

**South Asia Industries (P.) Ltd. Vs. Commissioner of Income-tax, Delhi (Central)**

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**Court :** Delhi

**Decided On :** Feb-18-1981

**Reported in :** ILR1981Delhi196

**Judge :** Leila Seth and; S. Ranganathan, JJ.

**Acts :** [Income Tax Act, 1922](#) - Sections 10(2)

**Appeal No. :** Income-tax Reference No. 69 of 1972

**Appellant :** South Asia Industries (P.) Ltd.

**Respondent :** Commissioner of Income-tax, Delhi (Central)

**Judgement :**

Leila Seth, J.

1. At the instance of the assessed, the income-tax Appellate Tribunal has referred for our opinion the following questions of law :

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that Rs. 45,088 incurred on account of commission of inquiry expenses is not allowable as revenue expenditure

2. Whether, on the facts and in the circumstances of the case the amount of Rs. 19,170 on account of expenses of the law department could be allowed as deduction in determining the company's profits ?'

2. The assessed is a private limited company belonging to a group of companies controlled by Mrs. R. Dalmia. The assessment year with which we are concerned is 1958-59 and the corresponding previous year is the year ending March 31, 1958.

3. On December 11, 1956, the Govt. of India (Ministry of Finance, Dept of Economic Affairs), in exercise of the power under s. 3 of the Commissions of Inquiry Act, 1952, appointed a Commission of Inquiry to report, inter alia, on the administration of the affairs of the companies specified in the Schedule (the assessed being at Serial No. 3 of the Schedule) and the nature extent of the control of certain person or their relatives or employees in such companies (Mr. Ram Krishna Dalmia being one of the person mentioned in this connection). The Commission was also to inquire into the nature and extent of the investment by and/or loans to and/or for the use of the funds or assets by/and transfer of funds between the companies mentioned in the Schedule; as also the consequences of such investment and transactions and/or reason and motives and their bona fides; the extent of losses suffered by the investing public and the extent and nature of gains made by the person or groups; any irregularity, fraud or breach of trust.

4. This Commission which came to be popularly known as : 'the Vivian Bose Commission' investigated the matter and submitted its report sometime in the third week of January, 1963, which was not favorable. The assessed incurred expenses, in connection with this investigation, amounting to Rs. 45,088 in the accounting

period relevant to the assessment year 1958-59, and claimed the same as an allowable deduction.

5. The ITO rejected the claim of the assessed holding that these expenses were to incurred in connection with or in respect of carrying on the business of the company. The AAC confirmed this disallowance and the Income-tax Appellate Tribunal held that the expenditure was not as allowable business expenditure especially as a similar claim for the earlier year has been rejected. Distinguishing the decision in CIT v. Dhanrajiriji Raja : [1970]77ITR318(AP) , relied on by the assessed, the Tribunal held that such an inquiry could not be considered as a normal hazard of an honest businessman and the expenditure incurred could not be treated as normal business expenditure. The expenditure in the present case having been incurred in connection with an inquiry which was with respect to certain allegation involving acts against public policy on behalf of the members of the groups.

6. Mr. Bishamber Lal, learned counsel for the assessed, however, has contended that, in fact, the expenses incurred with regard to the Commission of Inquiry were expenses incidental to the business and necessitated by commercial expediency. they were incurred for the preservation and the protection of the assessed's business.

7. We find merit in his contention. The notification appointing the Commission of Inquiry specifically required the Commission to inquire into and report in respect of the administration of the affairs of the companies specified in the Schedule thereto. As noticed above, the assessed was indicated in the Schedule at item No. 3 as Lahore Electric Supply Company Ltd. (now known as South Asia Industries Ltd.). In fact, the Schedule mentioned nine companies which included Dalmia Jain Aviation Ltd. (now known as Asia Udyog Ltd.), Allen Berry Co. Ltd. and Bharat Union Agencies Ltd.

8. It appears that after the Commission has been appointed, the principal officer of the assessed was required by the secretary of the Commission, by his letter of May 3, 1957, to produce certain documents.

9. Mr. R. Dalmia, Mr. Jaidayal Dalmia, Mr. Shanti Prasad Jain and Mr. Sriyans Prasad Jain individually wrote to the assessed and the other three companies noticed above, that all the expenses, legal or otherwise, incurred in connection with or relating to the Commission of Inquiry should be borne by the three companies and assessed, as their names were being associated and/or connected with the companies.

10. On October 28, 1957, the board of directors of the assessed resolved that the said expenses would be incurred by the four companies above mentioned proportionately. The total expenditure incurred during the accounting year for legal fees, hotel expenses, traveling expenses in this connection was Rs. 1,80,351. This amount was divided into four equal amount and debited to M/s. Bharat Union Agencies Ltd. Allen Berry & co., Asia Udyog (P.) Ltd., and the assessed. It was as a result of the above mentioned resolution and apportionment that the amount of Rs. 45,088 was allocated to the assessed.

11. In CIT v. Birla Cotton, Spinning and Weaving Mills Ltd. : [1971]82ITR166(SC) , the Supreme court has observed that it is well settled that the deductibility of an expenditure in prosecuting a civil proceeding does not depend on the final outcome of the proceedings, but on whether it is honestly incurred to promote the interest of the business. The court opined that (p. 171) :

'The essential test which has to be applied is whether the expenses were incurred for the preservation and protection of the assessed's business form 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.'

12. In that case the expenditure was incurred in proceedings before the Taxation on Income (Investigation Commission) which was not a civil proceeding, but a statutory proceedings intended for collecting information. However, the Supreme Court opined that as the Commission was holding an investigation on a suspected escapement of income to the tune of Rs. 4 crores, which the assessed felt was unlawful, it was justified in taking proper steps to prevent it from the payment of the onerous and crippling taxes and

penalties. The monies spent on lawyers, fees, etc., was expenditure honestly incurred to preserve the business from the coercive legislation and the objective was the saving of taxation. It was, therefore, justified by commercial expediency, and allowable under s. 10(2)(xv) of the Indian I.T. Act, 1922.

13. It would appear to use that in the present case, the money spent in connection with the investigation by the Commission of Inquiry was expenditure honestly incurred for the preservation and protection of the assessed's business. A Commission of Inquiry into the administration of the affairs of the assessed has been ordered. The assessed had been required by the Secretary of the Commission to produce certain documents. The assessed could not sit tight but in its own interest has to respond and co-operate with the Commission of Inquiry. This was necessary to protect its reputation and its business. If the assessed did not take steps to protect its reputation, the value of its shares might have plummeted to an all-time low. The assessed was the best judge of how to preserve and protect its assets and interest and it did so with the help of lawyers, etc. It is not a case of payment of penalty for an infraction of the law but an inquiry not only against certain individuals or groups who were connected and has to be defended but also an inquiry into the administration of the affairs of the assessed. All irregularities in respect of the companies and the firms whose affairs were being investigated were being gone into by the Commission of Inquiry. The Affairs of the assessed and the individuals were interlinked and it would appear that the assessed honestly incurred the expenditure in order to preserve and protect its business. The ultimate decision of the Commission of Inquiry was not material. This entire aspect of the matter has been totally ignored by the Income-tax Appellate Tribunal.

14. It is also necessary in this connection to notice a few relevant decisions. In CIT v. Dhanrajgirji Raja Narsingiriji : [1973]91ITR544(SC) , the Supreme Court (this part of the decision of the Andhra Pradesh High Court in CIT v. Dhanrajgiriji Raja : [1970]77ITR318(AP) being affirmed) while dealing with a case, where the assessed resorted to civil and criminal litigation against an associate, held that no distinction can be made between civil and criminal litigation if it is incurred for the purpose of the business. It further opined at p. 550 :

'The contention that, as the Government was conducting the prosecution, there was no necessity for the assessed to engage his own lawyers is not substantial. It was for the assessed to decide how best to protect his own interest. It was the duty of the assessed to see that the prosecution was properly conducted. He was interested in successfully prosecuting the case. The fact that he did not leave the carriage of the case in the hands of the prosecuting agency of the Government is no ground for disallowing the expenditure. It is not open to the department to prescribe what expenditure an assessed should incur and in what circumstances he should incur that expenditure. Every businessman knows his interest best.'

15. We will not advert to numerous other decisions of various High Courts but refer only to the decision in Parshva Properties Ltd. v. CIT : [1976]104ITR631(Cal) of the Calcutta High Court, where the expenditure incurred was for defending a director, agent and manager of the company who were being criminally prosecuted for violating certain regulations with regard to the working of a mine. In that case, Sabyasachi Mukharji J., who spoke for the court, referred to a catena of cases in connection with the deductibility of expenditure incurred for defending criminal and other prosecutions. The learned judge started with the Supreme Court decisions in CIT v. H Hirjee : [1953]23ITR427(SC) , Haji Aziz and Abdul Shakoor Bros. v. CIT : 1983ECR1942D(SC) , Sree Meenakshi Mills Ltd. v. CIT : [1967]63ITR207(SC) and CIT v. Dhanrajgirji Raja Narasingiriji : [1973]91ITR544(SC) (noticed earlier) and when on to deal with the various decisions of the High Courts including a decisions of this court in CIT v. Chaman Lal and Bros. ITR 383. From these decisions he has culled out the principles that emerge at p. 641 as follows :

'(1) The question of deductibility of expenditure of this nature must depend on the purpose and nature of the expenditure incurred, (2) in order to determine whether the expenditure was deductible or not, it is necessary to find out in what capacity the expenditure was incurred, (3) the ultimate result or decision in which the expenses were incurred does not in any way affect the question of allowability of the expenditure. The aim and purpose of incurring the expenditure should also be examined, and (4) but a penalty for not following the

law is not an expenditure which can be said to be incurred by the assessed in the course of his business.'

16. Applying these principles to the present case, it is apparent from what has been stated earlier that the aim of incurring the expenditure was motivated by commercial expediency and the purpose was to protect the credit of the company and its assets. The money was spent for sale guarding and saving the business and keeping it on a sound footing. The expenses were incurred by the assessed in its business or trading capacity and were for the purpose of the business and not for the payment of a penalty for an infraction of the law.

For the reason outlined above, it would appear to us that the expenses incurred by the assessed on account of the Commission of Inquiry were an allowable business expenditure.

With regard to the second question, it is the admitted case that the sum of Rs. 19,170 was spent by the law department of the assessed in connection with the Commission of Inquiry. The ITO has disallowed this amount on the same basis as the expenditure of Rs. 45,088 and the AAC and the Tribunal has affirmed the disallowance. Since we have held that the assessed honestly incurred the expenditure of Rs. 45,088 to safeguard its interest before the Commission and to preserve and protect its reputation and business, this amount which was expended by its law department must also be allowed.

17. In the result, questions No. 1 is answered in the negative and in favor of the assessed. Question No. 2 is answered in the affirmative and in favor of the assessed. The assessed will be entitled to its costs. Counsel, s fee is Rs. 300.

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