

(2002) 09 MAD CK 0232

Madras High Court

Case No: Tax Case No. 832 of 1990 18 September 2002

Commissioner of
Income Tax

APPELLANT

Vs

Bradford Trading Co.
(P) Ltd.

RESPONDENT

Date of Decision: Sept. 18, 2002

Citation: (2002) 125 TAXMAN 632

Hon'ble Judges: V.S. Sirpurkar, J; N.V. Balasubramanian, J

Bench: Full Bench

Advocate: T. Ravikumar, for the Revenue, for the Appellant;

Judgement

@JUDGMENTTAG-ORDER

N.V.Balasubramanian, J.

This is reference at the instance of the Commissioner, Tamil Nadu III, Chennai. The respondent, hereinafter referred to as "the assessee", was incorporated as a private limited company on 15-2-1970 and its main object was to construct a multi-storey Four Star Hotel at Chennai at Cathedral Road, later known as Edward Elliots Road. The assessee purchased a plot to achieve the object and also to put up a construction thereon. The paid up capital of the assessee-company was Rs. 10 lakhs contributed by one Adbul Aziz, the Chairman of the assessee-company and five others. The assessee became heavily indebted to Indian Overseas Bank and the assessee was in need of further finance and also expertise to complete the construction of the hotel and to make it as a commercial venture. One A.M. Buhari was a hotelier in Chennai and he was approached by the Chairman of the assessee-company to participate in the venture and take over the management of the hotel. A.M. Buhari agreed to advance a sum of Rs. 5 lakhs and he was to be allotted 2500 shares in the assessee-company. Accordingly, on 3-8-1973, 2500 shares" were transferred to A.M. Buhari and he paid a total sum of Rs. 5 lakhs. There

was also an agreement to the effect that after the hotel was constructed, it should be sold to A.M. Buhari for a sum of Rs. 43 lakhs and he should be made the Managing Director of the hotel. Meanwhile, Abdul Aziz, the Chairman of the assessee-company entered into negotiations with Indian Tobacco Company Ltd. for the sale of the entire undertaking for a total consideration of Rs. 46 lakhs and on 2-9-1973, an agreement was entered into for the sale of the undertaking.

2. A.M. Buhari dissented the agreement and he filed a company petition in C.P. No. 84 of 1973 on the file of this court to set aside the agreement entered into between the Chairman of the assessee-company and India Tobacco Company Ltd. on the ground that the decision to transfer the undertaking was taken behind his back and if the transfer takes place, it would affect his rights as a minority shareholder and his interest in the company would be seriously jeopardised and the entire substratum of the undertaking would be lost. Along with the company petition, he also filed an application in C.A. No. 354 of 1973 for temporary injunction restraining the Chairman of the assessee-company from implementing the agreement dated 2-9-1973. In the company application, the case of the third respondent, viz., India Tobacco Company Limited was that the third respondent was prepared to go through the sale transaction in pursuance of the sale agreement subject to all the risks attendant with the proceedings initiated by the company petitioner, and on the basis of the statement made by the third respondent therein, the learned Single Judge of this court dismissed the application for temporary injunction. Against the order of the learned Company Judge passed in the company application, an appeal was preferred in O.S.A. No. 74 of 1973 on the file of this court. During pendency of the appeal, the parties settled the differences among themselves and entered into a compromise and they filed a memo of compromise and prayed for a decree in terms of the compromise. Under the compromise, A.M. Buhari was required to transfer 2500 shares held by him in the assessee-company to the wife of Abdul Aziz for a consideration of Rs. 2,50,000 and the assessee-company should repay to A.M. Buhari a sum of Rs. 2,50,000 advanced by him and in consideration of A.M. Buhari withdrawing the company petition, appeal proceedings, etc., the assessee-company paid to A.M. Buhari a sum of Rs. 2,00,000 in full and final settlement of all claims, demands and outstanding against all the respondents including the assessee-company. India Tobacco Company Ltd. agreed to reimburse a sum of Rs. 1.50 lakhs to the assessee for the payment of Rs. 2 lakhs to be made to A.M. Buhari. A.M. Buhari also confirmed that on receipt of payment, he would have no claim against the shares of the assessee-company or any of its assets, whether movable or immovable including the assets disposed of by the assessee-company prior to the compromise or against any of the respondents therein. Accordingly, the appeal as well as the company petition was withdrawn and dismissed.

3. The assessee-company had disclosed capital gain of a sum of Rs. 1,06,490 in its return for the assessment year 1974-75. The Income Tax Officer was of the view that the capital gain shown by the assessee-company was on the low side and proposed

certain additions. The case of the assessee before the Income Tax Officer was that the sum of Rs. 2 lakhs was an expenditure incurred wholly and exclusively in connection with the said sale and it was allowable as a deduction u/s 48(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"). The Income Tax Officer rejected the claim of the assessee on the ground that the company petition was filed by A.M. Buhari claiming to be a minority shareholder and the payment of Rs. 2 lakhs and no connection or nexus with the sale and the sale did not have any direct nexus with the expenditure and the matter was settled between the majority and minority shareholders and the assessee-company had nothing to do with the compromise. The Income Tax Officer, therefore, held that the sum of Rs. 1.5 lakhs received from India Tobacco Company Ltd. by way of reimbursement should be treated as a part of sale consideration. The Income Tax Officer also disallowed the balance sum of Rs. 50,000 paid by the assessee-company to A.M. Buhari and the legal expenditure incurred in connection with the litigation and completed the assessment determining the capital gains arising out of the transfer of the capital asset.

4. The assessee, aggrieved by the order of the Income Tax Officer, filed an appeal before the Commissioner (Appeals) and the Commissioner (Appeals) upheld the order of the Income Tax Officer holding that the expenditure incurred did not relate to the sale of the property and it was only to secure interest of the minority shareholders and the payment had no connection whatsoever with the sale of the property. The Commissioner (Appeals) thus dismissed the appeal preferred by the assessee. Aggrieved by the order of the Commissioner (Appeals), the assessee preferred a further appeal before the Income Tax Appellate Tribunal.

5. The Income Tax Appellate Tribunal was of the view that the payment of a sum of Rs. 2 lakhs had an intimate connection with the sale of the property and it was an expenditure incurred wholly and exclusively in connection with the transfer of the property. As far as a sum of the Rs. 1.5 lakhs is concerned, the Appellate Tribunal held that it did not form part of the sale consideration and the assessee had received the money from India Tobacco Company Limited and passed on the same to A.M. Buhari and, therefore, the sum of Rs. 1.5 lakhs was not a part of the sale consideration for the sale of the property. The Appellate Tribunal also took the view that even if the sum of Rs. 1.5 lakhs was taken as a part of the sale consideration, the amount paid to A.M. Buhari would constitute an expenditure incurred wholly and exclusively in connection with the transfer. As far as Rs. 50,000 is concerned, the Appellate Tribunal held that it was incurred wholly and exclusively in connection with the transfer and it would be allowable u/s 48(1) of the Act. The Appellate Tribunal, on the same reasoning, allowed the sum of Rs. 16,000 claimed as legal expenditure on the ground that it was incurred wholly and exclusively for the purpose of transfer of the capital asset. The Appellate Tribunal accordingly allowed the appeal preferred by the assessee.

6. The revenue sought for a reference and on the basis of the directions of this court, the Appellate Tribunal has stated a case and referred the following three questions of law for our consideration :

1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding, and had valid materials to hold that the sum of Rs. 2 lakhs paid by the assessee to Shri A.M. Buhari is an expenditure incurred wholly and exclusively in connection with the transfer of the Bradford Undertaking ?

2. Whether, on the facts and the circumstances of the case, the Appellate Tribunal was justified in holding that the sum of Rs. 1.5 lakhs received by the assessee from India Tobacco Co. Ltd. and passed onto Shri A.M. Buhari did not become part of the consideration for sale in the hands of the assessee-company and as such the sum of Rs. 1.5 lakhs is not available for assessment in the hands of the assessee as part of the sale consideration ?

3. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the amount of Rs. 16,000 spent by the assessee towards legal expenses in connection with the compromise agreement entered into with Shri Buhari is a permissible deduction in computing the capital gains in the assessee's case ?

7. Though three questions have been referred, all the three relate to the mode of computation of capital gains under the Act. Section 48 of the Act deals with the mode of computation of capital gains. For arriving at the income chargeable under the head "Capital gains". Section 48 provides for deduction of the cost of acquisition of the asset and the cost of any improvement to the capital asset and also the expenditure incurred wholly and exclusively in connection with the transfer of capital asset from the full value of consideration received or accruing as a result of the transfer of capital asset. The only question that arises is whether the sum of Rs. 2 lakhs paid by the assessee-company to A.M. Buhari is an expenditure incurred wholly and exclusively in connection with the transfer of the capital asset.

8. The submission of the learned counsel for the revenue was that A.M. Buhari initiated legal proceedings against the respondents in the company petition in his capacity as a shareholder and a payment of Rs. 2 lakhs was made to A.M. Buhari in settlement of his rights as a shareholder and it has no connection with the transfer of capital asset effected by the assessee-company in favour of India Tobacco Company Ltd. Though the argument appears to be attractive, we are unable to accept the same. A.M. Buhari, no doubt, initiated proceedings under the provisions of the Companies Act to enforce his rights as a minority shareholder, but the main purpose of the litigation was to prevent the transfer of the hotel buildings in favour of India Tobacco Company Limited. His main case in the company petition before this court was that he had contributed share capital in the assessee-company and he had also lent money for participation in hotel business and in the running of

hotel as Managing Director and if the assessee-company was allowed to transfer its hotel undertaking in favour of India Tobacco Company Limited, the substratum of the assessee-company would be lost and the main object with which the assessee-company was formed would be defeated. His case was that the shareholders are to participate in the running of the hotel and if the hotel undertaking of the assessee-company was disposed of in favour of M/s. India Tobacco Company Limited, it would do away with the entire business for which the company was formed and hence, he sought for interim injunction restraining the Managing Director of the assessee-company from transferring the hotel in favour of India Tobacco Company Limited. The proceedings in the litigation clearly show that a sum of Rs. 2 lakhs was paid to A.M. Buhari in settlement of his claim against the transfer of the assets of the company, more particularly, against the hotel undertaking which was to be transferred in favour of India Tobacco Company Limited and he received the money in full and final settlement of his claims against all the respondents in the company petition including the assessee-company. As far as the sum of Rs. 5 lakhs contributed by A.M. Buhari is concerned, it was paid to him under the same compromise. We are concerned only with the balance amount of Rs. 2 lakhs. We are of the view that if a sum of Rs. 2 lakhs was not paid, the litigation would go on and the assessee-company with a view to purchase peace with A.M. Buhari to enable it to transfer the property in favour of India Tobacco Company Limited had paid the money to A.M. Buhari. We are of the view that the entire chain of events started from the contribution made by A.M. Buhari to the company and the payments made by the company to A.M. Buhari show that there is an inextricable link between the payment to A.M. Buhari and the transfer of the capital asset. We are of the view that the sum of Rs. 2 lakhs was paid to A.M. Buhari over and above his contribution of Rs. 5 lakhs so as to pave way for easy transfer of the property in favour of India Tobacco Company Ltd. In other words, we are of the view that only by the payment of Rs. 2 lakhs, the assessee was in a position to transfer the property, viz., capital asset in favour of India Tobacco Company Limited, and hence we hold that the payment was made wholly and exclusively in connection with the transfer of the capital asset. It was not a payment made partly for the transfer of the asset and partly for the settlement of A.M. Buhari's right as a shareholder as the sum of Rs. 5 lakhs was paid to him separately in settlement of the amounts contributed by him. Hence, the payment of the sum of Rs. 2 lakhs would be referable to the transfer of the assets. Though the litigation was instituted by A.M. Buhari in his capacity of a shareholder of the company, it will be too much to expect on the part of the assessee-company to keep quiet and to allow the litigation to go on thus rendering itself helpless to transfer the property and unable to realise the sale price, when an agreement was entered into on behalf of the assessee for the sale of its property in favour of India Tobacco Company Ltd., though the purchaser was willing to take the property with the risk of litigation.

9. The Bombay High Court in [Commissioner of Income Tax Vs. Shakuntala Kantilal](#), has dealt with a case where the assessee owned a piece of land and she entered into an agreement of sale of the said property with one R and a dispute subsequently arose and R filed a suit for specific performance and there was a settlement whereby the assessee agreed to pay certain sum of money to R and in the meantime, the assessee entered into another agreement of sale in 1967 in respect of the same property with one C and C gave an assurance to R that on the completion of the sale, they would deduct a sum of Rs. 35,504 from the total consideration and pay it to R. The assessee claimed that the sum of Rs. 35,504 should be allowed as deduction for the purpose of computing her income from capital gains. The Bombay High Court held that unless the assessee had settled the dispute with R, the sale transaction with C could not have materialised and the sale consideration had to be reduced by the amount of compensation paid to R. We are in agreement with the view expressed by the Bombay High Court that the expression used in section 48 of the Act, "expenditure incurred wholly and exclusively in connection with such transfer" has wider connotation than the expression, "for the transfer". We are of the view that but for the payment of Rs. 2 lakhs, the transfer would not have taken place and the payment has necessarily to be made for the transfer of the hotel in favour of India Tobacco Company Limited. Hence, we are of the view that the sum of Rs. 2 lakhs was expended by the assessee wholly and exclusively in connection with the transfer of the capital asset and not dehors the transfer.

10. A similar view was also taken by the Bombay High Court in a subsequent case in [Commissioner of Income Tax Vs. Abrar Alvi](#), and the Bombay High Court held that the expenditure incurred in removing encumbrances would be deductible in the computation of capital gains.

11. Learned counsel for the revenue relied upon the decision of this court in D.D. Chittaranjan v. CIT (1992) 193 ITR 238, but the decision is distinguishable as the payment made in that case under a compromise decree had no connection with the transfer of the property sold and hence, the payment was held to be not deductible. This decision has no application at all as there was a serious dispute between A.M. Buhari and the respondents in the company petition only with reference to the property agreed to be sold to India Tobacco Company Limited and but for the payment to A.M. Buhari, the asset could not have been transferred. We are of the view that there is an inextricable connection between the payment and the transfer of the hotel undertaking in favour of India Tobacco Company Limited.

12. Learned counsel for revenue relied upon the decision of this court in [Commissioner of Income Tax Vs. N. Vajrapani Naidu](#), wherein this court was dealing with a case of deduction of money paid in the discharge of mortgage by the vendee and this court held that the amount paid by the vendee in the discharge of mortgage was not deductible in the computation of capital gains. This court

followed the decision of the Supreme Court in [Rm. Arunachalam Vs. Commissioner of Income Tax](#), where the Supreme Court was considering the question whether the sum paid by the assessee for discharging the mortgage by the assessee is a sum which would go to reduce the cost of acquisition. The Supreme Court held that since the mortgage was created by the assessee after he acquired the property, the amount paid in discharge of the mortgage was not deductible. In our view, the decision in N. Vajrapani Naidu's case (supra) has no application at all as in that case, mortgage was created by the assessee subsequent to the acquisition of the property and therefore there is no difficulty in holding that the payment made to discharge the mortgage was not an expenditure incurred wholly and exclusively in connection with the transfer. The distinction pointed by the Supreme Court in R.M. Arunachalam's case (supra) is that where the assessee acquired property subject to mortgage and later on it was discharged at the time of transfer by vendee, then, it would become an expenditure incurred in connection with the transfer, and where the assessee himself created the mortgage after acquisition of capital asset, the amount would not go to reduce the full value of consideration received by the assessee. We are of the view that the decision in N. Vajrapani Naidu's case (supra) has no application. On the facts of the case, there were impediments against the transfer of the property by way of litigation and unless the amounts were paid, the litigation would not have been settled enabling the assessee to transfer the property in favour of the purchaser giving it a clear title and quiet enjoyment of the property. Secondly, in the case of mortgage, by the creation of mortgage, there is a transfer of interest in the property in favour of the mortgagee and after the creation of mortgage the mortgagor has the right of redemption and when he sold the property, he is entitled to receive the entire sale consideration as the owner of the property and a part of it would go to discharge the mortgage which was created by him. Therefore the decision in N. Vajrapani Naidu's case (supra) has no application to the facts of the case.

13. Learned counsel for revenue also relied upon the decision of the Supreme Court in [Commissioner of Income Tax Vs. Attili N. Rao](#), and the case has no application to the facts of the case as in that case the property was sold in auction and the entire money realised belonged to the assessee and after realisation, the State deducted its due towards kist. The Supreme Court held that capital gains had to be computed on the full price less admissible deductions realised at the time of transfer. A similar view was also taken by the Delhi High Court in [Sita Nanda Vs. Commissioner of Income Tax](#), and the Delhi High Court held that payment of interest in the shape of damages for late payment of unearned increase is not an expenditure incurred wholly and exclusively in connection with the transfer. This decision has no application to the facts of the case as well.

14. We, therefore, hold that the amount of Rs. 2 lakhs was paid to get over the difficulties created by A.M. Buhari for the sale of the property and unless the amount was paid, the transfer of property would not have taken place at all. We,

therefore, hold that the Appellate Tribunal was right in holding that the payment had an intimate connection with the transfer of the undertaking as by allowing the litigation to go on the hands of the company would be tied against the transfer of the undertaking in favour of India Tobacco Company Limited and the assessee would not have realised the sale consideration from the prospective purchaser.

15. Insofar as a sum of Rs. 1.5 lakhs paid by India Tobacco Company Limited is concerned, we are of the view that though the sum of Rs. 1.5 lakhs was paid by the said company only to settle the claim of A.M. Buhari, the money was received by the assessee in connection with the transfer of the hotel undertaking and it would form part of sale consideration. However, since the money was paid by the assessee-company, it would also constitute an expenditure wholly and exclusively in connection with the transfer. In the case of payment of Rs. 50,000, the same analogy would apply. In so far as the litigation expenditure of a sum of Rs. 16,000 is concerned, we hold that the Appellate Tribunal was right in holding that the litigation expenditure was also incurred wholly and exclusively in connection with the transfer and thus, it was deductible.

16. Accordingly, we answer the questions of law referred to us as under :

First question :

In the affirmative, against the revenue and in favour of the assessee.

Second question :

In view of the answer to the first question, no answer is necessary to the second question.

Third question :

In the affirmative, against the revenue and in favour of the assessee.

No costs.