(2012) 08 CAL CK 0020

Calcutta High Court

Case No: IT Appeal No''s. 98, 99 and 265 of 2003 (Arising out of orders of Tribunal in ITA No. 698 of 1999 dated 28-11-2002 and ITA No. 1177 of 2000 dated 10-6-2003)

Standipack (P.) Ltd.		APPELLANT
	Vs	
Commissioner of Income Tax, Kolkata-IV		RESPONDENT

Date of Decision: Aug. 30, 2012

Acts Referred:

- Civil Procedure Code, 1908 (CPC) - Section 27
- Contract Act, 1872 - Section 68
- Income Tax Act, 1961 - Section 143(3), 37(1), 73

Citation: (2013) 350 ITR 251 : (2012) 211 TAXMAN 144

Hon'ble Judges: K.J. Sengupta, J; Joymalya Bagchi, J

Bench: Division Bench

Advocate: J.P. Khaitan, D. Mitra and S. Das, for the Appellant; R.N. Bandhopadhyay, S.B. Sarof, Aniket Mitra, Siddartha Chatterjee, Dipak Som and Prithu Dindhuria, for the Respondent

Final Decision: Dismissed

Judgement

Joymalya Bagchi, J.

The aforesaid appeals have been heard analogously and are being disposed of by a common judgment and order since they relate to similar questions of law and facts.

I.T.A. No. 98 of 2003 was admitted in respect of assessment year 1991-92 on the following questions of law :

(I) Whether on the facts and in the circumstances of the case the tribunal misdirected itself in law and it adopted a wholly erroneous approach in confirming the disallowance of overseas travel (Rs. 40,443/-) and educational expenditure (Rs. 3,37,084-/) in the aggregate sum of Rs. 3,77,527/-incurred by the appellant/assessee

company herein in respect of his trainee employee, Sri Saumya Meattle and whether its findings on the aforesaid issue are vitiated in law having been recorded by it without any material and/or in disregard of the undisputed material facts including the relevant and vital evidences on record and whether such findings are wholly unreasonable and/or otherwise perverse.

(II) Whether on the facts and in the circumstances of the case the tribunal misdirected itself in law and it adopted a wholly erroneous approach in confirming the disallowances of Rs. 1,66,660/- representing commission paid by the appellant/assessee company to M/s. Telecom Ancillaries Pvt. Ltd. and whether its findings on the aforesaid issue are vitiated in law having been recorded by it without any material and/or in disregard of the undisputed material facts including the relevant and vital evidences on record and whether such findings are wholly unreasonable and/or otherwise perverse.

(III) Whether on the facts and in the circumstances of the case the and on a correct interpretation of Section 73 of the income tax Act, 1961 the tribunal misdirected itself in law and it adopted a wholly erroneous approach in confirming the disallowances of short term capital loss in the aggregate sum of Rs. 4,17,550/- suffered by the appellant/assessee company in purchase and sale of shares of M/s. Reliance Industries Ltd. and M/s. JCT Ltd. the two quoted Public Limited Companies and whether its findings on the aforesaid issues are vitiated in law having been recorded by it without any material and/or in disregard of the undisputed material facts including the relevant and vital evidences on record and whether such findings are wholly unreasonable and/or otherwise perverse.

1. I.T.A. No. 99 of 2003 was admitted in respect of assessment year 1993-94 on a question of law similar to question No. II in I.T.A. No. 98 of 2003 as follows :

Whether the tribunal could confirm the disallowance of Rs. 12,00,000/-representing payment made by the appellant/assessee company to M/s. Telecom Ancillaries Pvt. Ltd. on the erroneous Finding that the agreement was made on 25th March, 1992 not on 25th January, 1992 and thereby holding that this was entered at the fag end of the year and was not followed by a business necessity or expediency and even then the agreement would not eliminate competitors other than M/s. Telecom Ancillaries Pvt. Ltd. and hold that it was not an arrangement out of prudent business planning but was made to reduce tax liability and thus had come to a perverse finding.

I.T.A. No. 265 of 2003 was admitted in respect of assessment year 1996-97 on a question of law similar to question (I) in I.T.A. No. 98 of 2003, save and except the fact that the disallowance for overseas travel and educational expenses was to the tune of Rs. 3,043,591/- for the said assessment year.

For the sake of convenience question No. I in I.T.A. No. 98 of 2003 and that in I.T.A. No. 265 of 2003 are taken up for consideration simultaneously.

2. The factual background from which such question of law emanates is set out hereinbelow.

The appellant company was mainly engaged in the business of manufacturing and trading of corrugated sheets, curtains, flexible plastic bags and pouches, filling machines, filling of oil and other materials in plastic pouches and supplying them to Public Sector Oil Companies. The company also carried on investment in shares and securities of quoted companies. On or about 28.05.1990 the company appointed one Saumya Meattle, minor, aged about 17 years two months, who had passed the 10 + 2 examination as a trainee in the appellant company for a remuneration of 2000/- per month. In terms of his letter of appointment, Saumya Meattle was to join the company on or before 1st June, 1990. Within a few days from his date of joining, the company took a resolution in its Board meeting held on 04.06.1990 for sponsoring the aforesaid Saumya Meattle for advance study in Computer Science from University of South California Lose Angles, USA as an employee of the company on condition, inter alia, that he shall continue be an employee of the company for seven years after completing his course in USA and he along with his guarantor Ms. Gnan N. Swarup, would execute a surety bond for a sum of Rs. 2,00,000/- plus all costs and charges that shall/may be incurred by the company in that regard.

Pursuant to such understanding it appears that a surety bond was got to be duly executed by the Saumya Meattle and Ms. Gnan Swarup as his guarantor. On attaining majority, the said Saumya Meattle by a further undertaking dated 21.08.1991 ratified his liabilities under the contract and the said bond. It is apposite to mention that even prior to his appointment the said Saumya Meattle made an application on 23.04.1990 to the banker for release of foreign exchange for studies abroad which was granted by the banker on 22.06.1990. Saumya Meattle completed his studies in the University of South California, USA and obtained a bachelor degree in the field of Computer Science in May, 1995.

In the meantime, the company in its Board meeting held on 16.05.1994 took another resolution to sponsor the said Saumya Meattle for pursuing his Master Degree in Accounting at the self-same University, inter alia, on the condition that the said Saumya Meattle along with his guarantor Ms. Gnan Swarup shall execute fresh surety bond to the tune of Rs. 3,50,000/-plus all costs and charges that shall or may be incurred by the company in that regard and that he shall serve as an employee of the company for a minimum period of seven years after completing his degree. The said Saumya Meattle along with Ms. Gnan Swarup duly executed such bond and he successfully completed his course and obtained a Master Degree in Accounting from the said University on 12.05.1995. Thereafter, Mr. Meattle obtained practice training in the reputed International Private Company Group of Marlin, London as an intern from July, 1995 to July, 1996.

3. By letter dated 15.07.1996 the appellant company appears to have confirmed the service of Saumya Meattle with effect from the self-same date and it appears that thereafter Mr. Meattle worked in the appellant company.

The company filed return of income for the assessment year 1991-92 showing a total income declaring an assessable income of Rs. 11,30,410/-.

4. The Assessing Officer after examining the relevant records and/or evidence produced in the course of the assessment proceeding completed income assessment for the said year and by the impugned assessment order dated 21.03.1994 passed u/s 143(3) of the Act determined total income of the appellant company for the said year to the tune of Rs. 22,14,416/- by inter alia disallowing the educational expenses and expenses of account of foreign travel undertaken by the company in connection with the aforesaid Saumya Meattle to the tune of Rs. 3,37,084/and Rs. 40,443/- respectively.

5. The assessee company appealed against such order before the Commissioner of income tax (Appeals) and the said Commissioner (Appeals) dismissed the said appeal by its order dated 19.02.1999.

6. Being aggrieved by the said appellate order dated 19.02.1999 the appellant company filed an appeal before the tribunal which was being I.T.A. 698 (Cal.) of 1999. The said appeal was heard along with another appeal filed by the appellant company being I.T.A. No. 699 (Cal.) of 1999 arising out of assessment year 1992-93 and both the appeals were disposed of by the learned tribunal by its impugned order dated 28th November, 2002. Hence, the present appeal being I.T.A. No. 98 of 2003 has been filed in respect of assessment year 1991-92.

7. Similarly, in respect of the assessment year 1996-97 the Assessing Officer passed an assessment order dated 30.03.1999 u/s 143(3) of the income tax Act by disallowing the overseas educational and training expenses to Saumya Meattle to the tune of Rs. 2,44,991 /- and his overseas travel expenses to the tune of Rs. 98,600/- for the said assessment year.

8. Such order was also appealed before the Commissioner of income tax-X, (Appeals) Calcutta who dismissed the same by his order dated 09.03.2000 inter alia on the ground that on similar ground such disallowance had been confirmed in the earlier assessment year 1991-92, as aforesaid. The appellant company thereafter approached the tribunal against the said order of CIT (Appeals). The tribunal dismissed the said appeal being I.T.A. No. 1177 (Cal.) of 2000 by impugned order dated 10th June, 2003 in view of its earlier order dated 28th November, 2002 passed in respect of the assessment year 1991-92 in I.T.A. No. 698 (Cal.) 1999, as aforesaid. The present appeal being I.T.A. No. 265 of 2003 has been filed challenging the said order of the tribunal in respect of assessment year 1996-97.

9. Hence in both these appeals the self-same issue falls for decision as to whether the confirmation of disallowance of overseas educational expenses and foreign travel expenses undertaken by the appellant company in respect of its trainee Saumya Meattle was vitiated in law or was based on findings which are wholly unreasonable or otherwise perverse.

10. Mr. Khaitan, learned Senior Counsel appearing for the appellant submitted that the appointment was made to Saumya Meattle after assessing his academic achievement with the intention sponsoring his overseas education on the understanding that the trainee would serve the appellant company for a minimum period of seven years. The Board resolutions to that effect were passed by the appellant company and the trainee and his surety executed necessary bonds. He assailed the finding of the learned tribunal on the ground that the minority of Saumya Meattle at the time of his appointment was not material inasmuch as he subsequently ratified the surety executed by him upon attaining majority and that a contract executed by a minor is good against the whole world and the minor if he wishes to have the same annulled has to take recourse to appropriate proceeding.

11. In support of his contention he relied on a decision reported in Dhurandhar Prasad Singh Vs. Jai Prakash University and Others, . That apart, he submitted that u/s 68 of the Indian Contract Act, 1972 the appellant was entitled to be reimbursed from the property of the minor inasmuch as "necessaries" within the meaning of the said section included educational expenses. Recourse could also be taken against the surety in terms of the section 120 of the Contract Act.

12. Mr. Khaitan further challenged the finding of the tribunal that the sponsorship was colourable in nature. He strongly disputed the finding of the tribunal that such expenditure was personal expenditure in the guise of "staff welfare expenses". He submitted that such finding was wholly perverse as the trainee had no relation with any of the directors of the appellant company. He however admitted that the mother of the trainee was a partner in a firm in which the company was also a partner and that in respect of the assessment year 1996-97 relating to I.T.A. No. 265 of 2003 a relative of the trainee held substantial shares in the appellant company.

13. He further submitted that the findings of the tribunal were based on mere surmise and the expenses incurred by the company for overseas educational foreign travel were clearly deductible in terms of Section 37(1) of the income tax Act.

14. Mr. Khaitan relied on a unreported decision of this Court in I.T.A. No, 249 of 2005 (M/s. Gour Nitya Tea Industries Ltd. v. CIT) delivered on 24th June, 2010 in support of his contention that since there are materials on record that the appellant had served the company after returning from abroad it cannot be said that the expenditure undertaken by the company was colourable and not wholly and exclusively for the purpose of its business.

15. Mr. Khaitan also submitted certain additional documents to bolster his contention that the appellant had in fact been in the service of the company till 31st March, 2009 and salaries had been duly paid to him.

16. Mr. Som, learned senior advocate appearing for the revenue in I.T.A. No. 265 of 2003 hotly contested the submissions of Mr. Khaitan. He submitted that the letter of appointment of Saumya Meattle on 28.05.1990 was void inasmuch as he was a minor at that time. In support of his contention he relied on decisions reported in AIR 1941 Bom 215 (Sic), 32 ITR 550 (Sic), Ram Nagina Singh Vs. Governor-General in Council, and Hari Satya Banerjee and Others Vs. Mahadev Banerjee and Others,

17. He further submitted that the action of the company to sponsor the aforesaid trainee was clearly a colourable one and is device to keep aside a portion of income from the purview of tax liability inasmuch as the decision to sponsor his overseas education was taken within a couple of days of his joining as a trainee and that there was no exceptional circumstance to justify the same, particularly, bearing in fact that the company had not undertaken such sponsorship in respect of any employee either in the past or thereafter.

18. He further submitted that Saumya Meattle had already been selected for the overseas course prior to his appointment on 28.05.1990 which is evident from the date of his application for release of foreign exchange i.e. 23.04.1990. He submitted that additional documents submitted before this Court should not be taken into consideration inasmuch as the same have not been admitted in terms of order 41 rule 27 of the Civil Procedure Code.

19. Learned Counsel further submitted that the decision in the case of Gour Nitya Tea Industries (supra) is clearly distinguishable from the facts of the instant case.

20. Learned counsel appearing in I.T.A. No. 98 of 2003 adopted the submission of Mr. Som and further submitted that the decision in Sassoon J. David and Co. Pvt. Ltd., Bombay Vs. Commissioner of Income Tax , Bombay, s clearly distinguishable in the facts of the instant case.

21. In view of the aforesaid submissions of the parties one requires to test whether the finding of the tribunal that the sponsorship for overseas studies and the travel expenses undertaken by the company was colourable or not or in other words was such expenditure wholly and exclusively for the business of the company or the same was merely the designed for ulterior purpose.

22. It is true that the letter of appointment of the trainee was issued at a time when he was a minor. However, it must be borne in mind that subsequently the minor on attaining majority had ratified of such contract and also his liabilities arising therefrom.

The judgments cited by Mr. Som in this regard are clearly distinguishable on facts as in none of the cited cases the minor on attaining majority had ratified his liabilities

arising from such contract. On the other hand, in the case reported in Dhurandhar Prasad Singh such a contract is held to be good against the whole world.

23. In view of such fact it may not be correct to hold that there was no binding contract between the company and the trainee in the instant case. However, a more relevant issue in the matter is whether the act of the company in sponsoring such a minor trainee within a couple of days of his appointment for pursuing the studies in Computer Science, without assessing his competence and capability, can be construed to be a bona fide act on its part or a colourable devise for ulterior purposes. The Tax Authorities below have rightly come to conclusion on facts that the appellant company without assessing the competence of the trainee and within a couple of days from his joining sponsored him for pursuing study in software development - an area which was unconnected with the business activity of the company at the time when such decision was taken.

24. It is an admitted position that the principal business of the company was manufacturing and supplying of packets/pouches to oil manufactures for filling and packaging their products. It was only in the assessment year 1992-93 the company made necessary amendments in its memorandum to enable it to enter the business of computer operation and data processing while the decision to send the trainee abroad for computer education was in 04.06.1990.

25. Therefore, it cannot be said that the sponsoring of the trainee for overseas computer education was for the business of the company at the time when such decision was taken on 04.06.1990. Furthermore, the trainee had already secured admission for such course in the foreign University and applied for release of foreign exchange with regard thereto five weeks prior to his appointment. Hence, the finding of the tribunal that the sponsorship of the trainee was colourable in nature and not for the purpose of business of the company his wholly justified and borne out from the materials on record.

26. We, however, do not agree with the tribunal that the trainee was a relation of one of the directors of the company but that is neither here nor there inasmuch as the purpose for which the trainee was being sent abroad, namely, computer education was admittedly not one of the businesses in which the company was indulging in at the time when the board resolution was taken to sponsor his foreign education.

27. Subsequently, whether the company was marginally engaged in the business of computer software development or that after his foreign sojourn the trainee worked for some period in the appellant company does not change the attending circumstance that at the time when the board took resolution to sponsor his overseas education of the trainee on 04.06.1990. The Company had no business expediency so as to treat the same as being business expenditure.

28. In this regard, it has been rightly argued on behalf of the revenue that the ratio in the case of Gour Nitya Tea Industries Ltd v. CIT is clearly distinguishable on facts. In that case, the appellant had been sent abroad after working as a trainee for more than nine months in the assessee company and the purpose of overseas education was in an area which the principal business of the assessee company. The said facts are significantly absent in the instant case to justify the deduction claimed by the appellant company u/s 37(1) of the income tax Act.

29. The ratio of the case reported in Sasoon J. David & Co. (P.) Ltd (supra) is not applicable in the facts of the instant case since the business of the company which is principally in the area of manufacturing and marketing of plastic pouches cannot justify the sponsoring of the trainee for overseas education in computer software development and accounting. Even for accounting purpose of the company no employee is required to be sent at road. It must be borne in mind that this was also not a regular practice of the company, inasmuch as no one before or thereafter had been selected by the company for such preferential treatment in the matter of obtaining overseas education.

30. For the aforesaid reasons, we find that the findings of the tribunal in this regard are wholly justified and do not require interference. The question No. I in I.T.A. No. 98 of 2003 and I.T.A. No. 265 of 2003 is therefore answered in the negative in favour of the revenue and against the appellant.

31. The question No. II in I.T.A. No. 98 of 2003 and the sole question of I.T.A. No. 99 of 2003 are taken up for consideration simultaneously. The issue involved herein is whether the confirmation of disallowance with regard to commission paid by the company to M/s. Telecom Ancillaries Pvt. Ltd. to the tune of Rs. 1,66,6660 in assessment year 1991-92 (in I.T.A. No. 98 of 2003) for providing expertise to apply for tender and follow up action for acceptance of tender and a sum of Rs. 12,00,000/- to the said M/s. Telecom Ancillaries for the assessment year 1992-93 (in I.T.A. No. 99 of 2003) for restraining the latter from participating in the tender and for taking follow up action for acceptance of the tender in favour of the appellant company was justified or not.

32. Mr. Khaitan appearing for the appellant company argued that the finding of the tribunal that the said agreements were entered into at the end of the financial year was perverse and that the disallowance was confirmed on the basis of irrelevant considerations. He emphasized that this was a standard practice which was adopted by the company in earlier and subsequent years and that due to the arrangement of non-participation of M/s. Telecom Ancillaries in the tender the appellant company earned substantial profit in the subsequent years. He further relied on the decision reported in S.A. Builders Ltd. Vs. Commissioner of Income Tax (Appeals), Chandigarh and Another, that if the expenses are incurred as a measure of commercial expediency, the revenue cannot put itself in the armchair of the businessman and decide the reasonableness of such expenditure.

33. The learned counsel appearing for the revenue resisted such contention on the ground that the findings of the tribunal were wholly justified. It was submitted that the purpose for entering such agreement with M/s. Telecom Ancillaries Pvt. Ltd. in the matter of providing expertise for applying for tender and follow up action for obtaining the same were woefully vague and were wholly impermissible in the matter of public tender floated by Public Sector Companies. It was his submission that in the event the gist of the agreement appeared to be one which was impermissible in the factual backdrop of the transaction, the question of commercial expediency did not arise.

34. It is true that the agreement between M/s. Telecom Ancillaries Pvt. Ltd. and the appellant company was executed on 25.01.1992 (in the assessment year 1992-93) instead of 25.03.1992 as wrongly recorded by the tribunal in paragraph 11 of its order in I.T.A. No. 99 of 2003. However, bearing in mind the nature of the contract namely providing expertise in preparation and procurement of tender in favour the appellant company with regard to tender floated by Public Sector organization we have no doubt in our mind that scope and ambit of payment of such commission transcended the lawful or permissible limits of participation in such tender. Furthermore, the tribunal has rightly held that the nature of such expertise in preparation of tender documents and follow up action for obtaining such tender has not been clearly spelt out. When the commission payments had been made in for purposes which are prima facie impermissible in law the question of permitting such expenses on the anvil of commercial expediency does not arise at all. The decision in S.A. Builders Ltd.''s case (supra) is not of any assistance to the appellant as it did not relate to legally impermissible expenditure as in the instant case.

35. The issue of payment of 12 lakh inter alia, for ensuring non-participation of M/s. Telecom Ancillaries Pvt. Ltd. in the tender and also for follow up action to procure such tender in favour of the opposite party also smacks of creating a cartel in the matter of public tender which equally impermissible in law. Furthermore, the finding of the tribunal that such agreement does not shut out other companies from contesting the tender also a justifiable ground for such disallowance.

36. We, therefore, hold that the findings of the tribunal are clearly justified and the confirmation of the aforesaid disallowance is justly warranted in law. The question No. II in I.T.A. No. 98 of 2003 and the sole question in I.T.A. No. 99 of 2003 is accordingly answered in the negative in favour of the revenue and against the appellant.

37. Question No. III in I.T.A. No. 98 of 2003 relates to the confirmation of disallowance of short term capital loss to the tune of Rs. 4,17,550/- suffered by the appellant company in the purchase and sale of shares of M/s. Reliance Industries Ltd. and M/s. ITC Ltd. for the assessment year 1991-92.

38. Mr. Khaitan has argued that the tribunal after holding that the appellant company is not in the business of purchase and sale of shares ought not to have disallowed such short term capital loss on the ground that the same are speculation losses as provided in the Explanation to section 73. Learned counsel appearing for the revenue opposed such submission. He submitted that the appellant company need not be primarily into the business of purchase and sale of shares and even if a few transaction of that nature are evident the loss suffered in such transactions shall be construed to be speculation loss by the deeming provision contained in the Explanation to section 73 of the income tax Act.

39. This issue therefore calls for an interpretation of the Explanation to Section 73 of the income tax Act.

Explanation to Section 73 of the income tax Act is read as follows :

Losses in speculation business.

Explanation : Where any part of the business of a company other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

40. A plain reading of the aforesaid provision of law would show that if a part of the business of the company consisted of purchase and sale of shares of other companies, the said company would be deemed to be in speculation business and loss suffered by such company in such activity, i.e. purchase and sale of shares, would be deemed to be speculation loss and would not be deductible from the profits and losses of the said company in respect of other businesses. Hence, the condition precedent for attracting the said provision is that a part of the business of the company must relate to purchase and sale of shares.

41. Indisputably CIT (Appeals) as well as the tribunal had come factually to a conclusion that the appellant company was not involved in the business of sale and purchase of shares. Merely indulging in purchase and sale of shares for investment is not business activity in sale and purchase of share of other companies for the purpose of this section.

42. In view of such fact, precondition necessary for attracting the Explanation to section 73 is absent in the instant case and the disallowance of this loss treating the same being speculation one is wholly unwarranted.

43. Furthermore, the conduct of the company in selling the shares in questions soon after taking delivery of the shares when it is found that the value of such shares

were rapidly decreasing cannot be said to be unjustified or imprudent. The reasoning of CIT (Appeals) that there was no pressing need for the appellant company to sell the shares on 18.12.1990 within a short span of time of its acquisition was clearly perverse in the admitted facts of the instant case.

44. The confirmation of the disallowance of such short term capital loss suffered by the company in the assessment year 1991-92 as speculation loss is illegal and therefore set aside- Question No. III in I.T.A. No, 98 of 2003 is accordingly answered in affirmative in favour of the assessee and against the revenue. I.T.A. No. 98 of 2003 is allowed in part, as aforesaid. I.T.A. No. 99 of 2003 and I.T.A. No. 265 of 2003 are dismissed. The interim order, if any, stands vacated. The Assessing Officer is directed to recompute the total income and the tax payable by the appellant company in respect of the assessment year 1991-92 in terms of the findings in the instant judgment and order.