(1994) 11 BOM CK 0055

Bombay High Court

Case No: Income-tax Reference No. 449 of 1983

Commissioner of Income Tax	APPELLANT
Vs	
Sales Magnesite (Pvt.) Ltd.	RESPONDENT

Date of Decision: Nov. 25, 1994

Acts Referred:

- Income Tax Act, 1961 - Section 37, 40, 40A(5), 80VV

Citation: (1995) 214 ITR 1

Hon'ble Judges: S.M. Jhunjhunwala, J; B.P. Saraf, J

Bench: Division Bench

Advocate: T.U. Khatri, for the Appellant; S.J. Mehta, for the Respondent

Judgement

DR. B.P. Saraf, J.
By this reference u/s 256(1) of the Income Tax Act, 1961, made at the instance of the Revenue, the Income Tax Appellate Tribunal, Bombay Bench "C", Bombay ("the Tribunal"), has referred the following two questions of law to this court for opinion :

"1. Whether, on the facts and in the circumstances of the case, compensation paid to sole selling agents on the termination of the agency in accordance with the provisions of the Companies Act, 1956, as amended on August 1, 1975, was an allowable deduction for the assessment year 1977-78 ?

2. Whether, on the facts and in the circumstances of the case, in the case of a director who is also an employee of the assessee-company, the provisions of section 40(c) of the Income Tax Act, 1961, are applicable and not the provisions of section 40A(5) of the said Act ?"

2. Counsel for the parties are agreed that the controversy in the second question is covered by the decision of this court in Commissioner of Income Tax Vs. Hico Products (P.) Ltd., ; where it has been held that the provisions of section 40(c) of the Income Tax Act, 1961, would be applicable in the case of a director who is also an

employee of the assessee-company, and not the provisions of section 40A(5) of the Act. In view of the above, we answer the second question in the affirmative and in favour of the assessee.

3. The only controversy that survives for our consideration is the one involved in question No. 1 which relates to the allowability of the sum of Rs. 1,85,855 paid by the assessee to its sole selling agents, Messrs. Sun Traders (Bombay) Private Ltd., for loss of office of sale selling agency of the assessee-company. The material facts relevant for determination of the above Controversy are as follows :

The assessee had appointed as sole selling agents another company called Messrs. Sun Traders (Bombay) Pvt. Ltd. under an agreement dated August 1, 1951. Initially, the agreement was for a period of two years subject, however, to termination by either party by giving at least three months'' notice. The remuneration was fixed at 2 1/2 per cent. of the net sales. This agreement was renewed from time to time. The last renewal in accordance with the provisions of the Companies Act, 1956, was effected on January 1, 1971, for a period of five years. Thus, in the normal course, the sole selling agency would have come to an end on December 31, 1975. However, on account of amendment of the Companies Act, 1956, with effect from February 1, 1975, no company could appoint a sole selling agent who had a substantial interest in the company unless such appointment was previously approved by the Central Government. Moreover, though, according to the provisions of the Income Tax Act, the sole selling agent cannot be treated as a person having a substantial interest, the sole selling agent in the present case was liable to be so treated under the provisions of the Companies Act and as the prior approval of the Central Government was not taken, the sole selling agency stood terminated as on August 1, 1975.

By a letter dated July 14, 1976, the sole selling agents claimed compensation for the loss of office of sole selling agency. There was an exchange of letters on the subject between the assessee and the sole selling agents. The assessee also obtained the opinion of its solicitors who opined that the assessee was liable to pay compensation for the loss of office to the sole selling gents Messrs. Sun Traders (Bombay) Pvt. Ltd. The solicitors considered the provisions of section 294AA of the Companies Act and indicated that the assessee was not prohibited from paying such compensation. Situated thus, the assessee paid a sum of Rs. 1,85,855 as compensation to the sole selling agents. This amount more or less conformed to the remuneration which the sole selling gents would have obtained for the unexpired term of the office. The payment fell during the accounting year relevant to the assessment year 1977-78.

4. The assessee claimed deduction of this amount in the computation of its income in both the assessment years, viz., 1976-77 and 1977-78. The Income Tax Officer being of the opinion that the compensation paid by the assessee was not allowable as business expenditure; rejected the claim of the assessee for deduction of the

same.

5. The assessee appealed to the Commissioner of Income Tax (Appeals), who affirmed the order of the Income Tax Officer and dismissed the appeals of the assessee. While doing so, the Commissioner (Appeals) was influenced by the fact that the assessee did not exercise its option of terminating the agency agreement under the provisions of the agreement of 1951 by giving three months'' notice to the sole selling agents but the agreement stood terminated by virtue of the provisions of the Companies Act with effect from August 1, 1975, and that the assessee could have easily avoided the payment of compensation. He, therefore, held that the payment was not governed or dictated by commercial expediency.

6. The assessee went in further appeal to the Income Tax Appellate Tribunal. The Tribunal considered the case of the assessee and observed that compensation had been given by the assessee in the light of its solicitor''s opinion and the provisions of the Companies Act. The Tribunal also observed that there was nothing to say that the payment made by the assessee was illusory of mala fide. It was also noted by the Tribunal that no evidence Had been brought on record by the Revenue to show that the transaction in question was a got-up affair in order to hoodwink the Revenue and that the claim made by the sole selling agents was a sham claim. From the facts and circumstances of the case, the Tribunal was satisfied that in the instant case, compensation was paid by the assessee for the best interests of business of which, in the absence of any thing on record to the contrary, the assessee was the best judge. The Tribunal also observed that the claim for compensation being made by the sole selling agents in the previous year relevant to the assessment year 1977-78, the liability arose in the said assessment year and, hence, it was allowable in the assessment year 1977-78 and not 1976-77. Aggrieved by this order of the Tribunal, the Revenue has come to this court with this reference for opinion on the question of law arising out of the above order which has been referred by the Tribunal as question No. 1

7. We have carefully considered the facts of the case. We have also noted the finding of the Tribunal that the payment made by the assessee to its sole selling agents as compensation for termination of the sole selling agency was a business expenditure which was incurred by the assessee after proper consideration of the facts and circumstances of the case and on the basis of legal opinion of its solicitors. The Tribunal has also recorded a clear finding of fact that the payment was made for commercial expediency. In view of this clear finding that the payment for termination of the sole selling agency was wholly on business considerations, we do not find any cogent reason to hold that the claim of the assessee was not allowable as a business deduction.

8. The principles governing the allowance of deduction in respect of such expenditure are well-settled by now by a catena of decisions of the Supreme Court and the various High Courts. Such deductions are ordinarily claimed and allowed u/s

37 of the Act which is a residuary section extending the allowance of deduction to items of business expenditure not covered by any of the preceding sections (sections 30 to 36) and section 80VV. The only conditions are that : (i) it is not an expenditure, (a) in the nature of capital expenditure, or (b) personal expenses of the assessee, and (ii) it is laid out or expended wholly and exclusively for the purposes of the business or profession.

9. Various tests have been evolved by the courts from time to time to decide whether an expenditure is incurred for the purposes of business. One of the tests often applied is whether it is incurred by the assessee in his character as a trader. To hold it to be an expenditure allowable as a deduction u/s 37, it is not essential that it should be necessary, legally or otherwise, to incur the same or that it should directly and immediately benefit the business of the assessee. Even expenditure incurred voluntarily on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business would be deductible under this section. The question whether it was necessary for commercial expediency or not is a question that has to be decided from the point of view of the businessman and not by the subjective standard of reasonableness of the Revenue. As observed by the, Supreme Court in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , the question must be viewed in the larger context of business necessity or commercial expediency. No abstract or pedantic view can be taken in the matter.

10. Applying these tests to the facts of the present case, it is clear that the payment of compensation made by the assessee to its erstwhile sole selling agents for loss of the sole selling agency is allowable as a deduction u/s 37 of the Act in the computation of the income of the assessee. This is particularly so in view of the following findings of fact arrived at by the Tribunal which are not the subject-matter of challenge in this reference application :

(i) The factum of payment is proved;

(ii) There is, nothing on record to show that the payment was illusory or that the assessee''s claim was mala fide;

(iii) There is no evidence on record to show that the transaction was a got-up affair to hoodwink the Revenue;

(iv) The claim of the sole selling agents is not sham;

(v) The compensation has been given in the light of the opinion of the solicitors, who advised the assessee to pay the same;

(vi) The amount paid by way of compensation more or less corresponds to the amount of remuneration that would have been payable for the unexpired period of the agency;

(vii) The payment was for business or commercial expediency.

11. Learned counsel for the Revenue placed reliance upon the provisions of section 294AA(2) of the Companies Act, 1956, in support of his contention that the sale selling agency stood automatically terminated in the absence of the approval of the Central Government. It was urged that there being no legal obligation on the assessee to pay any compensation to the said sole selling agents, the payment made by the assessee by way of compensation for loss of office of sole selling agents cannot be held to be for commercial considerations. We are not impressed by these submissions. So far as the second contention regarding payment for extra-commercial considerations is concerned, we find that it is wholly untenable in view of the clear finding of the Tribunal to the contrary. The Tribunal, on consideration of the totality of the facts and circumstances of the case, has come to a clear findings of fact that the payment was dictated by commercial expediency. This finding of fact having not been challenged on the ground of perversity or the like, it is not open to the Revenue at this stage to contend that the payment of compensation by the assessee was not for business considerations but was a payment for extra-commercial considerations. On the facts also, there does not appear to be anything wrong or unusual in the payment of the sum of Rs. 1,55,855 by way of compensation to the sole selling agents for loss of office which they had been holding for more than three decades and in claiming deduction of the same in the computation of its total income. We, therefore, answer the first question also in the affirmative and in favour of the assessee.

12. In the facts and circumstances of the case, parties shall bear their own costs.