(1987) 04 KL CK 0037

In the High Court Of Kerala

Case No : ITR No. 105 of 1983

Commissioner of Income Tax — APPELLANT

Vs

Commonwealth Trust Ltd. — RESPONDENT

Date of Decision : 10-04-1987

Acts Referred:
Income Tax Act, 1961 — Section 29, 37

Citation : (1987) 66 CTR 26 : (1986) 2 ILR (Ker) 556

Hon'ble Judges : T. Kochu Thommen, J;K.P. Radhakrishna Menon, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; Jose Joseph, for the Respondent

Judgement

T. Kochu Thommen, J.—The following questions have been, at the instance of the Revenue referred to us by the Income Tax Appellate Tribunal, Cochin Bench:

"1. Whether, on the facts and in the circumstances of this case, the Tribunal is right in holding that-

(a) the payments were in the course of business ;

(b) the payments did not arise out of any transfer of the business;

(c) the expenditure was incurred to protect the business ?

2. If the answer to the above question is in the affirmative, whether the expenditure, being for a substantial change in the capital structure which resulted in changing the ownership of the business, is a revenue expenditure ?

3. Whether, on the facts and in the circumstances of the case, the ''dilution expenses'' are an admissible deduction ?"

2. During the accounting year relevant to the assessment year 1978-79, the assessee-company which was a non-resident company expended Rs. 1,38,520 for payment to I.C.I.C.L., M/s. Billimoria & Co., and M/s. Menon & Menon for professional services rendered in regard to the steps taken for compliance with

Section 29 and other provisions of the Foreign Exchange Regulation Act, 1973. This expenditure is referred to by the assessee as "dilution expenses" for Indianisation of the foreign holding as required under the said Act. The assessee claimed this amount as business expenditure deductible u/s 37 of the Income Tax Act, 1961, The claim was disallowed by the officer on the ground that the so called "dilution expenses" were incurred for the purpose of transfer of equity capital held by foreign citizens to Indian citizens and such expenditure was capital expenditure and, therefore, not deductible as business expenditure. This finding was confirmed by the Commissioner of Income Tax (Appeals). He held that the expenditure directly related to the capital structure of the company and was not business expenditure. On further appeal by the assessee, the Tribunal, relying upon certain decisions, particularly the decision of the Supreme Court in Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna, , came to the conclusion, which in our view was totally unwarranted, that the expenditure in question was a business loss and not a capital expenditure. What the Supreme Court stated was that, if litigation expenditure was incurred to create or cure or perfect the assessee''s title to capital, it was capital expenditure ; whereas if such expenditure was incurred to protect the business of the assessee, it would be deductible as a business expenditure. The former, and not the latter, is the position in the present case.

3. On the admitted facts, the expenditure was incurred for the purpose of changing the capital structure of the company to suit the requirements of the Foreign Exchange Regulation Act, 1973, by obtaining the shares held by foreigners and transferring them to Indian citizens thereby converting what was a non-resident company to a resident company. The structure, character and status of the company changed by this expenditure. The expenditure was incurred for creating or curing or perfecting title to the share capital of the company in accordance with the requirements of the statute and not for the protection of the business of the company. The expenditure, in our view, was undoubtedly capital expenditure and, therefore, not deductible as a business expenditure. In the circumstances, we answer question No. 3 in the negative, that is, in favour of the Revenue and against the assessee. The other questions, in the light of this answer, do not require to be answered, and they are not accordingly answered.

4. We direct the parties to bear their respective costs in this tax referred case.

5. A copy of this judgment under the seal of the High Court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.