
(1991) 03 CAL CK 0010

In the Calcutta High Court

Case No : Income-tax Reference No. 30 of 1988

Endogram Tea Co. Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 18-03-1991

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1993) 203 ITR 511 : (1995) 78 TAXMAN 24

Hon'ble Judges : Shyamal Kumar Sen, J;Ajit K. Sengupta, J

Bench : Division Bench

Advocate : D. Pal and Anil Roy Chowdhury, for the Appellant;

Judgement

Shyamal Kumar Sen, J.—In this application u/s 256(1) of the Income Tax Act, 1961, the following questions have been referred to this court for determination :

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that payment of Rs. 10 lakhs to Messrs. Octavius Steel and Co. Ltd. under the agreement dated March 10, 1983, was capital in nature and hence was not admissible as a revenue expenditure ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in confirming the disallowance of litigation expenses of Rs. 1,05,019 claimed by the assessee as revenue expenditure ?"

2. The facts leading to the reference, inter alia, are that the year of assessment involved is 1982-83. The assessee is a non-resident company having its head office in the U. K. and was carrying on the business of cultivation and manufacture of tea in India and sale thereof in and outside India. It has no other branch in any other country except its head office in the U. K. The assessee-company entered into an agreement dated December 17, 1975, to sell its Coombergram Tea Estate to Messrs. Octavius Steel and Co. Ltd. (for brevity, "OSCL") with effect from January 1, 1975, and it was, inter alia, provided thereunder that all the profits and losses on and from January 1, 1975, shall

belong to OSCL. The said sale agreement was rescinded by the assessee. Consequently, the OSCL instituted a suit in the original jurisdiction in this court for specific performance of the said contract (sale agreement dated December 17, 1975) which was decreed by the High Court in favour of OSCL directing the assessee to execute the deed of conveyance of the said tea estate in terms of the agreement. The assessee went in appeal before the High Court (in appellate jurisdiction) against the said judgment and decree of the High Court on the original side. During the pendency of that appeal, parties compromised. A memorandum of settlement dated December 22, 1981, was recorded. In terms of the said settlement, OSCL agreed to forgo and abandon all its claims and rights under the said decree of the High Court and, in consideration thereof, the assessee agreed to pay Rs. 23,61,000 equal to half of the assessable income of the assessee for the years 1975 to 1981, subject to certain conditions. The said settlement was substituted by another settlement dated March 10, 1982, in terms of which the assessee-company agreed to pay Rs. 10 lakhs to OSCL in full and complete settlement of all the claims which OSCL had under the decree of this court or in anywise OSCL to meet its cost of litigation expenses, etc. The assessee claimed deduction of the said amount of Rs. 10 lakhs agreed to be paid to OSCL. The assessee further claimed deduction of Rs. 1,05,019 as litigation expenses in the said matter. The Income Tax Officer disallowed the claim on the reasoning that Rs. 10 lakhs was agreed to be paid in connection with the title of a business and not for deriving profit out of the business activities of the assessee. Further, the Income Tax Officer observed that the settlement took place on March 10, 1983, that is to say, after the close of the accounting period of the assessee on December 31, 1981, for the instant assessment year 1982-83 and as such the said claim did not relate to the instant assessment year. The Income Tax Officer also disallowed the claim of deduction of Rs. 1,05,019 on the same reasoning, viz., that the expenditure was made concerning the title of the business and not for the purpose of earning any income.

3. The assessee went in appeal before the Commissioner of Income Tax (Appeals) who endorsed the order of the Income Tax Officer and upheld the disallowance of Rs. 10,00,000 on the ground that the liability did not accrue during the relevant previous year. However, he did not decide the question as to whether the payment was in the nature of revenue or capital. He also did not decide the objection of the assessee as to disallowance of Rs. 1,05,019 though such ground of objection was raised before him.

4. The assessee came in second appeal before the Tribunal and in support placed reliance upon *Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna*, It was also contended on behalf of the assessee before the Tribunal that since the original settlement dated December 22, 1981, was recorded within the instant previous year the tax authorities below were not justified in holding that the claim of deduction did not arise in this year. According to the assessee, the later settlement dated March 10, 1982, agreeing to pay Rs. 10 lakhs to OSCL, was a mere substitution of the original settlement

already arrived at.

5. The Tribunal held that the decision in the case of Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna, was based on different facts and was not applicable to the case of the assessee. The Tribunal relied upon SWADESHI COTTON MILLS CO. LTD. Vs. COMMISSIONER OF Income Tax, U. P. (NO. 2)., and held that the amount of Rs. 10 lakhs and the expenses of Rs. 1,05,019 incurred in respect of the said litigation was a capital expenditure and not revenue expenditure.

6. The assessee thereafter made an application u/s 256(1) of the Income Tax Act, 1961, whereupon the aforesaid questions were referred to this court.

7. It has been submitted on behalf of the assessee that the amount of Rs. 10 lakhs which has been paid to OSCL by way of settlement of all the claims OSCL had under the decree of the High Court was not for acquiring any title to the asset, viz., the tea estate, which was agreed to be sold to OSCL. By reason of the agreement, no title to the immovable property of the tea estate passed to OSCL. The settlement was made in order that the decree which OSCL has obtained in the suit for specific performance of the contract may be given up. In other words, the expenditure which was incurred by way of compensation was to protect the tea estate which was the source of the business of the assessee and for maintaining its business asset, viz., the tea estate. Such an expenditure is incurred not for acquiring or curing any title to the property but for preserving and maintaining the business assets. The expenditure, therefore, is to be considered as revenue expenditure incurred wholly and exclusively for the purpose of the business.

8. In support of the aforesaid contention, the learned advocates for the assessee, Dr. D. Pal and Mr. Anil Roy Chowdhury, relied upon several decisions.

9. It has been submitted by the learned advocate for the assessee that the Tribunal was not correct in relying upon the decision in the case of SWADESHI COTTON MILLS CO. LTD. Vs. COMMISSIONER OF Income Tax, U. P. (NO. 2)., .

10. It was argued that the appellant in the said case entered into two contracts for the purchase of textile machinery in order to expand the factory. Having regard to the altered circumstances, the appellant subsequently cancelled the contracts, as the machinery to be purchased would not be required for the business, and paid Rs. 15,000 and Rs. 20,000, respectively, to the other contracting parties as compensation.

11. According to the learned advocate for the assessee, the facts in the said case are different.

12. It was argued that in the decision in the case of SWADESHI COTTON MILLS CO. LTD. Vs. COMMISSIONER OF Income Tax, U. P. (NO. 2)., the purchase of plant and machinery was not required for the business of the assessee. Hence the compensation which was paid for the cancellation of the contract was a

payment for breach of the contract in respect of purchase of textile machinery which would have been a capital asset. In the instant case, no such capital asset was acquired by the assessee. The capital asset belonged to the assessee and hence the aforesaid decision is inapplicable according to him.

13. In the case of *Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna*, the assessee took on lease from the Government the Murli Hills for the purpose of quarrying limestone for a period of one year. Thereafter, the assessee worked the quarry as agent of the Government with an understanding that the Murli Hills would be ultimately leased out to the assessee. While the assessee was in possession of the Murli Hills as agent of the Government, the Kalyanpur Lime Co., on the basis of an earlier agreement with the Government, filed a suit for specific performance and in the alternative, damages against the Government, impleading the assessee also as a defendant. The suit was resisted by the Government as well as by the assessee. The assessee incurred expenses the sum of Rs. 1,29,994 in resisting the suit, in which ultimately the Supreme Court granted a decree for damages, and the question was whether the litigation expenses constituted expenditure laid out wholly and exclusively for the purpose of the business.

14. It was held that the assessee resisted the suit in order to protect its business and not to safeguard its prospects of getting a new lease. It did not initiate the proceedings : it merely defended the claim made against it. The suit was launched against it because of one of its business activities and, therefore, the litigation expenses were revenue expenditure laid out wholly and exclusively for the purpose of the business.

15. Where litigation expenses are incurred by the assessee for the purpose of creating, curing or completing the assessee's title to the capital, the expenses incurred must be considered as capital expenditure. But if the litigation expenses are incurred to protect the business of the assessee, they must be considered as a revenue expenditure.

16. In the case of *Commissioner of Income Tax, Tamil Nadu-IV Vs. O.P.N. Arunachala Nadar*, , it was held by the Division Bench of the Madras High Court that any legal expenditure incurred by an assessee to protect the source of his income or the title to his business or to preserve or maintain his business assets must be regarded as expenditure incurred wholly and exclusively for the purpose of his business and, therefore, allowable as a deduction for the purpose of computing the profits for Income Tax purposes. There is a distinction between expenditure incurred for the acquisition of a capital asset as well as expenditure incurred for the substantial expansion or improvement of a capital asset on the one hand, and expenditure incurred for merely protecting and maintaining the title to an existing capital asset on the other. The former expenditure is capital in nature, whereas the latter expenditure is revenue in character.

17. In the case of *Commissioner of Income Tax, Delhi Vs. New Garage Ltd.*, the

assessee-company, which carried on the business of repairing vehicles, selling tractors, implements and spares from Escorts Ltd., maintained a showroom. The landlord of the premises where the shop was maintained filed a suit against the assessee-company for eviction which was later compromised on the assessee agreeing to pay a sum of Rs. 10,000 to the landlord. The Income Tax Officer rejected the claim of the assessee for deduction of the sum of Rs. 10,000 on the ground that it was not paid for any legitimate business needs of the assessee-company. On appeal, the Appellate Assistant Commissioner affirmed the order of the Income Tax Officer. On further appeal, the Tribunal held that the assessee was and continued to be the tenant of the premises and the tenancy rights which were very valuable were in jeopardy when the landlord filed the eviction suit, that the assessee was merely protecting the danger to its capital assets in the shape of tenancy rights, that the amount was, therefore, spent to maintain the existing capital assets, that the assessee did not acquire a new lease by paying the amount, that as a result of the expenditure the assessee did not acquire any asset or enduring advantage and that the assessee was, therefore, entitled to the deduction of the sum of Rs. 10,000 in computing its business income. On a reference it was held, affirming the decision of the Tribunal, that the sum of Rs. 10,000 paid to the landlord was business expenditure entitled to deduction in computing the total income of the assessee.

18. In the case of Commissioner of Income Tax, Bombay City-II Vs. Mohanlal Bros., the assessee-firm, which carried on business in art silk cloth as wholesalers, entered into an agreement with Messrs. G. G. The agreement was in the form of a letter addressed by the assessee to Messrs. G. G., whereby Messrs. G. G. were to act as commission agents of the assessee at an agreed rate. The agreement also purported to create a leave and licence in favour of the assessee in respect of the shop for a period of three years. This agreement was renewed by a fresh one dated June 23, 1955, on similar terms with regard to the rate of commission, etc., but with a change in the duration of the period of the agreement, this time the same being for four years from July 1, 1955, to June 6, 1959. The assessee claimed deduction of Rs. 6,000 per year towards the payment of commission which was allowed up to June 6, 1959.

19. On May 13, 1959, an Ordinance was issued recognising sub-tenancies created till that date and protecting such sub-tenants from eviction to which they were otherwise liable. On the coming into operation of the said Ordinance, the assessee refused to pay commission of Rs. 500 per month to Messrs. G. G. from July 1, 1959, and started paying only the rent of the shop premises which was Rs. 95 per month. Thereafter Messrs. G.G. filed a suit on July 11, 1959, in the City Civil Court, Bombay, for a declaration that they were in lawful possession and that the assessee was not entitled to remain in possession of the shop after June 30, 1959. In the suit, a compromise was arrived at between the parties on June 15, 1964, and a consent decree was taken. In terms of the consent decree, Messrs. G. G. admitted and declared that the assessee was in lawful possession of the shop since June 30, 1952. It was provided that, in respect of the claims

made by Messrs. G. G. for commission, compensation and damages, the assessee would pay Rs. 50,000 to Messrs. G. G. The assessee paid the sum on June 14, 1964, and claimed it as a deduction for the assessment year 1965-66. The Income Tax Officer disallowed the claim on the ground that the expenditure was of a capital nature. The Appellate Assistant Commissioner allowed the claim of the assessee. The Tribunal held that the consent decree showed that the payment was mainly for commission due to Messrs. G. G. and it was an allowable deduction. The Tribunal also held that the agreements of 1952 and 1955, though purporting to create the selling agency, had in fact created a sub-tenancy in favour of the assessee, and that since there was already a sub-tenancy created in favour of the assessee as far back as June 30, 1952, it could not be said that the payment of Rs. 50,000, which was made under the decree of 1964, was a payment for the acquisition of a sub-tenancy under the consent decree. In this view, the Tribunal held that the expenditure of Rs. 50,000 was not of a capital nature. On a reference, it was held that the Tribunal had recorded a finding of fact that the agreements of 1952 and 1955 had created a sub-tenancy in favour of the assessee. The consent decree showed that Messrs. G. G. had accepted the position that the assessee was in possession of the shop as sub-tenant right from 1952. The assessee had become a lawful sub-tenant as a result of statutory intervention. It could not be said that the sub-tenancy was created for the first time on the date of the consent decree. Hence, the amount of Rs. 50,000 which was paid by the assessee to Messrs. G. G. could not be said to be an expense in the nature of a capital expenditure. It was an allowable deduction,

20. In the case of DARJEELING DOOARS PLANTATIONS LTD. Vs. COMMISSIONER OF Income Tax., , the assessee owned and ran a tea estate. In March, 1975, it entered into an agreement to buy the B tea estate from the R company and paid an amount of Rs. 4 lakhs as earnest money. Disputes arose subsequently and some of the shareholders of the R company filed a suit to set aside the sale and the assessee also filed a suit against the R company for specific performance of the contract. The assessee claimed deduction of the sum spent in litigation in the assessment year 1979-80. The Income Tax Officer noted that, in its return, the assessee had stated that the income from the said tea estate was not taxable in its hands as the conveyance for the said tea estate had not been executed in favour of the assessee and disputes between the parties were pending adjudication in court. The Income Tax Officer held that the legal expenses incurred in connection with the acquisition of any investment were capital expenditure. He also held that an amount of Rs. 60,000, being interest calculated at the rate of 15 per cent. on the said advance of Rs. 4 lakhs, could have been avoided if the said payment was either withdrawn or not incurred and he added a further sum of Rs. 60,000 to the taxable income of the assessee. The Commissioner of Income Tax (Appeals) held that the disallowance of litigation expenses and the addition of Rs. 60,000 on account of interest were not justified. On further appeal, the Tribunal held that the expenditure did not relate to the existing business of the assessee and as the assessee had claimed that

the income from B estate was not assessable in its hands, the expenditure on litigation was not deductible. Regarding the addition of Rs. 60,000, the Tribunal held that the Income Tax Officer had not specifically found that the money paid as advance for the purchase of the said tea estate was not from borrowed funds. The Tribunal held that it was necessary to probe into the matter further to ascertain to what extent the borrowed funds had been utilised by the assessee for making the said advance of Rs. 4 lakhs. It reversed the decision of the Commissioner of Income Tax (Appeals) and remanded the matter. On a reference, it was held, (i) that the facts showed that the assessee was carrying on the business of cultivation and manufacture of tea and owned a tea estate and was in the process of acquiring another tea estate. There was no evidence to show that the assessee intended to carry on a separate business with the B tea estate. The B tea estate was a property and could be considered to be an asset. The right to acquire the property was also an asset in the hands of the assessee. The question whether the B tea estate would be a part of the existing business of the assessee would arise only after the acquisition of the B tea estate was complete. But, in the interim stage, to the extent that the assessee acquired a right to the transfer of the B tea estate to itself, the same was an asset in its hands. The litigation expenses incurred by the assessee in defending the suit filed by the shareholders of the R tea company to set aside the agreement of sale of the B tea estate was admissible as revenue expenditure for the purpose of the assessee's business ;

(ii) that the expenses incurred by the assessee in the suit filed by it against the R company for specific performance of the contract was in the nature of capital expenditure and was not deductible ;

(iii) that there was no material to come to the conclusion that the borrowed funds had at all been utilised for making the payment of the said Rs. 4 lakhs. The Tribunal was not justified in remanding the matter to the Income Tax Officer for further investigation to determine as to what extent the borrowed funds had been utilised by the assessee. In any event, the expenditure had been incurred by the assessee in the acquisition of an asset.

21. In the case of Shree Meenakshi Mills Ltd., Madurai Vs. Commissioner of Income Tax, Madras, it was held by the Supreme Court that, in order that an expenditure may be admissible as a deduction u/s 10(2)(xv), it is not necessary that the primary motive in incurring it must be directly to earn income thereby.

22. I have considered the respective submissions of the parties and the decisions cited from the Bar. It appears that, in the instant case, the agreement in respect of which specific performance was claimed clearly relates to the title in respect of the assets and/or property sought to be transferred to Messrs. Octavius Steel and Co. Ltd. by the assessee. The decree was also passed by the court directing the execution of the conveyance.

23. The assessee preferred an appeal. In the appeal, terms of settlement were

executed and filed. The said settlement during the pendency of the appeal, inter alia, provided that OSCL agreed to forgo and abandon all its claims and rights under the said decree of this court and, in consideration thereof, the assessee agreed to pay Rs. 23,61,000 equal to half of the assessable income of the assessee for the years 1975 to 1981 subject to certain conditions. The said settlement was substituted by another settlement dated March 10, 1982, in terms of which the assessee-company agreed to pay Rs. 10 lakhs to OSCL in full and complete settlement of all the claims which OSCL had under the decree of this court or in anywise OSCL to meet its cost of litigation expenses.

24. There cannot be any doubt that this amount mentioned in the terms of settlement was agreed to be paid in consideration of the fact that OSCL would forgo all its right, title and interest which had accrued in its favour in the said property or assets in terms of the decree of the court.

25. Under such circumstances, the amount of Rs. 10 lakhs and the expenses of Rs. 1,05,019 incurred in respect of the said litigation was a capital expenditure and not a revenue expenditure towards the cost of litigation which were meant for the protection or preservation of its assets and as such should be treated as capital expenditure.

26. Accordingly, both the questions Nos. 1 and 2 are answered in the affirmative and in favour of the Revenue.

27. There will be no order as to costs.

Ajit K. Sengupta, J.

28. I agree.