(1942) 04 BOM CK 0014

Bombay High Court

Case No: Income-tax Reference No. 5 of 1941

COMMISSIONER OF Income Tax		APPELLANT
	Vs	
SIR HOMI M. MEHTA.		RESPONDENT

Date of Decision: April 7, 1942

Acts Referred:

- Income Tax Act, 1961 - Section 66(2)

Citation: (1943) 11 ITR 142

Hon'ble Judges: Beaumont, C.J

Bench: Division Bench

Judgement

BEAUMONT, C.J. - This is a reference made by the Income Tax Commissioner u/s 66(2) of the Income Tax Act. The year of assessment is the financial year 1937-38, and the accounting periodis the calendar year 1936; so that we have to deal with the; Income Tax Act of 1922 before the amendment of 1939.

The Commissioner has raised two questions. The first one is :-

"Whether in the circumstances of the case there was evidence before the Income Tax authorities on which they could come to the conclusion that the sum of Rs. 96,587, which has been included in the assessment, represented profits from trading in shares and not capital appreciation."

On that question no argument has been addressed to us, and Sir Jamshedji Kanga for the assessee says that he does not wish to press the question, and agrees that it should be answered in the affirmative, that being the sense in which the Commissioner has answered it. So that we are only concerned with the second question, which is in these terms :

"Whether in the circumstances of the case of sum of Rs. 3,28,645 paid by the assessee on behalf of the British India General Insurance Company is expenditure allowable u/s 10(2)(ix) or under the provisions of Section 7 or Section 12 of the Act."

It appears from the case that the Insurance Company in question, which is in fact a Limited Company, though it is not so stated in the question, was promoted by the assessee, and the assessee continues to be a Director and Managing Director of the Company, for which he receives a salary, and he holds 25,000 shares out of a total of a lac of shares. The Company got into financial difficulties owing to a large claim made against it by a foreign Company, and the assessee came to the rescuer of this Company, and during the accounting period made to it a gift of the sum mentioned in the question, and we have to determine whether that sum can be allowed as a deduction. It is, of course, obvious that primarily the business for the preservation of which the payment was made, was the business of the Company, and not the business of the assessee. But it is said that the payment was made, in part, in order to preserve the fees payable to the assessee as Director and Managing Director and the dividends on his shares in the Company. So far as those items of income are concerned, it seems to me that they clearly would not come within Section 10 of the Act, which deals with deductions allowable from income derived from business, but would have to be brought within the provisions of Section 12, which deals with tax on other sources of income. It is said, however, that the case may be brought within Section 10, because part of the business of the assessee consists in the promotion and financing of Companies. And that the object of this payment was to preserve such business and the assessees reputation as a businessman, so as to secure income from future promotion of Companies.

Dealing with the particular items of income derived by the assessee from this company, which as I have said, fall within Section 12 as income derived from other sources, a deduction can be made u/s 12(2) for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains. It seems to me quite impossible to say that this payment was made to the company solely for the purpose of enabling the assessee to maintain his income derived from the Directors and Managing Directors fees and dividends on shares. The object of the expenditure must have been also the preserve the value of the other 75 per cent. of the shares in the company which the assessee did not hold. If his sole purpose had been to preserve his income derived from that particular Company, obviously a more business-like arrangement would have been to make to the Company a loan, which could have been re-paid to the assessee as a debt. But the main object was to keep the Company going, to maintain his own reputation as the man who had promoted the Company.

When one comes to the expenditure u/s 10, an allowance may be made under sub-section (2)(ix) for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains. The "profits or gains" referred to must be, for the purpose of this case, the profits or gains which the assessee makes by his business of promoting Companies, and I think it impossible to say that this payment was made solely for the purpose of earning such profits or gains. It was partly for the purpose of earning the other

income which falls within Section 12, partly for the protection of the income of the other shareholders in the Company, and partly for the protection of the assessees business reputation. On this aspect of the matter, I agree with the Commissioner of Income Tax in thinking that this is a capital expenditure. The maintenance of business reputation is undoubtedly a capital asset.

Sir Jamshedji Kanga has relied on a recent decision in Southern (H.M. Inspector of Taxes) v. Borax Consolidated, Ltd., reported in the Supplement to the Income Tax Reports, Vol. X, (1942) p. 1 in which case Mr. Justice Lawrence held that where a sum of money was laid out for the acquisition or the improvement of a fixed capital asset, it was attributable to capital, but if no alteration was made in the fixed capital asset by the payment, then it was properly attributable to the revenue, being in substance a matter of maintenance, the maintenance of the capital structure or the capital assets of the Company. The Court was dealing there with an expenditure made in maintaining the title of the Company to certain land, which had been challenged in a Court of law, and it was held that the capital asset, namely the land, remained exactly the same after maintaining the title as before. But I find it very difficult to apply that principle to so intangible a capital asset as business reputation. It is impossible to say that the assessees business reputation remained exactly the same after the payment as before it. The object of the payment, I think, was to enhance the reputation of the assessee, and to avoid his being associated with a company which had failed. In my view, it is impossible to say that payment for the maintenance of business reputation is not payment for a capital purpose.
The answer to the second question referred to us must be in the negative.

The assessee to pay costs.

KANIA, J. - I agree. The deduction is sought to be allowed under three sections which are mentioned in question (2). Section 7 is clearly inapplicable, and the argument advanced on behalf of the assessee is, therefore, limited to Sections 10(2)(ix) and 12 of the Act. The relevant sections to be considered are before the Amending Act of 1939.

As the payment was not made of the purpose of saving the business of the assessee, but was made to save the business of the Insurance Company, I do not think the case falls at all u/s 10(2)(ix). u/s 12 the decision of Mr. Justice Lawrence in Southern (H.M. Inspector of Taxes) v. Borax Consolidated, Ltd., might have been helpful, if the facts were that the payment was made only to save certain property of the assessee. In the statement of case it is clearly stated that the assessee claimed that if he had not made the above gift, the Company would have failed, and he would have lost (1) his capital invested in the Company, (2) his salary of Rs. 1,000 per mensem as Managing Director, and (3) his business reputation and credit. It may be open to argument that the first two, namely, saving the capital invested in the Company and saving the salary, might be covered by the judgment of Mr. Justice

Lawrence. But it is clear that business reputation and credit cannot be merely in relation to the Insurance Company. It must be in respect of the general business reputation and credit of the assessee as a promoter of different companies, of which he is either the Managing Director or a partner in the managing agency firm. In that view it is clear that allowance is not solely for the purpose of making or earning the income, profits or gains shown under the first two items. It is in the nature of a general capital expenditure, not merely limited to this particular Insurance Company.

I, therefore, think that the case is not clearly covered by Section 12(2). It is claimed as an allowance, and, therefore, it is the duty of the assessee to show that it is covered by the exception. As that is not shown, the answer must be that this payment cannot be allowed as an expenditure.

Reference answered accordingly.