
(2007) 02 KAR CK 0042

In the Karnataka High Court

Case No : Income Tax Referred Case No. 739 of 1998

Commissioner of Income Tax

APPELLANT

Vs

MICO Ltd.

RESPONDENT

Date of Decision : 23-02-2007

Acts Referred:

Income Tax Act, 1961 — Section 10 (2) (xv), 37

Citation : (2007) 209 CTR 377

Hon'ble Judges : R. Gururajan, J;N. Ananda, J

Bench : Division Bench

Advocate : M.V. Seshachala, for the Appellant; Dastur . for King and Patridge, for the Respondent

Judgement

1. The assessee company entered into an agreement with Ghaziabad Engineering Company Private Ltd., on 9-2-1977 to get some services rendered by them for which the assessee had to pay a consideration of Rs. 5,50,000/- per year. The tenure of the contract was two years and fees had to be made in advance. The first installment was payable on 19-2-1977 and the second, a year after. Thereafter deduction was claimed by the assessee relating to the second installment as it fell during the period of account. Disallowance was made in the assessment on the ground that there was No. supporting evidence proving performance of the contract by GEC. The tribunal noticed on an earlier occasion this very issue and remitted the matter back to the commissioner for reconsideration. The remand is for the reasons mentioned in detail in the order of the tribunal. The tribunal did not accept the contention of the assessee. The assessee claimed sum of Rs. 33,00,000/- being the installment payment made to GEC. GEC was the sole distributor for MICO products in certain states of North India and the distribution agreement was for a certain period. Since it was prematurely cancelled by the assessee, the assessee had to agree to pay compensation of Rs. 99,00,000/-payable in installments in triennium, but such installment was payable in the year of account. Assessee paid a compensation of Rs. 99,00,000/-and claimed deduction of the same in the assessment for the

year 1970-79. There was dispute between the assessee and the revenue, not only with regard to allowability of the same for the year 1978-79 but also whether the expenditure could go into the revenue field. The tribunal held that if Rs. 99,00,000/- is allowed as deduction in the assessment year 1978-79 then there could be no deduction in this year and if at all deduction is to be allowed, it would be of the sum of Rs. 33,00,000/- paid in this year. The tribunal in the light of a reference application has chosen to refer the following questions of law in the light of the order passed in RA No. 198/Bang/1995, RA No. 213/bang/1995 and RA No. 214/Bang/1995.

RA No. 198/Bang/1995;

1. Whether on the facts and in the circumstances of the case, the tribunal ought to have held that the expenditure of Rs. 5,50,000/- incurred by the applicant in respect of the amount paid to Ghaziabad Engineering Co. Pvt., Ltd., was deductible in computing the total income?
2. Whether the tribunal erred in not dealing with the alternative contention raised at the time of hearing that if it is held that the aforesaid amount was not for services to be rendered, it would be of the same nature as the sum of Rs. 99,00,000/- paid to GEC and as the same had been allowed, the above amount was also allowable?

RA No. 213 & 214/Bang/1995

3. Whether on the facts and in the circumstances of the case, the appellate tribunal was right allowing depreciation at higher rates on roads and culverts, pipelines (in factory), storage tanks, and all in factory?
 4. Whether on the facts and in the circumstances of the case, the appellate tribunal was right in law in allowing deduction u/s 40A(7) of the Act of a sum of Rs. 10.48 lakhs being the additional liability for gratuity in respect of this assessment year, even though the payment to the fund had been made in March, 1989 i.e., after a lapse of ten years from the end of the relevant previous year and in not following its own earlier order for the assessment year 1978-79 on this issue?
2. The facts regarding the question suggested by the revenue in reference application in RA No. 213 & 214/1995 are as under;
3. Assessee was charging in the books of accounts only the actual consumption of consumable stores and machinery spares to the profit and loss account, but in the accounting year relevant to the assessment year 1979-80, the entire purchase was charged in the books and this also included the opening a took of that year. The explanation offered for the switchover was that the assesses had been experiencing inconvenience in accounting innumerable items involved in consumable stores and machinery spares and that the change in the method was bonafide. The Income Tax Officer did not accept the changing over of charging in the books only actual consumption of consumable stores and machinery spares

and also the new method of valuing finished goods. The Income Tax Officer therefore made additions on the ground that they had caused loss of substantial revenue. In appeal, the Commissioner (Appeals) deleted the additions. On a second appeal by the revenue, the tribunal upheld the order of the Commissioner (Appeals) deleting the additions. It is in these circumstances, revenue is before us by way of reference proceedings.

4. Heard the learned Counsel for the assessee. He would take us through the material on record in support of his submission. He refers to the agreement dtd 9-2-1977. Various clauses are read over to us. He would say that various services have been rendered by the Company and the company had long standing relationship in the matter. He would also say that on an earlier application, the authorities accepted the expenditure of Rs. 2.75 lakhs and the issue of remaining Rs. 2.75 lakhs is not considered as the matter was remanded and the matter is pending decision. In these circumstances, he wants the first question to be answered in favour of the assessee. He would rely on certain judgments in support of his submission. He would say that in the event of the first question being answered in favour of the assessee, there is no need to consider the second question.

5. Sri Seshachala, learned Counsel would support the order and he would say that the tribunal was justified in rejecting the case of the assessee in the absence of any acceptable material by way of evidence. He would say that the claim has to be based on evidence and it cannot be accepted without any evidence on record. He would rely on a couple of judgments.

6. After hearing we have carefully perused the material on record. Material on record would reveal of an agreement between the assessee and the GEC. The said GEC was acting as a sole distributor of for MICO right from 1954. It is also seen from the material on record that MICO wanted to establish its own Sales House in Delhi on the pattern similar to its existing sales house net work in the territories assigned to it under the aforesaid agreements and arrangements and that such replacement would be Implemented in three phases of five years each, the first commencing from February 1972, the second from February 1977 and the third to be completed In February, 1982. The agreement would show that GEC shall, as and when asked for by MICO render to the best of its ability, experience and knowledge advice and guidance to MICO in respect of all matters available with it or in respect of which it has knowledge relating to the marketing of MICO Bosch products In the territories in which it was operating immediately before the 10th Day of February, 1977. Several clauses are provided in the agreement in the matter of services. The agreement provides for payment of Rs. 5,50,000/-to GEC payable annually in advance. The first of such payment is to be made over on 10-2-1978. When this amount was claimed as expenditure, the tribunal in its order would notice that the advice to be given by the GEC has to be in writing. The tribunal noticed that there exists contract. The tribunal also noticed that the income tax officer is entitled to go behind the contract to find

out as to what purpose had been served and how the assessee had received the benefit in terms of the contract. The sum and substance of the finding of the tribunal is for want of evidence with regard to the service provided by GEC, the said claim cannot be accepted. We have elaborately referred to the agreement and the agreement would show the long standing relationship between the parties. In view of the long-standing relationship, advice need not be always in writing as ruled by the tribunal. Oral advice cannot be totally disregarded particularly, in the light of long standing relationship between the parties. In fact the company has mentioned that it had been obtaining oral advices from the GEC. At this stage, it is to be noticed that this very agreement was considered by the tribunal in STA No. 11/Bang/1991. The tribunal after noticing the very agreement and after noticing the availability of the contract has chosen to allow Rs 2.75 lakhs as allowable expenditure u/s 37 of the Act and the said order has become final and the same is not challenged. For the remaining Rs. 2.75 lakhs, the matter is pending consideration. In the given circumstances, we are of the view that a detailed roving enquiry is unnecessary in such cases unless the very agreement is doubted or rejected by the taxing authority. Admittedly, in the case on hand, despite an adverse finding, the tribunal would never say that the agreement is not a bonafide agreement. The agreement is accepted. Once the agreement is accepted, the authorities must be slow in rejecting the contention of the assessee unless a very strong case is made out against the assessee. In the case on hand, as mentioned earlier, longstanding relationship between the parties, the earlier acceptance of Rs. 2.75 lakhs as allowance expenditure in terms of the order of the tribunal and the oral advise, it cannot be said that the said expenditure is not allowable as held by the tribunal. On facts, in the case on hand, we are satisfied that the assessee has placed acceptable material before the tribunal. Rejection of the case of the assessee only on the ground of no evidence particularly in the light of the material produced before the tribunal, is not acceptable to us. Case laws are not wanting in this regard.

7. The revenue strongly relies on the judgment reported in Lachminarayan Madan Lal Vs. Commissioner of Income Tax, West Bengal, . We have seen the facts in the said case. In the said case, the Supreme Court has noticed its earlier decision in Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1), . Thereafter, the Supreme Court would say that the question whether the amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of the assessee's business, profession or vocation has to be decided on the facts and in the light of the circumstances of each case. A mere existence of agreement assuming that there was such payment does not bind the Incomes Tax Officer to hold that the payment was made exclusively and wholly for the purpose of the assessee's business. Although there might be such an agreement in existence and the payment might have been made, it is still open to the Income Tax Officer to consider all the relevant factors and determine for himself whether the remuneration paid to the Employee or any portion thereof is properly deductible u/s 10(2)(xv) of the Income Tax Act.

8. There can be no quarrel over this proposition. There can be some acceptable material in a given case. As mentioned earlier, in the case on hand, the agreement is not in dispute. The earlier order of the tribunal passed accepting Rs. 2.75 lakhs, is not challenged and oral advice is accepted.

9. Revenue also refers to Indian Press Exchange Ltd. Vs. Commissioner of Income Tax, Central-I, . In the said judgment the facts would show that the assessee carried on a business of advertising agency, claimed deduction of the commission paid for procuring business. It was disallowed by the Income Tax Officer. The Appellate Commissioner set aside the Income Tax Officer's order. The tribunal reversed the same. When the order of the tribunal was challenged, the Calcutta High Court noticed on facts that no service was rendered to the Company by the two individuals. The fact that they were supposed to be rendering service at a stage when they were minors was not conclusive but was a relevant piece of evidence. The whole course of conduct had been taken into account specially in the background that there was no written agreement entered into between the assessee and those two persons who were supposed to procure business for the assessee. It was on the facts and circumstances of that case, the Calcutta High Court accepted the order of the tribunal. The judgment of the Calcutta High Court is distinguishable on facts.

10. We would be failing in our duty if we do not refer to the judgment of this Court in the case of this very assessee reported in Commissioner of Income Tax Vs. Motor Industries Co. Ltd., . In the said case also, this very company Division Bench of this Court has chosen to refer to the test prescribed by the Supreme Court in Commissioner of Income Tax, Andhra Pradesh Vs. Dhanrajgiri Raja Narasingirji, as under;

the legal position as stated in the above decisions, can thus be said to be fairly well settled, namely, the commercial expediency of a businessman's decision to incur an expenditure cannot be tested on the touchstone of strict legal liability to incur such an expenditure. Such decisions in the very nature of things have to be taken from a business point of view and have to be respected by the authorities no matter that the transaction is properly entered into as a part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business and it is immaterial that a third party also benefits thereby. But, in every case it is a question of fact whether the expenditure was expended wholly and exclusively for the purpose of the trade or business of the assessee.

The Division Bench also noticed at page 136 as under;

In the instant case the finding returned by the tribunal is that MICO had taken a bonafide commercial decision to make the payment of the amount in question for otherwise it would have been faced with protracted litigation causing disruption in the distribution of its products. The tribunal has found that GEC had been operating in this territory for over 20 years and due to its dominance in the area was in a position to seriously prejudice the respondent's business if the

distributorship were to be prematurely terminated without compensation. It has further held that the bonafides behind the decision taken by the assessee were established by the subsequent events, according to which as against a projected profit of Rs. 1,50,000/- the company made an actual profit at Rs. 1,96,000/-. With the said findings in the background, it is difficult to see how the view taken by the tribunal can be said to be in any way erroneous.

It is not difficult to conceive of cases where the legal liability of the employer may be doubtful, and yet the employer may like to take a view in the matter based on commercial expediency and not on the basis of what the court may ultimately decide. The employer's right to use his own judgment and act as a prudent businessman, cannot be denied, for it is he who knows what is best for his business and its promotion. Legal liability to pay or the compulsion of circumstances to incur an expenditure is one thing while the commercial expediency to do so totally different. A businessman may find it commercially expedient to make the payment even when he is strictly speaking, not obliged to make any such payment, and should such a decision be taken by him the same has to be respected so long as it is not proved to be so utterly irrational or far removed from the realities that it would look like a device adopted to evade taxes.

Ultimately, the tribunal holds that the legal position can thus be said to be fairly well settled, namely, the commercial expediency of a businessman's decision to incur an expenditure cannot be tested in the touchstone of strict legal liability to incur such an expenditure. Such decisions in the very nature of things have legal liability to incur such an expenditure. Such decisions in the very nature of things have to be taken from a business point of view and have to be respected by the authorities no matter that it may appear to the latter that the expenditure incurred was unnecessary or avoidable.

11. In the case on hand, the authorities in our view have committed a legal error in not accepting the case of the assessee. In these circumstances, we deem it proper to answer the first question in favour of the assessee. In the light of our answer in favour of the assessee to the question No. 1, the second question need not be answered. Since it is only an alternative question raised by the assessee.

12. Two more questions (numbered as Question No. 3 and 4) have been referred to us by the tribunal in terms of the RA No. 213 & 214/Bang/95.

The question with regard to allowance of higher rates of depreciation on roads and culverts, storage tanks and pipelines is concerned, we have seen the material on record.

In so far as roads and culverts are concerned, the same is covered by the judgment of the jurisdictional High Court in Commissioner of Income Tax Vs. Motor Industries Co. Ltd., in the case of the very assessee. The Supreme Court in a case reported in Commissioner of Income Tax, Bombay Vs. Gwalior Rayon Silk Manufacturing Co. Ltd., has also noticed that "roads and drains" are to be

treated as "plant" for the purpose of depreciation. Hence we answer this issue in favour of the revenue.

In so far as "storage tanks" are concerned, the same has been considered in the case of the very assessee in Commissioner of Income Tax Vs. Motor Industries Co. Ltd., and they are held to be "plant" for the purpose of Income Tax. We therefore hold this issue in favour of the revenue.

The only item that remains for consideration is "pipelines" in factory. For the very reason stated in Commissioner of Income Tax, Bombay Vs. Gwalior Rayon Silk Manufacturing Co. Ltd., , we deem it proper to answer even the pipelines" in favour of the revenue.

Question No. 4 that is referred to us is with regard to gratuity. That very question has been considered by us in 617 ITRC 1998. The said finding in that reference would hold good for this case as well. Following the said judgment, we answer this question in favour of the assessee.

14. In the result, the following order is passed.

Questions No. 1 with regard to whether the amount paid to GEC was deductible is answered in favour of the assessee.

Question No. 2 is not answered in view of our answer to question No. 1.

Question No. 3 with regard to roads, culverts, storage tanks and pipelines, is answered in favour of the revenue and

Question No. 4 with regard to gratuity is answered in favour of the assessee.