

Escorts Ltd. Vs. Inspecting Assistant

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Sep-05-2000

Judge : V Dongzathang, D Singh

Appellant : Escorts Ltd.

Respondent : inspecting Assistant

Judgement :

1. to 12.[These paras are not reproduced here as they involve minor issues] 12. In ground No. 2(b), the challenge is posed by the assessee to maintaining the disallowance of Rs. 1,65,425 by the CIT(A) on account of legal and professional charges paid to M/s. J.B. Dadachandji holding that it is not connected with the business of the company.

13. We have heard the rival submissions. It is seen that the assessee paid an amount of Rs. 1,65,525 to M/s. Dadachandji & Co. solicitors in connection with registration of shares by non-resident companies of Mr.

Swaraj Paul. The assessee was requested to indicate how this expenditure could be related to carrying on the business. In its letter dated 30-6-1986, the assessee stated that the company had to secure opinion on the circulars issued by the RBI in connection with the investment to be made by the non-residents, registration of shares in their names and in connection with the writ filed by the company in the Bombay High Court challenging the legality of such registration. The Assessing Officer was of the opinion that :-- "Section 37 requires that expenditure must be

incurred or laid out wholly and exclusively for the purposes of assessee's business. The expression "for the purposes of business" though is wider than the expression "for the purposes of earning profit" and it covers not only the running of the business or its administration but also the measures for preservation of business and protection of its assets and property. It cannot be so wide as to take within its sweep any other expenditure having no direct or proximate nexus with running of such business. The nexus had to be established between the expenditure incurred and the activity undertaken by the assessee which nexus is wanting in the present case. Registration of shares in the name of non-resident or in the name of somebody else does not affect in any way the running of assessee's business. As far as the company is concerned, its share capital would remain the same whether such capital is held by 'A' or 'B'. The conflict as is well known was between Shri H.P. Nanda, Managing Director and Chairman Shri Swaraj Paul and the attempt of the latter was to grasp the hold on the assessee-company. In that connection, some expenditure was incurred and for that matter, as far as the company is concerned, such expenditure cannot be said to have been incurred for its business. I, therefore, disallow the assessee's claim." 14. Aggrieved by this, the assessee went in appeal before the CIT(A) who discussed it on pages 12 to 18 of his order. Relying on the decision of the Supreme Court in LIC of India v. Escorts Ltd. AIR 1986 (SC) 1370 wherein their Lordships held :-- 'We do not see why the company Escorts Ltd. should be mulcted with costs. The litigation was launched by Mr. Nanda and he should be personally made liable for the costs.' 15. Still aggrieved by the order of the first appellate authority, the assessee is in appeal before us.

16. It was submitted on behalf of the authorised representative of the assessee that as a corporate entity doing business in India, it had to adhere to the laws of the land as there are a multiplicity of laws on various aspects of running a company and business in India and for the same help of legal, financial and technical experts has to be sought from time to time. It was also the submission that the costs in question are with regard to opinions, meetings and conferences obtained by the company through their solicitors M/s. J.B. Dadachandji & Co. who in turn engaged Senior counsels such as Mr. N.A. Palkiwallah, R.F.Nariman, Prof. Ved Vyas etc. The copies of their bills have been placed before us from pages 91

to 96 of the Paper Book on record. It was also his submission that under the laws of the land as per the foreign exchange manual under Section 29(1)(b) of FERA 1973, no person resident outside India whether an individual, firm or company incorporated outside India can acquire shares of any company carrying on trading, commercial or industrial activity in India without the prior permission of the RBI. Also under Section 19(1)(6) and 19(1)(d), the transfer and issue of any security which includes the shares in favour of or to a person resident outside India require the prior permission of the RBI. Attention was also drawn to Section 19(4) FERA which lays down that :-- "Notwithstanding anything contained in any other law no person shall except with the permission of the RBI; (a) Enter any transfer or securities in any register or books in which securities are registered or inscribed or he has ground for suspecting that the transfer involves any contravention of the provision of this section." The authorised representative of the assessee submitted that any person contravening Section 19(4) of the FERA 1973 under Section 50 "... shall be liable to such penalty not exceeding five times the amounts or value involved in any such contravention". Besides this, under Section 56, he is liable for imprisonment for a term which shall not be less than six months but which may extend to 7 years with fine. A reference was also made to the judgment of the S.C. relied upon by the CIT(A) in denying the relief to the assessee wherein at page 1391, the total amount of non-resident fund spent for purchasing Escorts Ltd. shares was Rs. 6.33 crores and in case, the penalty fine as above had levied on Escorts Ltd., the above would have been to the tune of Rs. 31.65 crore which is more than twice the share capital of the company which is at Rs. 14.17 crores. The total net worth of the company is Rs. 51.39 crores and if it had to pay a fine of Rs. 31.65 crores, the whole business of the company would have come to a standstill, apart from the humiliation of the company in which its top management would have been imprisoned between six months to 7 years. Therefore, it was his submission that the expenses were incurred to seek legal opinion to help the assessee-company to do business in a legal manner and not in contravention of any laws of the land and as such, the expenses are legitimate business expenditure allowable under Section 37 of the Income-tax Act. It is further submitted that the suspicion of the company was raised that the Caparo Group had not taken the prior permission of the RBI and the investment proposition was

in contravention of the provisions of FERA 1973 Sections 29(1)(B), 19(1)(d) and 19(4) were confirmed by the Government of India through their legal department and the same was reported by their Lordships of the Supreme Court in LIC of India's case (supra) para 39 of page 1387 of the judgment. He submitted that the controversy was raised that the RBI who agreed with the company that these non-resident investors did not have the prior permission and therefore acquisition of shares was against the law of the land. It was only later that the Government of India retrospectively changed the law to give ex-post-facto approval to this acquisition. Therefore, it was his argument that the crux of the matter is whether Escorts Ltd. i.e. assessee-company was within its rights as a good businessman doing business in India to seek legal opinion on such serious matters which would have shut the company down for the contravention of FERA 1973. It was his submission that the Hon'ble Supreme Court itself recognised this aspect of the matter and did set aside this issue "as to whether these purchases by the Caparo Group was within the laws or not ?" For this, reference was made to page 1427 para 111 of the judgment wherein their Lordships stated ;-- "Setting aside the judgment of High Court we direct the RBI to make a full and detailed inquiry into the purchase of shares of Escorts Ltd. by the Caparo Group of Companies and considered afresh the question whether permission ought or ought not to have been granted." 17. & 18. Their Lordships of the Supreme Court in regard to the various dealers through whom these purchases were made held in para 112 : "We also direct the RBI to inquire into the conduct of P.N.B. and take such action as may be necessary including cancellation of the authorisation granted under Section 6 of the Foreign Exchange Regulation Act." 19. Therefore, it was his submission that the Hon'ble Supreme Court vindicated the stand of the company and upheld its bona fide belief that there was something wrong with these purchases and detailed inquiry was necessitated by the RBI. Therefore, it was his argument that what action the company should take and whether they were entitled to refuse registration, what were its obligations under FERA were important questions which the company's internal department was ill-equipped to answer. For this purpose, the company sought legal opinion from legal luminaries and their Jurists through their solicitors M/s. J.B. Dadachandji & Co. further, it was his submission that even the Hon'ble Supreme Court to some extent reversed the

decision of the Hon'ble Bombay High Court which is one of the premier judicial institutions of the country and the Bombay High Court had upheld all the pleas of the assessee which only goes to show that the assessee's litigation and its seeking of opinion was bona fide.

20. Reliance was placed on the following authorities in support of its submission that the legal expenses deserved to be allowed :-- 1. CIT v. Birla Cotton Spg. & Wvg. Mills Ltd. [1971] 82 ITR 166 wherein their Lordships held that the Supreme Court held :-- "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 convictions, 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 reasonable and honestly incurred to promote the interests of the business." 21. Reliance was placed on the decision of the Jurisdictional High Court in South Asia Industries (P.) Ltd. v. CIT [1981] 132 ITR 144 (Delhi) and on the decision of the Punjab & Haryana High Court in Atlas Cycle Industries Ltd. v. CIT [1990] 181 ITR 18 and CIT v. Patiala Flour Mills Co. (P.) Ltd [1989] 180 ITR 75.

22. The authorised representative of the assessee thereafter made the submissions on the point of what the Hon'ble Supreme Court meant by the passage reproduced twice by the learned CIT(A). The "costs" spoken of by the Hon'ble Supreme Court are the costs which are taxed under the Supreme Court Rules by the Jt. Registrar of the Supreme Court. A reference was made to pages 97-99 of the Paper Book before us wherein the order passed by the Jt. Registrar on 24-9-1986 is included and it was the submission of the authorised representative of the assessee that the same were not paid by the company but by Mr. H.B. Nanda. For this reference was made by letter dated 26-4-1989 on pages 100-101 of the Paper Book. He submitted that all these took place much beyond the previous year ended 31-3-1983. Therefore, the "costs" awarded by the Hon'ble Supreme Court against Mr. H.P. Nanda were paid by him and not borne by the company that is also many years subsequent to the previous year relevant to the assessment year 1984-85. The costs referred to by the Hon'ble Supreme Court are not the consultation fees etc. paid to the Sr. Counsels while obtaining their

opinion.

23. Ld. DR, on the other hand, submitted that the dispute was between the two groups of shareholders and it had nothing to do with the business of the assessee-company and legal expenses incurred by the company for settling the disputes between the two shareholders were not allowable expenditure under Section 37 of the Income-tax Act. He placed reliance on the orders of the authorities below. To support its contention that such expenses are not incurred wholly and exclusively for the business purposes, reliance was placed on the following authorities :-- 1. *Albert David Ltd. v. CIT* [1981] 131 ITR 192 (Cal.) wherein it was held that the litigation was relating the offshoot of the disputes and quarrels between the two groups over the control of the assessee. The assessee-company was used as a spring board. It cannot be said that in the litigation the company was only seeking to preserve its book debts as business asset. It does not appear that the business exigencies required the assessee-company to file the suit. Hence, the expenses claimed are not allowable.

2. *Premier Construction Co. Ltd. v. CIT* [1966] 62 ITR 176 (Bom.) wherein their Lordships held that the expenses were not allowable as the litigation related to a matter which concerned the shareholders and the Board. Expenses were not incurred for carrying on the business of the company. Reliance was also placed on *CIT v. Shiwalik Talkies Ltd.* [1967] 63 ITR 83 (Punj.) wherein their Lordships held that expenditure incurred in resisting a suit by the shareholders questioning the appointment of some of the Directors cannot be considered to be an expenditure laid down or expended wholly and exclusively for the purposes of the company and therefore not allowable.

24. It was also his submission that the case laws relied upon by the counsel of the assessee were distinguishable on facts :-- (1) In *South Asia Industries (P.) Ltd. 's* case (supra) the expenses were incurred for the commission of inquiry appointed to inquire into administrative affairs of the company.

(2) *CIT v. Loke Nath & Co. (Construction)* [1984] 147 ITR 624 (Delhi) Expenses incurred on account of compensation paid by assessee to Municipality for deviations made from original plan of construction.

(3) Patiala Flour Mills Co. (P.) Ltd's case (supra) Litigation expenses were incurred to force the underwriter to subscribe the shares underwritten as agreed upon.

25. The authorised representative of the assessee in reply submitted that the main reliance of the Ld. DR has been on the case of Calcutta High Court in Albert David Ltd's case (supra), the facts of which case were slightly different. Their Lordships of the Calcutta High Court held at page 197 thereof:-- "The Tribunal after considering the respective submissions of the parties and various decisions cited before it held that it should not be incurred nor established that the expenditure in question were incurred by the assessee bona fide and exclusively for its business. The Tribunal held further that the ultimate reason for incurring such expenditure was the litigation between the rival groups which did not jeopardise the business of the assessee." 26. The finding of the Tribunal has been upheld by the Calcutta High Court referred to on page 203. It was submitted in the present case that no existing Director has been ousted. The expenses have been incurred in getting legal advice and opinion as to whether the company should register the shares which have come for transfer belonging to a nonresident without permission of the RBI. Whether these shares have been purchased in contravention of Section 29(1)(6) of the FERA and the company was duly bound to refuse transfer even if its suspicions were raised in accordance with Section 19(4) of FERA. Therefore, it was his submission that as per the facts of the case, it was first upheld in toto by the Hon'ble Bombay High Court and then partially by this Hon'ble Supreme Court. Accordingly, the assessee's suspicions were bona fide. It was his submission that the Hon'ble Bombay High Court had actually struck down the transfer completely and held that RBI could not give ex-post facto permission where prior permission was required.

The Hon'ble Supreme Court upheld the right of the Government to retrospectively amend the law and even give ex-post facto permission under Section 29(1)(b), yet it indirectly held that the suspicions of the company were correct and the RBI needed to do a detailed investigation and inquiry into the whole matter of the acquisition of shares by the Caparo Group of Companies.

27. Reliance was also placed on CIT v. Indo Burmah Petroleum Co. Ltd. [1983] 142 ITR 141 (Cal). In this, the suits had been filed by shareholders and another company against the assessee-company, their managing agents, chairman and director. In the suits, there were allegation of mismanagement for personal benefits by the Chairman and the managing agents. The suits were defended by the company and litigation expenses were also incurred by the company. The Calcutta High Court after considering the previous judgment relied upon by the Id. DR in Albert David Ltd v. CIT 131 ITR 192 held the legal expenses to be allowable expenditure. Further, the Calcutta High Court in the case of Ananda Marga Pracharaka Sangha v. CIT [1994] 76 Taxman 88 held that where legal expenses were incurred by the assessee association for defending its President against criminal charges, the same were allowable as business deduction while computing the income of the assessee association under Section 37 of the Income-tax Act.

28. After hearing the rival submissions addressed at length by both the parties and the case law relied upon as well as the material placed on record before us, we are of the opinion that in the facts and circumstances of the case, the ground raised by the assessee deserves to be allowed. We have come to this conclusion for the reason that whatever may have been the outcome of the case before the Supreme Court, there is no doubt that there was distinctly a suspicion and apprehension and a bona fide belief on the part of the assessee that there were certain provisions of the FERA which were being violated and the legal opinion sought by the assessee was in order to ensure that the assessee-company was not visited by the penal consequences for violating the provisions of FERA and the legal expenses incurred by the company were to discharge its lawful duties within the framework of the Constitution and the laws of this land. In the facts and circumstances of the case before us, there was a genuine apprehension/suspicion in the mind of the assessee that the violation of any of these provisions would have resulted in huge financial liabilities and also prosecution of its management. The expenditure is incurred to protect its existing business and assumed the character of revenue expenditure. Coming to the direction of the Hon'ble Supreme Court that the assessee-company should not be mulctated with the 'costs' of this litigation here, we are of the opinion that the costs which were discussed by the Hon'ble Supreme Court were the costs within the meaning of the provisions of the

Supreme Court rules and not the professional bills raised by the solicitors of the assessee-company and the opinion sought by it on various aspects of the case. It may be pertinent to state here that the Supreme Court Rules, 1966 were framed by virtue of Article 154(1) of the Constitution of India by the Supreme Court.

29 to 158. [These paras are not reproduced here as they involve minor issues.]

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