Commissioner of Income-tax, Punjab Vs. Shiwalik Talkies Ltd.

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Court : Punjab and Haryana

Decided On : Dec-01-1965

Reported in : [1967]63ITR83(P& H)

Appeal No. : Income-tax Reference No. 5 of 1962

Appellant : Commissioner of Income-tax, Punjab

Respondent : Shiwalik Talkies Ltd.

Judgement :

I. D. DUA J. - These three income-tax references (I.T.Rs. Nos. 2, 3 and 5 of 1962) are being disposed of by the same judgment because they raise one common question, and indeed arguments have only been addressed in I.T.R. No. 5 of 1962, it being conceded at the Bar that the decision in this case would govern the other two cases as well.

The learned counsel for the Commissioner of Income-tax had read out to us the statement of the case from the paper-book relating to I.T.R. No. 5 of 1962 arising out of the assessment of M/s. Shiwalik Talkies Ltd., Nangal Township, for the assessment year 1953-54. The assessee is a private limited company and during the relevant accounting period ending March 31, 1953, there was litigation in the High Court among its directors. Some of the shareholders during that controversy filed an application under section 153C of the Indian Companies Act, 1913, questioning the appointment of some of the directors of the assessee-company. It is observed in the statement of the case that the learned counsel for assessee attempted to point out to the Income-tax Appellate Tribunal (Delhi Bench 'B') that an application for appointment of a receiver had also been field in the main petition, but the Tribunal found nothing on its records on which this assertion could be upheld. At the same time, that Tribunal considered it relevant to point out that there were certain observations in its own earlier order suggesting the existence of prayer for the appointment of receiver. In this application in the High Court, the contesting parties effected a compromise agreement in 1954. In the assessment proceedings in question, a sum of Rs. 551 was claimed as legal fees which included a sum of Rs, 250 stated to have been paid to Shri K. C. Malhotra as his consultation fee in connection with the aforesaid litigation. This amount was disallowed by the Income-tax Officer and the Appellate Assistant Commissioner confirmed this order. Appeals from the three assessment years 1953-54, 1954-55 and 1955-56 were preferred by the assessee with the Appellate Tribunal which by a common order dated March 28, 1957, allowed all the three appeals with the observation that there could be no doubt that, if the receiver had been appointed, the smooth running of the company would have been affected and the company would not have been able to make profits or gains. It is in these circumstances that in pursuance of this courts order dated

January 31, 1961, a statement of the case was drawn up and forward to this court by the Appellate Tribunal, the question of law referred being :

'Whether, on the facts and circumstances of the case, the legal expenses amounting to Rs. 250 could be allowed as a deduction under 10(2)(xv) of section of the Income-tax Act, 1922 ?'

In order to understand the precise scope of clause (xv) of section 10(2), I consider it desirable at the outset to read section 10 so far as relevant for our purpose :

'10. (1) The tax shall be payable by an assessee under the head profits and gains of business, profession or vocation in respect of the profits and gains of any business, profession or vocation carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely : - ...

(xv) any expenditure (not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation...'

I considered it equally important at this stage to read, so far as relevant, section 153C added to the Indian Companies Act, 1913, in 1951 by Act LII of 1951.

'153C. Alternative remedy to writing up in case of mismanagement or oppression. - (1) Without prejudice to any other action that may be taken, whether in pursuance of this Act or any other law for the time being in force, any member of a company who complains that the affairs of the company are being conducted -

(a) in a manner prejudicial to the interests of the company, or

(b) in a manner oppressive to some part of the members (including himself) may make an application to court for an order under this section.

(2) An application under sub-section (1) may also be made by the Central Government if it is satisfied that the affairs of the Company are being conducted as aforesaid.

(3) No application under sub-section (1) shall be made by any member, unless -

(a) In the case of company having a share capital, the member, complaining -

(i) has obtained the consent in writing of not less than one hundred in number of the members, whichever is less, or

(ii) holds not less than one-tenth of the issued share capital of the company upon which all calls and other sum due have been paid; and

(b) in the case of a company not having a share capital, the member complaining has obtained the consent in writing of not less than on-fifth in number of the members....

(4) If on any such application the court is of opinion -

(a) that the companys affairs are being conducted as aforesaid, and

(b) that to wind up the company would unfairly and materially prejudice the interests of the company or any part of its members, but otherwise the facts would justify the making of a winding up order on the ground that it is just and equitable that the company should be wound up,

the court may, with a view to an end the matters complained of, make such order in relation thereto as it thinks fit.

(5) Without prejudice to the generality of the powers vested in a court under sub-section (4), any order made under that sub-section may provide for -

(a) the regulation of the conduct of the companys affairs in future;

(b) the purchase of the shares or interest of any members of the company by other members thereof or by the company;

(c) in the case of purchase of shares or interest by the company being a company having a share capital, for the reduction for the reduction accordingly of the companys capital or otherwise;

(d) the termination of any agreement, howsoever arrived at, between the company and its manager, managing agent, managing director or any of its other directors;

(e) the termination or revision of any agreement entered into between the company and any person other than any of the person referred to in clause (d), provided that no such agreement shall be terminated or revised except after due notice to the party concerned and, in the case of the revision of any such agreement, after obtaining the consent of the party concerned thereto;

(f) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under sub-section (1), which would, if made or done by or against an individual, be deemed in his insolvency to be fraudulent preference.

(6) Where an order under this section make any alteration in, or addition to, the memorandum or articles of any company, then notwithstanding anything contained in any other provision of this Act, but subject to the provisions of the order, the company concerned shall not have power without the leave of the court to make any further alteration in or addition to, the memorandum or article inconsistent with the provision of the order, but subject to the foregoing provisions of this sub-section the alterations or addition made by the order shall have the same effect as if duly made by resolution of the company, and the provision of this Act shall apply to the memorandum or articles as so altered or added to accordingly.....

(8) It shall be lawful for the court the application of any petitioner or of any respondent to a petition under this section and upon such terms as to the court appears just and equitable, to make any such interim order as it thinks fit for regulating the conduct of the application.

(9) Where any manager, managing agent, managing director or any other director or

any other person who has not been impleaded as a respondent to any application under this section applies to be made a party thereto, the court shall, if it is satisfied that his presence before the court is necessary in order to enable the court effectually and completely to adjudicate upon and settle all the question involved in the application, direct that the name of any such person be added to the application.

(10) In any case in which the court makes an order terminating any agreement between the company and its manager, managing agents or managing director or any of its other directors, as the case may be, the court may, if it appears to it that the manager, managing agent, managing director or other directors as the case may be, the court may, if it appears to it that the manager, managing agent, managing director or other as the case may be, has misapplied or retained or become liable or accountable for any money or property of the company or has been guilty of any misfeasance or breach of trust in relation to the company, compel him to repay or restore the memory or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sums to the assets of the company by way of compensation in respect of the misapplication, retainer misfeasance or breach trust as the court thinks just, and the provisions of section 235 and 236 of this Act shall apply as they apply to a company in the course of being wound up.

Explanation. - .....'

At the bar Van den Berghs Limited v. Clark (H. M. Inspector of Taxes), Morgan (H. M. Inspector of Taxes) v. Tate & Lyle Ltd. judgments of the House of Lords, and Commissioner of Income-tax v. Malayalam Plantations Ltd. a judgment by our Supreme Court, have principally been relied on in support of the rival contentions advanced before us. Some other decisions have also been refereed to but these decision have been stated to be more or less basic. I may first advert to the decision in the case of Van den Berghs (which I will hereinafter call the assessee.) That company had been incorporated as a limited company in Britain in 1895 and had since been carrying on the business of manufacturing and dealing in margarine and similar products on a very extensive scale both in Britain and abroad. They had as their keenest competitors the Dutch company which was engaged in the same business in Holland. On February 13, 1908, the two companies entered into an agreement whereby they bound themselves for the future to 'work in friendly alliance' and to share their profits and losses in conformity with elaborate scheme detailed in the agreement. These two companies had each a controlling interest in a number of other companies and they understood that, if either of them or any of the companies controlled by them should acquire an interest in any other margarine concern, the fact should be communicated to the party, who should have an option to require such interest to be brought within the operation of the agreement. They both further undertook on behalf of themselves and of their controlled companies not to enter into any pooling or price arrangement with third parties which may be inimical to their interests under the agreement. There were some other provisions which need not be detailed here. In 1914, a supplemental agreement was entered into between the parties reciting that the Dutch Company had acquired rights in a process for hardening oils and that the parties were desirous of formulating a scheme for the merger of their assets or the unification and commercial interests etc., but that such a scheme could not at that time be fully elaborated to their satisfaction, and that it was desirable to regulate their mutual relations and modify and extend the principal agreement in the manner specified. According the case stated by the Commissioners for the General Purpose of the Income Tax for the City of London, each company

carried on its business independently but, in general, they observed the terms of their agreements during 1908 to 1913 and their profits were accounted for for these years. Payments made to the Dutch company were deducted as an expense and when made by the Dutch company were brought in as a receipt in making up the assessees profit and loss accounts for the years in which payments were in made or received. During the war, the two companies did not operate the agreement, and after peace was restored they found it desirable to enter into a fresh agreement in an endeavour to render workable the two previous agreements which where then was running and would not terminate till 1940. This third agreement was made in October, 1920, reacting that some of the provisions of the previous agreements had become obsolete or impracticable, and proceeding to provide that, subject to the amendments and additions thereby effected, the principal agreement should remain in force till December 31, 1940. Meantime, the assessee had been endeavouring to estimate the sum which they believed had accrued due to them by the Dutch company over the war period. There were dispute between the parties in this connection, but in 1927, they came to an arrangement embodied in three agreements, all dated September 24, 1927. In one of these agreements, it was stated that the Dutch company had expressed to the assessee a desire to determine the agreements of 1908, 1913 and 1920 contrary to the provisions contained therein and that the assessee had consented there in consideration of the payment by the Dutch company of Pounds 4,50,000 as damages. This amount was paid in cash by the Dutch company to the assessee before the expiry of the year 1927 and it was this sum which was the subject-matter of controversy in the reported decision. The General Commissioners held this amount to have been paid in respect of the pooling agreements which must be brought in for purpose of arriving at the balance of profits and gains of the assessee for the year ending December 31, 1927. This conclusion was reversed by Finally J., who held the amount not to be an income receipt at all. The Court of appeal reversed this judgment and restored the determination of the General Commissioners, holding that the sum had not been received by the assessee in consideration of the surrender of a fixed capital asset but arose from a transaction attributable to circulating capital, and was consequently an income receipt. In the House of Lords, the judgment of the Court of Appeal was reversed and that of Finally J. restored. The facts of this case, as just stated, would show that they do not bear any close similarity to those with which we are concerned. Both sides have referred to some of the decisions noticed by Lord Macmillan at page 430 of the report, but I am far from satisfied that any one of those decisions are of any direct assistance in solving the problem before us. The question posed by Lord Macmillan was whether the sum received by the assessee in the circumstances narrated in the reported case could properly be described as an item of profit arising or accruing from the carrying on of their trade which ought to be credited as an income receipt. Clearly, to find an answer to that question, would involve consideration of aspects very much different from those which confront us.

In Morgan v. Tate & Lyle Ltd. the assessee-company was carrying on sugar refining business in Britain. It refined 53 per cent. of all sugar refined in the country. During the years immediately following the political changes in Britain in 1945, the directors of the assessee-company because increasingly concerned by reason of the Labour Governments inclination towards nationalisation of sugar industry. In 1949, the election manifesto of the Labour Party in this connection gathered great momentum. In September, the company resolved to empower its directors to do everything to meet the threats of the nationalisation. By the time the decision to intensify the anti-nationalisation propaganda campaign was taken, the coal, the railway, gas and

electricity industries had been nationalised, which, broadly stated, took the form of compulsory acquisition of the respective businesses in return for compensation, usually by way of Government stock, though in some instances the companies engaged in the industry retained their assets and continued to carry on their business. The General Commissioners for the City of London found that the sum spent in such propaganda was money wholly and exclusively laid out for the purpose of the companys trade and was an admissible deduction from its profits for income-tax purposes. The case was stated for the opinion of the High Court which agreed with the view taken by the Commissioners. On appeal, this view was affirmed by majority. Leave to appeal to the House of Lord was granted and it is the judgment of the House of Lord on which reliance has been placed at the Bar, both counsel seeking supports for their respective contention. The various speeches of the learned Law Lords in the House of Lords contain passages which, taken in isolation, may, to an extent, lend some support to the reasoning of one or the other rival points of view canvassed before us by the learned counsel for the contesting parties. None of those passages, I may point out, possess binding force for this court court; they, of course deserve great respect, coming as they do from men of great learning, but for all the regard and respect they merely serve as aids - albeit very useful aids - in our search for the true scope and effect of the statutory provision which concerns us. These passages are worth only as much as they weigh in reason, logic and righteousness and more. Indeed, this court is fully competent, if it finds good reason so to do, to disagree with the view expressed in those speeches. I, however, do not consider it necessary to deal in detail with the various passages relied on in support of the rival contentions of the parties because the Supreme Court has in Commissioner of Income-tax v. Malayalam Plantations Ltd. fully considered the effect of these and of some other decision of the courts in England. the facts before the supreme Court were undoubtedly not quite identical with those before us, but the discussion is illuminating and authoritative, and the appraisal of the English decision contained there is fully binding on this court. In the section 84 of the Estate Duty Act, 1953 (before amendment in 1958), by a resident company incorporated outside India on the shareholders not domiciled in India. This amount was claimed as lawful deduction under section 10(2)(xv) Indian Income-tax Act, 1922, and the Supreme Court, repelling this claim, held that, although the amounts paid were 'expenditure', they were not allowable under section 10(2)(xv) as business expenditure because the payments were not' for the purpose of the business'. The payments had nothing to do with the conduct of its business, and the obligation of the compnay to pay estate duty was a statutory duty connected with the business, though the occasion for the imposition arose because of territorial nexus afforded by the accident of its doing business in India. It was also observed that the expression 'for the purpose of the business' is wider in scope than the expression 'for the purpose of earning profits. But, however wide the meaning of the expression, its limits are also implicit in it. The purpose must be the purpose of the business; in other words, the expenditure incurred must be for the carrying on of the business and the assessee should incur it in his capacity as a person carrying on the business. In the course of the judgment, Subba Rao J., speaking for the court, after noticing several decisions of the courts in England, expressed his opinion about the English decision in these words :

'Pausing here, we shall briefly recapitulate the legal position in England. The relevant wordings of the section with which the English judges were concerned are, in efect, similar to the terms of section 10(2)(XV) of the Indian Income-tax Act, 1922. The test laid down by Lord Davey in Strong and Co. of Romsey Ltd. v. Woodifield, namely, the disbursement must be made for the purpose of earning profits, has been accepted

and followed throughout, though the content of that test has been expanded to meet diverse situations. Broadly, English courts applied two tests to ascertain whether a deduction was permissible or not, namely, (i) whether the expenditure was incurred for the purpose of the carrying on of the business and (ii) whether the assessee paid the amount in his capacity as businessman or in his personal capacity.'

The court then considered Indian decisions and recorded its final conclusion which has already been noticed a little earlier. At this stage, I may notice decision of the Bombay High Court in All India Reporter Ltd. v. Commissioner of Income-tax, in which a Division Bench held that the expenditure incurred by company in defending itself in a petition field by a shareholder for winding up the company is expenditure which enables the company to continue to run and earn profits from business and as such is an expenditure incurred wholly and exclusively for purposes of business deductible under section 10(2)(xv).

The point arising for determination before me is undoubtedly not very simple and it has caused me considerable anxiety in coming to the final conclusion. But, after considering the various decisions and the arguments addressed at the bar, I am inclined, as at present as advised, to think that the expenditure incurred in resisting an application by shareholders of the assessee-company under section 153C of the Indian Companies Act, questioning the appointment of some of the directors of the assessee-company, cannot be considered to be an expenditure laid out or expended wholly and exclusively for the purpose of the business of the company. Whether a particular director has been guilt of conduct which is objectionable, or whether the affairs of the company are being conduct by those entrusted by the shareholders to conduct them, in a manner prejudicial to the interests of the company, is a matter which may remote and in part be considered to relate to the purpose of the companys business, but I am extremely doubtful if it can be safely said that expenditure so laid out or expended on defending the conduct of the directors or of the company questioned by the shareholders can be said to be wholly and exclusively expended or laid out for the purposes of its business. The expression 'wholly and exclusively' appear to restrict and limit the operation of the clause. The decision of the Appellate Tribunal seems to me to be somewhat sketch and I do not feel impressed by the manner in which this question has been disposed of.

As a result of the foregoing discussion, the answer to the question referred must, in my opinion, be in the negative and I so order.

No separate a arguments were addressed in the other two cases and it was conceded that the answer in those two cases must follow the answer in this one. We accordingly record similar answers in those two cases. In the circumstances of the case, there would be no order as to costs in all the three cases.

P. C. PANDIT J. - I agree.