon'ble Supreme Court and in that connection the Apex Court has held that the expenditure incurred was capital in nature. However, the facts of the present case are distinguishable. Here there is no such question. Similarly in the case of Premier Construction Co. Ltd. (supra), there was a litigation between the shareholders and the Board of Directors of the company in which the assessee had incurred an expenditure for litigation. In that circumstances, the Bombay High Court has held that where the expenditure incurred by the company was for defending the suit in trial court that was allowable under section 10(2)(xv) of the 1922 Act. However, it was held that where the expenditure was incurred to defend the appeal relating to a matter concerning the shareholders and the Board it was not allowable. The facts of the present case are also not akin to the facts of that case. Similarly in the case of Dalmia Dadri Cement Ltd. v. CIT (supra) the question was implementation of scheme of gratuity for its employees and the expenditure was incurred in that connection. Here the Delhi High Court has taken the view that it is not allowable as a business expenditure. The facts of that case are not identical to the facts of the present case. Therefore, the ratio laid down in those cases is not applicable to the facts of the present case. The learned Departmental Representative also relied on the decision of the Calcutta High Court in the case of Albert David Ltd. v. CIT : [1981]131ITR192(Cal) In that case the personal right and title of certain shareholders in third party was the subject-matter of appeal. In those circumstances, a view was taken that the expenditure was not allocable. The facts of the present case are distinguishable from the facts of that case.³¹ The learned counsel for the assessee has prepared a chart showing that after the settlement, the financial position of the company has improved. This fact is clear from the annual report of the company appearing at pages 18 to 36 of the paper book, which shows that the profits of the company, which were going down, improved considerably. Therefore, from this angle also it is clear that the expenditure incurred was for the benefit and smooth functioning of the assessee-company. Taking into consideration the totality of the facts and circumstances of the case, we are of the considered opinion that the decision of the Tribunal in the

case of M/s Atul Chemical Industries Ltd. (supra) is in all fours, Therefore, we agree that the assessee-company had incurred the impugned expenditure out of business expediency and for its smooth functioning, which was wholly and exclusively incurred in the course of carrying on of its business. Hence, it is an allowable revenue expenditure. Accordingly, the order of the Commissioner (Appeals) on this issue is set aside and the assessing officer is directed to allow the impugned amount.³² In the result, the appeal filed by the revenue is dismissed while that filed by the assessee is partly allowed.

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