

BUSINESS EXPENDITURE - GENERAL PRINCIPLES

(WITH REFERENCE TO INCOME TAX ACT)

1) General requirements

- A) ***It should be established that none of the other provisions apply*** - Section 37(1) being a residual provision, it cannot be taken aid of, unless and until it is established that none of the provisions of sections 30 to 36 are applicable to a given case - *Malwa Vanaspati & Chemical Co. Ltd. v. CIT* [1985] 154 ITR 655 (MP).
- B) ***Expenses not deductible under sections 30 to 36 should alone be considered*** - If the expenses are deductible under sections 30 to 36, then section 37 is not to be resorted to - *Khimji Visram & Sons (Gujarat) (P.) Ltd. v. CIT* [1994] 209 ITR 993 (Guj.).
- C) ***Whether transaction was prudent/judicious/indispensable/necessary, is not relevant*** - In the absence of fraud, the question whether a transaction had the effect of reducing the assessee's taxable income or whether it was prudent or judicious or whether it was indispensable or necessary for the assessee to enter into the transaction, are all irrelevant in determining whether the expenditure relating to the transaction should be allowed under section 37 - *Narsingdas Surajmal Properties (P.) Ltd. v. CIT* [1981] 127 ITR 221 (Gauhati).

2) Form v. substance

- A) ***Legal character cannot be ignored and substituted by substance of the transaction*** - The legal character of the transaction which is the source of the receipt in question cannot be ignored and substituted by what the taxing authorities considered as the substance of the matter. - *CIT v. Puran Das Ranchhoddas & Sons* [1988] 169 ITR 480 (AP).

3) Conditions precedent

- A) ***The main requisites*** - To be an allowable expenditure under section 37(1), the money paid out or away must be (a) paid out wholly and exclusively for the purpose of the business or profession; and further (b) must not be; (i) capital expenditure; (ii) personal expense; or (iii) an allowance of the character described in sections 30 to 36 and section 80VV - *CIT v. Indian Molasses Co. (P.) Ltd.* [1970] 78 ITR 474 (SC)/*J.K. Cotton Mfrs. Ltd. v. CIT* [1975] 101 ITR 221 (SC)/*Sassoon J. David & Co. (P.) Ltd. v. CIT* [1979] 118 ITR 261 (SC).

4) Assessing Officer's powers

- A) ***Quantum of expenditure cannot be reduced, unless provided so under law*** - Unless there is a limitation put by the law on the amount of expenditure, a lesser amount than the amount expended cannot be allowed merely because the assessing authority thinks that the assessee could have managed by paying a lesser amount as a prudent businessman - *Jamshedpur Motor Accessories Stores v. CIT* [1974] 95 Taxman 664 (Pat.).
- B) ***Assessing Officer has the right and duty to enquire into purpose of expenditure*** - The doctrine that the businessman is the best judge of business expediency does not affect the right, any duty, of the assessing authorities to know whether it was incurred for business purposes and not for other extraneous considerations - *Jaipur Electro (P.) Ltd. v. CIT* [1996] 134 CTR (Raj.) 237.
- C) ***Department cannot dictate the circumstances in which expenditure is to be incurred*** - It is not open to the department to prescribe what expenditure an assessee should incur and in what circumstances he should incur that expenditure. Every businessman knows his interest best - *CIT v. Dhanrajgirji Raja Narasingirji* [1973] 91 ITR 544 (SC).
- D) ***Department cannot consider expediency factor, but must confine its examination to the reality aspect*** - The expediency of the expenditure is not for the revenue to consider. That is a matter entirely left to the judgment of the assessee concerned. In allowing or disallowing a deduction the revenue has, of course, to have regard to the requisites of section 10(2)(xv) of the 1922 Act. The jurisdiction of the revenue under that section is, however, confined to deciding the reality of the expenditure, namely, whether the amount claimed as deduction was factually expended or laid out and whether it was wholly and exclusively for the purpose of the business - *Amarjothi Pictures v. CIT* [1968] 69 ITR 755 (Mad.)/*CIT v. Gobald Motor Service (P.) Ltd.* [1975] 100 ITR 240 (Mad.).
- E) The Assessing Officer can only decide whether the expenditure is real, whether it relates to the business and is wholly spent for that purpose - *Ramanand Sagar v. Dy. CIT* [2002] 255 ITR 134 (Bom.).

5) **Positive/negative tests**

- A) **Before expenditure can be claimed under section 37, the following essential conditions will have to be satisfied, namely:**
- I) It must be expenditure in the nature of revenue expenditure and not in the nature of capital expenditure.

II) It must be laid out or expended wholly and exclusively for the purpose of the business or profession.

III) It must not be of the nature described in sections 30 to 36 and section 80VV (which is enforced with effect from 1-4-1976).

IV) Subject to these three basic conditions being satisfied some tests can be evolved on principles. The tests can be divided into two categories, namely, (1) positive tests, (2) negative tests. One (at least one) of the positive tests must nod its head and none (not even one) must do so in order to affirmatively hold that the expenditure is business expenditure, *inter alia*, incurred on account of commercial expediency:

<i>Positive tests</i>	<i>Negative tests</i>
If the expenditure is incurred :	If it is incurred :
1. With a view to bring profits or monetary advantage either today or tomorrow.	1. for a mere altruistic consideration.
2. To render the assessee immune from impending or reasonably apprehended litigation.	2. Mainly in order to satisfy his philanthropic urges. <i>Explanation.</i> - Factors (1) and (2) are laudable but the altruistic or philanthropic urges can be satisfied at one's own cost or sacrifice. Not at the cost of public exchequer or other taxpayers and those living below the poverty line.
3. in order to save losses in foreseeable future.	3. Mainly in order to win applause or earn garlands or public appreciation.
4. For effecting economy in working which may pay dividends today or tomorrow.	4. for illegal, immoral or corrupt purposes or by any such means or for any such reasons.
5. for increasing efficiency in working.	5. Mainly in order to oblige a relative or an official.
6. for removing inefficiency in the working.	6. Mainly in order to earn the goodwill of a political party or a politician.
7. where the expenditure incurred is such as a, (i) wise, (ii) prudent, (iii) pragmatic, (iv)	7. Mainly in order to show off or impress others with his affluence or for ostentatious purposes.

ethical, man of the word of business would conscientiously incur with an eye on promoting his business prospects subject to the expenditure being genuine and within reasonable limits.

8. Where it is incurred solely by way of a civil duty owed by the assessee to the society having regard to the nature of his business which brings him profits but result in some detriment to the public at large either by way of health hazard or ecological pollution or serious inconvenience to the citizens with a view to mitigate the aforesaid evil consequences and consequences of a like nature, subject to its being genuine and within reasonable limit.
 8. Apparently for a factor listed as a positive factor in the left side column but in reality for one of the obnoxious purposes listed hereinabove.
 9. on a nebulous plea or pretext by way of an *alibi* in the name of winning profits in remote future or promoting business prospects but really for one or the other of the abovementioned purposes.
 10. It must not be a bogus, fictitious or sham transaction.
 11. It must not be unreasonable and out of proportion.
 12. It must not be expenditure merely with a view to avoid tax liability without any genuine purpose or reason in good faith.
 13. the advantage to be secured by incurring the expenditure must not be of the nature of a remote possible advantage depending on 'ifs'
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and ‘buts’, and if at all, to be secured at an uncertain future date which may be considered too remote.

As pointed out earlier, one of the positive tests must be attracted whereas none of the negative tests should be attracted - *CIT v. Navsari Cotton & Silk Mills Ltd.* [1982] 135 ITR 546 (Guj.).

6) Broad Principles : *The broad principles can be summarized as follows –*

A) In order to constitute an expenditure falling under section 37(1) of the Act the six conditions, viz.,

I) the expenditure should not be of the nature described in sections 30 to 36,

II) it should have been incurred in the accounting year,

III) it should be in respect of a business which was carried on by the assessee and the profits of which are to be computed and assessed,

IV) it should not be in the nature of personal expenses of the assessee,

V) it should have been laid out or expended wholly and exclusively for the purpose of such business and

VI) It should not be in the nature of capital expenditure should concur.

B) Though the expression “for the purposes of the business” is wider in scope than the expression ‘for the purpose of earning profits’ and may comprehend many acts incidental to the carrying on of a business its limits are implicit in it and the purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business.

C) The expenditure incurred is on the ground of commercial expediency and in order, indirectly, to facilitate the carrying on of the business.

D) The fact that there was no compelling necessity to incur the expenditure on which deduction is claimed is irrelevant to constitute expenditure under section 37(1) of the Act.

E) Even expenditure incurred by an assessee in the course of his or its business voluntarily and without necessity can be allowed as a deduction under section 37(1) of the Act if it is incurred

for promoting the business and to earn profits even though there was no compelling necessity to incur such expenditure.

- F) If the payment of expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may endure to the benefit of a third party also.
- G) In every case it is a question of fact whether the expenditure was incurred wholly and exclusively for the purpose of trade or business of the assessee.
- H) Where an assessee seeks to deduct from his or its business profits certain items of expenditure the onus of proving that such deductions are permissible is on the assessee. This is particularly so when the claims are based on facts which are exclusively within the knowledge of the assessee. Thus, it is for the assessee to plead and prove before the authorities that the expenses are incurred wholly and exclusively for the purpose of the business of the assessee.
- I) When a claim for deduction of expenditure under section 37(1) of the Act is made by an assessee the Assessing Officer is bound to conduct an enquiry as to whether the assessee satisfied all the requirements of the section before either allowing or rejecting the claim. The officer cannot mechanically either allow the deduction or deny the same. It is clear that these are not exhaustive and the application of these principles may vary from case to case and will depend on the facts and circumstances of each case - *Ram Bahadur Thakur Ltd. v. CIT* [2003] 1 KLT 687 (Ker.)(FB).

7) **Benefit to third party**

- A) ***Benefit enuring to third party is not relevant factor*** - If the payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may enure to the benefit of a third party. Another test is whether the transaction is properly entered into as part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is immaterial that a third party also benefits thereby - *CIT v. Chandulal Keshavlal & Co.* [1960] 38 ITR 601 (SC)/*Sassoon J. David & Co. (P.) Ltd. v. CIT* [1979] 118 ITR 261 (SC).
- B) ***Purpose should not be to foster business of somebody else, or for some improper or oblique purpose outside the course of business*** - If the expense is incurred for fostering the business of another only or is made by way of distribution of profits or is wholly gratuitous or for some

improper or oblique purpose outside the course of business, then the expense is not deductible - *CIT v. Chandulal Keshavlal & Co.* [1960] 38 ITR 601 (SC).

8) Meaning of Some Terms

A) Expenditure

I) ***'Expenditure' means something which is gone irretrievably*** - 'Expenditure' is what is 'paid out or away' and is something which is gone irretrievably - *Indian Molasses Co. (P.) Ltd. v. CIT* [1959] 37 ITR 66 (SC).

II) ***'Expenditure' need not involve actual parting with money or property*** - A mere liability to satisfy an obligation by an assessee is undoubtedly not 'expenditure'; it is only when he satisfies the obligation by delivery of cash or property or by settlement of accounts that there is expenditure. But expenditure does not necessarily involve actual delivery of or parting with money or property. A mere forbearance to realise a claim is not expenditure - *CIT v. Nainital Bank Ltd.* [1966] 62 ITR 638 (SC).

B) Liabilities

I) ***Provision for actuarial valued liabilities is allowable*** - If an amount is set apart for discharge of a liability on actuarial valuation that has to be allowed as deduction - *CIT v. Electric Lamp Mfrs. (India) (P.) Ltd.* [1987] 165 ITR 115 (Cal.).

II) ***Liabilities can be spread over a period of years, where found necessary*** - The facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. Issuing debentures at a discount is one such instance, where although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures - *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 91 Taxman 340/225 ITR 802 (SC).

III) ***Difficulty in estimation of value cannot convert accrued liability into conditional one*** - The difficulty in the estimation thereof would not convert an accrued liability into a conditional one - *Calcutta Co. Ltd. v. CIT* [1959] 37 ITR 1 (SC).

IV) ***Accrued but undischarged liability must be allowed under mercantile system*** - In the case of an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the

profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid. Just as actual receipts as well as those accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business - *Metal Box Co. of India Ltd. v. Their Workmen* [1969] 73 ITR 53 (SC).

V) *Liability of earlier year cannot be ignored straightaway* - If any liability, though relating to the earlier year, depends upon making a demand and its acceptance by the assessee and such liability has been actually claimed and paid in the later previous years, it cannot be disallowed as deduction merely on the basis of the accounts are maintained on mercantile basis and that it related to a transaction of the earlier year - *Saurashtra Cement & Chemical Industries Ltd. v. CIT* [1995] 80 Taxman 61/213 ITR 523 (Guj.).

VI) *Disputed liabilities are allowable in year of adjudication/settlement* - Where a liability arising out of a contractual obligation is disputed, the assessee is entitled, in the assessment year relevant to the previous year in which the dispute is finally adjudicated upon or settled, to claim a deduction in that behalf - *CIT v. Phalton Sugar Works Ltd.* [1986] 162 ITR 622 (Bom.).

VII) *Statutory liabilities can be claimed at any stage of proceedings* - A statutory liability of an assessee, following the mercantile system, is allowable in the year in which it arises notwithstanding the fact that it is disputed by the assessee and no entries are made in the books of account. The mere fact that such a deduction was not claimed before the ITO is not of much importance. If the liability arises, then a claim can be made *bona fide* at any stage before any higher authority, who is competent to grant relief - *CIT v. Central Provinces Manganese Ore Co. Ltd.* [1978] 112 ITR 734 (Bom.).

C) Contingent liabilities

I) *Contingent liabilities do not constitute 'expenditure'* - Contingent liabilities do not constitute expenditure and cannot be the subject-matter of deduction even under the mercantile system of accounting. Expenditure which is deductible for income-tax purposes is towards a liability actually existing at the time but setting apart money which might become expenditure on the happening of an event is not expenditure - *Shree Sajjan Mills Ltd. v. CIT* [1985] 156 ITR 585 (SC)/*Indian Molasses Co. (P.) Ltd. v. CIT* [1959] 37 ITR 66 (SC)/*Mahadeo Gangaprasad v. Second ITO* [1966] 61 ITR 384 (Bom.).

II) *Expenditure must be towards actually existing liability* - Expenditure which is deductible for income-tax purposes is one which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure - *Mysore Lamp Works Ltd. v. CIT* [1990] 52 Taxman 260/185 ITR 96 (Kar.).

III) *Discounted value of contingent liability can sometimes be treated as 'expenditure'* - Contingent liability discounted and valued as necessary, can be taken into account as trading expenses if it is sufficiently certain to be capable of valuation and if profits cannot be properly estimated without taking it into consideration - *Metal Box Co. of India Ltd. v. Their Workmen* [1969] 73 ITR 53 (SC).

IV) *Where obligation itself is purely contingent, question of estimating its present value will not arise* - Broadly stated, the present value on commercial valuation of money to become due in future, under a definite obligation, will be a permissible outgoing or deduction in computing the taxable profits of a trader even if in certain conditions the obligation may cease to exist because of forfeiture of the right. Where, however, the obligation of the trader is purely contingent, no question of estimating its present value may arise, for, to be a permissible outgoing or allowance, there must in the year of account be a present obligation capable of commercial valuation - *CIT v. Gemini Cashew Sales Corpn.* [1967] 65 ITR 643 (SC).

V) *Provision made by transporter towards claims for losses in transit is allowable* - The liability of a carrier of goods to make good any loss to the claimants due to the loss or destruction of goods stems from the provisions of the Carriers Act and hence the carrier's liability is statutory in nature. Any provision made in the books maintained under mercantile system towards claims for such loss is hence an allowable deduction, in the light of the Supreme Court decision in *Kedarnath Jute Manufacturing Co. Ltd. v. CIT* [1971] 82 ITR 363 (SC)/*CIT v. Kerala Transport Co.* [1999] 239 ITR 183 (Ker.).

D) 'Wholly and exclusively' - Meaning of

I) *Meanings of 'wholly' and 'exclusively'* - The adverb 'wholly' in the phrase 'laid out or expended for business' refers to the quantum of expenditure. The adverb 'exclusively' has reference to the object or motive of the act behind the expenditure. Unless such motive is solely for promoting the business, the expenditure will not qualify for deduction - *C.J. Patel & Co. v. CIT* [1986] 158 ITR 486 (Guj.)/*Siddho Mal & Sons v. ITO* [1980] 122 ITR 839

(Delhi)/*Mysore Kirloskar Ltd. v. CIT* [1987] 166 ITR 836 (Kar.)/*CIT v. T.S. Hajee Moosa & Co.* [1985] 153 ITR 422 (Mad.).

II) ‘Wholly and exclusively’ does not mean ‘necessarily’, fact that third party is also benefited is also not relevant - The expression ‘wholly and exclusively’ used in section 10(2)(xv) of the 1922 Act [corresponding to section 37(1) of the 1961 Act] does not mean necessarily. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under section 10(2)(xv) if it satisfies otherwise the tests laid down by law - *Sassoon J. David & Co. (P.) Ltd. v. CIT* [1979] 118 ITR 261 (SC).

III) Commercial expediency, and direct and immediate benefit to trade are relevant factors - A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the ground of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade - *CIT v. Delhi Safe Deposit Co. Ltd.* [1982] 133 ITR 756 (SC).

E) ‘For the purpose of business’ - Meaning of

I) ‘For the purpose of business’ is wider in scope than for the purpose of earning profits - The expression ‘for the purpose of business’ in section 10(2)(xv) of the 1922 Act [corresponding to section 37(1) of the 1961 Act] is wider in scope than the expression ‘for the purpose of earning profits’. Its range is wide; it may take in not only the day-to-day running of a business but also the relationship of its administration and modernization of its machinery, it may include measures for the preservation of the business and for the protection of its assets and property from expropriation or coercive process; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the carrying on of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the origin of the agency is voluntary or statutory; in that event, he pays the amount on behalf of another, and for a purpose unconnected with the business - *CIT v. Malayalam Plantations Ltd.* [1964] 53 ITR 140 (SC)/*Madhav Prasad Jatia v. CIT*

[1979] 118 ITR 200 (SC)/*CIT v. Birla Cotton Spg. & Wvg. Mills Ltd./CIT v. Birla Bros. (P.) Ltd.* [1971] 82 ITR 166 (SC).

II) Purpose must be to keep the trade going and making it pay - The words 'for the purpose of such business' mean for the purpose of keeping the trade going and making it pay - *Haji Aziz & Abdul Shakoor Bros. v. CIT* [1961] 41 ITR 350 (SC).

III) Expenditure on providing facilities to employees is 'for the purpose of businesses - The words 'for the purpose of business' used in section 37(1) should not be limited to the meaning of 'earning profit alone'. Business expediency or commercial expediency may require providing facilities like schools, hospitals for the employees or their children or for the children of the ex-employees. The employees of today may become the ex-employees tomorrow. Any expenditure laid out or expended for their benefit, if it satisfies the other requirements, must be allowed as deduction under section 37(1) - *Mysore Kirloskar Ltd. v. CIT* [1987] 166 ITR 836 (Kar.).

IV) Purpose must be to keep the trade going - The true test of an expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than that of a trader - *CIT v. Shahibag Entrepreneurs (P.) Ltd.* [1995] 215 ITR 810 (Guj.).

V) Purpose need not be to increase profits or to directly benefit the business - The allowance contemplated is not necessarily an allowance for amounts expended to increase profits only, so long as it is for the purpose of the business. It is not also necessary that profits should be earned by such expenditure, nor is it necessary that it should be expended directly for the purposes of business so long as the business indirectly profits - *R.B. Bansilal Abirchand Spg. & Wvg. Mills v. CIT* [1971] 81 ITR 34 (Bom.) (FB)/*F.E. Dinshaw Ltd. v. CIT* [1959] 36 ITR 114 (Bom.)/*Delhi Cloth & General Mills Co. Ltd. v. CIT* [1972] 85 ITR 261 (Delhi).

VI) Cutting down losses in running business is a business purpose - 'Purpose of the businesses, as this term is used in section 37, has a wide import. The things done to cut down the losses, when the business is still running are for the purpose of the business - *Ambala Cantt. Electric Supply Corpn. Ltd. v. CIT* [1982] 133 ITR 343 (Punj. & Har.).

VII) Connection between expenditure and object must be real, and not remote and illusory - It is well-settled by now that all expenditure incurred by the assessee, though voluntary *i.e.*, not obligatory, which is ultimately designed to further the objects and purposes of the

assessee can be treated as business expenditure so long as the connection between the expenditure and the object is real and not remote and illusory - *CIT v. Vazir Sultan Tobacco Co. Ltd.* [1988] 169 ITR 139 (AP)/*CIT v. Heath & Co. (Calcutta) (P.) Ltd.* [1978] 114 ITR 605 (Cal.).

F) Commercial expediency test

I) Test of commercial expediency should give way to intention of parties and other factors -

The test of commercial expediency cannot be reduced in the shape of a ritualistic formula, nor can it be put in a water-tight compartment so as to be confined in a strait-jacket. The test merely means that the Court will place itself in the position of a businessman and find out whether the expenses incurred could be said to have been laid out for the purpose of the business or the transaction was merely a subterfuge for the purpose of sharing or dividing the profits ascertained in a particular manner. It seems that in the ultimate analysis the matter would depend on the intention of the parties as spelt out from the terms of the agreement or the surrounding circumstances, the nature or character of the trade or venture, the purpose for which the expenses are incurred and the object which is sought to be achieved for incurring those expenses - *CIT v. Panipat Woollen & General Mills Co. Ltd.* [1976] 103 ITR 66 (SC).

II) Commercial expediency must be decided from businessman's point of view - 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 or 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 - *CIT v. Sales Magnesite (P.) Ltd.* [1995] 214 ITR 1/81 Taxman 334 (Bom.).

III) Commercial expediency must be tested in the context of current socio-economic thinking - Commercial expediency must be judged not in the light of the 19th century *laissez faire* doctrine which regarded man as an economic being concerned only to protect and advance his self-interest but in the context of current socio-economic thinking which places the general interest of the community above the personal interest of the individual and believes that a business or undertaking is the product of the combined efforts of the employer and the employees and where there is sufficiently large profit, after providing for the salary or remuneration of the employer and the employees and other prior charges such an interest

on capital, depreciation, reserves, etc. a part of it should in all fairness go to the employees - *Shahzada Nand & Sons v. CIT* [1977] 108 ITR 358 (SC).

IV) Contractual obligation is not necessary - Payments made, having regard to the commercial expediency, need not necessarily have their origin in contractual obligations. If the assessee which carries on a business finds that it is commercially expedient to incur certain expenditure directly or indirectly, it would be open to such an assessee to do so notwithstanding the fact that a formal deed does not precede the incurring of such expenditure - *CIT v. Associated Electrical Agencies* [2004] 266 ITR 63/135 Taxman 12 (Mad).

G) Carrying on of business

I) If expenditure is incurred as owner-cum-trader, it must be really incidental to carrying on of business - The test adopted by the Supreme Court in *Travancore Titanium Product Ltd. v. CIT* [1966] 60 ITR 277, that to be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business, *i.e.*, between the expenditure and the character of the assessee as a trader, and not as owner of assets, even if they are assets of the business, needs to be qualified by stating that if the expenditure is laid out by the assessee as owner-cum-trader, and the expenditure is really incidental to the carrying on of his business, it must be treated to have been laid out by him as a trader and as incidental to his business - *Indian Aluminium Co. Ltd. v. CIT* [1972] 84 ITR 735 (SC)/*Addl. CIT v. Kuber Singh Bhagwandas* [1979] 118 ITR 379 (MP) (FB).

II) Capacity as trader is sole consideration - The true test of an expenditure laid out wholly and exclusively for the purpose of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and making it pay, and not in any other capacity than that of a trader. It has to be examined whether the expense has been incurred with the sole object of furthering the trade or business interest of the assessee unalloyed or unmixed with any other consideration. If the expense is found to bear an element other than trade or business interest of the assessee, the expenditure is not allowable one - *B.K. Khanna & Co. (P.) Ltd. v. CIT* [2001] 247 ITR 705 (Delhi).

III) Expenditure must be directly and intimately connected with character of assessee as trader, and not as owner of assets –

(a) To be a permissible deduction, there must be a direct and intimate connection between the expenditure and the character of the assessee as a trader, and not as owner of assets,

even if they are assets of the business - *Travancore Titanium Product Ltd. v. CIT* [1966] 60 ITR 277 (SC).

- (b) To be a permissible allowance, the expenditure must be for the purpose of carrying on the business. Where accounts are maintained, on the mercantile system and liability to make the payment has arisen during the time the business is carried on, it may appropriately be regarded as an expenditure. But where the liability is, during the whole of the period that the business is carried on, it cannot fall within the expression 'expenditure laid out or expended wholly and exclusively' for the purpose of the business - *CIT v. Gemini Cashew Sales Corpn.* [1967] 65 ITR 643 (SC).
- (c) Mere payment by itself would not entitle an assessee to deduction of an expenditure unless the same was proved to be paid for commercial considerations; the onus of proof at all relevant times rests upon the assessee - *Assam Pesticides & Agro Chemicals v. CIT* [1997] 227 ITR 846 (Gau.)

IV) *Expenditure prior to setting up of business is not allowable* - The expression 'for the purpose of the businesses' refers to a business that is being carried on by the assessee. Thus expenditure incurred before the setting up of a business cannot be deducted and is treated as part of the capital expenditure for the setting up of the business - *Hotel Broadway Complex v. CIT* [1992] 63 Taxman 444/198 ITR 361 (Kar.).

H) Existence of business

- I) *Business for which expenditure is incurred must exist during relevant year*** - In order to sustain a claim for deduction by way of business expenditure the expenditure must have been incurred for the purpose of a business which was in existence in the year of account, the profits of which are under assessment. If during the relevant period there was, in fact, no business, no question of computation of its income after deduction of expenses can possibly arise - *S.P.B. Bank Ltd. v. CIT* [1980] 126 ITR 773 (Ker.)/*Perfect Pottery Co. Ltd. v. CIT* [1987] 166 ITR 196 (MP)/*Rani J. Sarala Devi v. CIT* [1962] 46 ITR 837 (AP).
- II) *Expenditure relating to business which ceased to exist at commencement of year is not allowable*** - For income of a business to be taxable under section 10 of 1922 Act [corresponding to section 28(i) of the 1961 Act] it is one of the conditions that the assessee must carry on the business in the relevant year of account. If the business is discontinued before the commencement of the accounting year, the income attributable to that business received in the year cannot be taxed under section 10, because the source of income had

ceased to exist. If an assessee carries on several distinct and independent businesses and one of such businesses is closed before the previous year, he cannot claim allowance under section 10 of an outgoing attributable to the business which is closed against the income of his other business in that year - *L.M. Chhabda & Sons v. CIT* [1967] 65 ITR 638 (SC).

III) *Traveling/legal expenses incurred after cessation of business are not deductible* -

Where the assessee-company sold its cement factories in Pakistan to a local cement company for which the sale consideration was receivable in the form of export of cement by that company to the assessee, but later when that company failed to supply cement, assessee had to incur legal and travelling expenses connected with the claim lodged with the bank which had furnished bank guarantee on behalf of the purchaser-company, such expenses were not deductible, being capital in nature. The expense could not also be allowed as wholly and exclusively incurred for the assessee's business, since after the sale of the factories the assessee could not be said to be carrying on any business - *Dalmia Dairy Industries Ltd. v. CIT* [2000] 241 ITR 9 (Delhi).

I) Closed business

I) *Where more than one businesses are inter-connected/inter-linked, expenditure of one such business which is closed is allowable* -

Where more than one businesses carried on by an assessee are found to constitute one and the same business due to inter-lacing, inter-connection, etc., and one of them is closed, the expenditure in relation to such closed business is deductible from the profits of the continuing business or business. - *CIT v. T.S. Srinivasa Iyer* [1991] 192 ITR 50 (Mad.).

II) *In case of winding up proceeding in Court, expenditure incurred by Official Liquidator is allowable* -

Unlike a running business, in case of winding up proceeding in court, expenditure incurred by Official Liquidator is expenditure which is essential, being expenditure authorized and required by law, and incurred under supervision of Court, and is required to be deducted for purpose of determining net taxable income of company in liquidation - *Palani Sri Murugan Textiles Ltd. v. Asstt. CIT* [2003] 127 Taxman 443 (Mad.).

J) Burden of proof

I) *Burden of proof is on assessee* -

In order to claim that an expenditure falls under section 37(1), the burden of proving the necessary facts in that connection is on the assessee - *CIT v. Calcutta Agency Ltd.* [1951] 19 ITR 191 (SC)/*Lakshimaratan Cotton Mills Co. Ltd. v. CIT* [1969] 73 ITR 634 (SC)/*Dalmia Jain & Co. Ltd. v. CIT* [1958] 33 ITR 294 (Pat.)/*Dey's*

Medical Stores Mfg. (P.) Ltd. v. CIT [1986] 162 ITR 630 (Cal.)/*Liberty Cinema v. CIT* [1964] 52 ITR 153 (Cal.)/*Hotz Trust v. CIT* [1952] 21 ITR 149 (Punj.).

II) Assessee must disclose purpose –

- (a) It cannot be disputed that before an assessee can become entitled to an allowance under section 37(1), he must satisfy the department of the purpose for which the amount is spent. - *CIT v. Shahibag Entrepreneurs (P.) Ltd.* [1995] 215 ITR 810 (Guj.).
- (b) Where an assessee claims a deduction the onus is on him to bring all material facts on record to substantiate his claim - *L.H. Sugar Factory & Oil Mills (P.) Ltd. v. CIT* [1980] 125 ITR 293 (SC).
- (c) If an expenditure is partly deductible and partly not deductible it is for the assessee to show which part is deductible, and if he fails, the whole of the expenditure should be disallowed - *Sabargarh Industries Ltd. v. CIT* [1962] 46 ITR 978 (All.).

III) Mere vouchers are not adequate proof - Mere production of vouchers in support of the claim for deduction of the expenditure would not prove the claim made by the assessee. It is his duty to prove payment especially when the ITO doubts the genuineness thereof - *CIT v. Chandravilas Hotel* [1987] 164 ITR 102 (Guj.).

IV) Documentary evidence for expenditure is necessary - The law can be stated as follows :

- (a) A person who claims that he has made certain expenditure is expected to have some documentary evidence;
- (b) In the absence of the above, he is expected to say how he has incurred the expenditure and why there is no documentary proof for such expenditure, and if he has any satisfactory evidence to show that documentary evidence has been lost or destroyed, he may take recourse to secondary evidence, viz., certified copies or attested copies of such documents, or copies made from the original by the mechanical processes which in themselves ensure the accuracy of the copy; copies compared with such copies; copies made from or compared with the original; and the oral accounts of the contents of a document given by some person who has himself seen it;
- (c) Circumstantial evidence in such cases as proof of expenditure by the assessee shall be rare and exceptional, and if at all, in the aid of the assessee, it shall so come to remove doubts as to the expenditure and to establish genuineness of the claim which is otherwise

sought to be proved by direct evidence or secondary evidence - *CIT v. Southern Sea Foods Ltd.* [1995] 215 ITR 176 (Mad.).

V) *Decision of fact-finding authority about adequacy of proof is conclusive and final* - It cannot be said that even if the taxpayer does not produce any evidence in support of the claim for allowance, the ITO himself independently is to collect evidence and decide that the allowance claimed is baseless having regard to the legitimate business needs of the assessee. It is for the taxpayer to establish by evidence that a particular allowance is justified. The law does not prescribe any quantitative test to find out whether the onus in a particular case has been duly discharged. A decision of the final fact-finding authority is conclusive and binding - *Assam Pesticides & Agro Chemicals v. CIT* [1997] 227 ITR 846 (Gau.).

VI) *Others* - The broad proposition that once there is tax audit under section 44AB, the ITO should not insist upon production of records or vouchers or details cannot be laid down - *Goodyear India Ltd. v. CIT* [2000] 112 Taxman 419/246 ITR 116 (Delhi).

K) Relevance of book entries

I) *Failure to make book entries is no bar to allow deduction* - If an assessee under some misapprehension or mistake fails to make an entry in the books of account and if under the law, a deduction must be allowed by the ITO, the assessee will not lose the right of claiming or will not be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter - *Kedarnath Jute Mfg. Co. Ltd. v. CIT* [1971] 82 ITR 363 (SC)/*Sutlej Cotton Mills Ltd. v. CIT* [1979] 116 ITR 1 (SC)/*CIT v. Sri Rama Sugar Mills Ltd.* [1952] 21 ITR 191 (Mad.).

L) Personal expenses

I) *'Personal expenses' includes those on personal needs of assessee and those having purposes unrelated to business* –

(a) Personal expenses include only expenses on the person of the assessee or to satisfy his personal needs such as clothes, food, etc., or for purposes not related to the business for which the deduction is claimed. Every expense to discharge a personal obligation does not become a personal expense - *State of Madras v. G.J. Coelho* [1964] 53 ITR 186 (SC).

(b) Where, in a partnership firm comprising father and his three children as partners, the father sent one of the said children abroad for higher studies, and the agreement between the firm and its partners provided that the said son should, on his return, join the firm and serve it for five years, the expenses incurred by the firm on the education of the son abroad is not allowable as business expenditure, being personal in nature - *M. Subramaniam Bros. v. CIT* [2001] 250 ITR 769 (Mad.).

(c) **Note:** Same view taken earlier in *CIT v. Hindustan Hosiery Industries* [1994] 209 ITR 383 (Bom.). Contrary view taken in *CIT v. Kohinoor Paper Products* [1997] 226 ITR 220 (MP) dissented from.

II) Expenditure on education of son of director is not deductible - Expenditure incurred on the education of the son of a director of a family-owned company cannot be claimed as deduction on the ground that the expenditure benefited the company since the son became a director. If this logic were to be accepted, in every family-owned business, all the expenditure incurred in bringing up the children who may later on be given a role in the business as partners or directors could be claimed as business expenditure incurred in training the prospective employees and directors of the business. The expenditure which a father incurs out of his natural love and affection for his children in meeting the cost of their education cannot become a business expenditure merely because he is also the owner or a director of a business in which son or daughter subsequently takes part. It was evident that a director-father had, instead of incurring the expenses from his personal account, which he should have, had merely chosen to debit the expenditure of his son's education to the business of which he was the director. Such expenditure does not become business expenditure merely because the father was in a position to debit the expenditure to the accounts of the business - *CIT v. R.K.K.R. Steels (P.) Ltd.* [2002] 258 ITR 306 (Mad. - Cegat).

M) Apportionment of expenses

I) In view of the various decisions, the following principles may be laid down regarding allowability of expenditure as business expenditure:

(a) If income of an assessee is derived from various heads of income, he is entitled to claim deduction permissible under the respective head whether or not computation under each head results in taxable income;

- (b) if income of an assessee arises under any of the heads of income but from different items *e.g.*, different house properties or different securities etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible; and
- (c) in computing 'profits and gains from business or profession' when an assessee is carrying on business in various ventures and some among them yield taxable income and the others do not, the question of allowability of the expenditure under section 37 will depend on : (a) fulfillment of requirements of that provision; and (b) on the fact whether all the ventures carried on by him constitute one indivisible business or not, if they do, the entire expenditure will be a permissible deduction but if they do not, the principle of apportionment of the expenditure will apply because there will be no nexus between the expenditure attributable to the venture not forming integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee - *Rajasthan State Warehousing Corpn. v. CIT* [2000] 242 ITR 450/109 Taxman 145 (SC).

N) Others

- I) *English authorities can be relied upon* - English authorities can be considered as aids to the interpretation of section 37(1), which enacts affirmatively what is stated in the negative form in the English statute and is substantially in *pari materia* with the English enactment and the Courts may consider the English authorities as aids to the interpretation thereof - *Indian Molasses Co. (P.) Ltd. v. CIT* [1959] 37 ITR 66 (SC)/*CIT v. India Tobacco Co. Ltd.* [1978] 114 ITR 182 (Cal.).
- II) *Payment made twice under coercion of law is deductible* - If the assessee had to pay twice for the same liability under coercion of law, then the assessee would be entitled to obtain deduction twice for the same. Thus, if the assessee sent money for payment of excise duty and the money, for some reason or other, did not reach its destination because of embezzlement by the servants or agents of the assessee, then the loss of money must be regarded as having arisen in the course of carrying on the business of the assessee - *CIT v. Bishnauth Tea Co. Ltd.* [1993] 70 Taxman 103/[1994] 205 ITR 578 (Cal.).
- III) *Departmental practice is not relevant* - The departmental practice cannot be made the foundation of a claim which was not legally admissible as a permissible deduction - *S.D. Sharma v. CIT* [1962] 45 ITR 107 (Mah.).

SECTION 37(1)

CAPITAL OR REVENUE EXPENDITURE - GENERAL PRINCIPLES

1) Relevant tests/factors

- A) *Nature and course of business and object behind expenditure are relevant factors*** - It is not easy ordinarily to evolve a test for ascertaining whether in a given case expenditure is capital or revenue, for the determination of the question must depend upon the facts and circumstances of each case. The Court has to consider the nature and ordinary course of business and the objects for which the expenditure is incurred. Whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. The question must be viewed in the larger context of business necessity or expediency - *Bombay Steam Navigation Co. (1953) (P.) Ltd. v. CIT* [1965] 56 ITR 52 (SC).
- B) *Character of expenditure must be decided on facts and circumstances of each case, upon a commonsense appreciation of guiding features*** - The character of the expenditure will have to be decided on the facts and circumstances of each case not by the application of rigid tests, but deriving support from many aspects of the whole lot of circumstances and the ultimate answer would depend upon a commonsense appreciation of the guiding features - *Chelpark Company Ltd. v. CIT* [1991] 191 ITR 249 (Mad.).
- C) *Legal liability is not relevant factor*** - It is fairly well-settled that the commercial expediency of a businessman's decision to incur an expenditure cannot be tested on the touchstone of strict legal liability to incur such an expenditure. - *CIT v. Motor Industries Co. Ltd.* [1997] 223 ITR 112 (Kar.).
- D) *Nature of business/expenditure/rights acquired, and their inter se relationship is the only key*** - To decide whether an expenditure is capital or revenue in nature, what is decisive is the nature of the business, the nature of the expenditure, the nature of the right acquired, and their relation, *inter se*, and this is the only key to resolve the issue in the light of the general principles, which are followed in such cases - *K.T.M.T.M. Abdul Kayoom v. CIT* [1962] 44 ITR 689 (SC).
- E) *Whether new asset was created, or business was just maintained, will decide nature of expenditure*** - In deciding whether a particular expenditure is capital or revenue in nature, what the Courts have to see is whether the expenditure in question was incurred to create any new asset or was incurred for maintaining the business of the company. If it is the former, it is capital

expenditure. If it is the latter, it is revenue expenditure - *Dalmia Jain & Co. Ltd. v. CIT* [1971] 81 ITR 754 (SC).

- F)** *Expenditure of identical nature cannot be regarded differently for different purposes* - Expenditure of identical nature cannot be regarded as revenue expenditure for one purpose and capital expenditure for another. - *CIT v. Vallabh Glass Works Ltd.* [1982] 137 ITR 389 (Guj.).
- G)** *Admission by assessee is not relevant* - Whether or not an expenditure is revenue expenditure or capital expenditure does not depend on the admission of the assessee. - *Avery India Ltd. v. CIT* [1993] 199 ITR 745 (Cal.).
- H)** *Quantum of expenditure is not relevant factor* - Whether the money paid is a revenue expenditure or capital expenditure depends not so much upon the facts as to whether the amount paid is large or small or whether it has been paid in lump sum or by instalments, as it does upon the purpose for which the payment has been made and expenditure has been incurred. It is the real nature and quality of the payment and not the quantum or the manner of the payment which would prove decisive - *M.K. Bros. (P.) Ltd. v. CIT* [1972] 86 ITR 38 (SC)/*Travancore Sugars & Chemicals Ltd. v. CIT* [1966] 62 ITR 566 (SC)/*CIT v. B.N. Elias & Co. (P.) Ltd.* [1987] 168 ITR 190 (Cal.)/*Gannon Norton Metal Diamond Dies Ltd. v. CIT* [1987] 163 ITR 606 (Bom.).
- I)** *Mere fact that payment is capital receipt in payee's hands is not relevant* - The fact that a certain payment constitutes incomes or capital receipt in the hands of the recipient is not material in determining whether the payment is revenue or capital disbursement *qua* the payer. Whether it is capital expenditure or revenue expenditure would have to be determined having regard to the nature of the transaction and other relevant factors - *Empire Jute Co. Ltd. v. CIT* [1980] 124 ITR 1 (SC).
- J)** *Connected documents as well as surrounding circumstances must be looked into - There is no single test of universal application* - The Court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little consequence. - *Travancore Sugars & Chemicals Ltd. v. CIT* [1966] 62 ITR 566 (SC).
- K)** *Obligations arising out of contract/statute/decreed, etc., should be examined with the connected document/statute, and not with reference to judicial precedents* - In considering the nature of the expenditure incurred in the discharge of an obligation under a contract or a statute or a decree or

some similar binding covenant, one must avoid being caught in the maze of judicial decisions rendered on different facts and circumstances of the case in hand. The surer way of arriving at a just conclusion would be to first ascertain by reference to the document under which the obligation for incurring the expenditure is created and thereafter to apply the principle enshrined in the decisions of those facts. Judicial statements on the facts of a particular case can never assist Courts in the construction of an agreement or a statute which was not considered in those judgments or to ascertain what the intention of the Legislature was. What must be looked at is the contract or the statute or the decree, in relation to its terms, the obligation imposed and the purpose for which the transaction was entered into - *CIT v. Travancore Sugars & Chemicals Ltd.* [1973] 88 ITR 1 (SC).

- L)** *Advantage must be in a commercial sense, and in the capital field* - It would not be enough to merely ascertain whether a particular expenditure has resulted in any advantage of an enduring character. The advantage must be in a commercial sense and, further, it must be in the capital field. If there is a payment made on the ground of commercial expediency and if such payment does not result in the acquisition of any capital or an enduring benefit, merely because such payment is made to get rid of the liability which is much larger, the outgoing amount cannot be considered as capital in nature - *CIT v. Pioneer Engg. Syndicate* [1988] 38 Taxman 151/[1989] 175 ITR 93 (Mad.).
- M)** *Fundamental principles emanating from English decisions* - Certain fundamental principles could be deduced from English cases to distinguish capital expenditure from revenue expenditure. The first is that capital expenditure cannot be attributed to revenue and *vice versa*. Secondly, it is equally clear that a payment in a lump sum does not necessarily make the payment a capital one. It may still possess revenue character in the same way as a series of payments. Thirdly, if there is a lump sum payment but there is no possibility of a recurrence, it is probably of a capital nature, though this is by no means a decisive test. Fourthly, if the payment of a lump sum closes the liability to make repeated and periodic payments in the future, it may generally be regarded as a payment of a revenue character. Lastly, if the ownership of the money, whether in point of fact or by a resulting trust, be still in the taxpayer, then there is acquisition of a capital asset and not an expenditure of a revenue character - *Indian Molasses Co. (P.) Ltd. v. CIT* [1959] 37 ITR 66 (SC).

N) Various tests laid down in judicial decisions - To determine the nature of expenditure, several tests that have been evolved over the years by the Supreme Court as also the High Courts may briefly be formulated as follows :

I) Bringing into existence an asset or advantage of enduring nature would lead to the inference that the expenditure disbursed is of a capital nature. These terms, such as ‘asset’ or ‘advantage’ of enduring nature are, however, purely descriptive rather than definite and no rule of universal application can be laid down. Ultimately, the question will have to depend on the facts and circumstances of each case, namely, quality and quantum of the amount, the position of the parties, the object of the transaction which has impact on the business, the nature of trade for which the expenditure is incurred and the purpose thereof, etc.

II) An item of disbursement may be regarded as of a capital nature when it is relatable to a fixed asset or capital, whereas if it is related to circulating capital or stock-in-trade it would be treated as revenue expenditure. As aptly and adroitly explained by Lord Haldane in *John Smith & Son v. Moore* [1921] 12 TC 266, ‘fixed capital’ is what the assessee turns into profits by keeping it in his own possession, and “circulating capital” is what he makes profits of by parting with it and letting it change masters.

III) Expenditure relating to framework of business is generally capital expenditure - *J.K. Cotton Mfrs. Ltd. v. CIT* [1975] 101 ITR 221 (SC).

(a) On a review of case laws, the following tests emerge:

(i) When expenditure is incurred not only once and for all, and with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, ordinarily such expenditure is on capital account;

(ii) Where the expenditure is incurred in the field of fixed capital, it is on capital account, but if it is a part of the circulating capital, it is on revenue account;

(iii) If the expenditure is a part of the working expenses in ordinary commercial trading, it is not capital but revenue expenditure;

(iv) If the expenditure is incurred for the initial outlay or for extension of business or substantial replacement of equipment, it is capital expenditure but if it is incurred for running the business or is laid out as part of the process of profit making, it is revenue in character; and

(v) If expenditure is incurred for ensuring the regular supply of raw material, maybe for period extending over several years, it is on revenue account - *Gujarat Mineral Development Corpn. Ltd. v. CIT* [1983] 143 ITR 822 (Guj.).

O) *Expenses for salvaging asset* - If nature of expenditure or nature of transaction is such as to be regarded as one in the revenue field, it cannot be treated as capital, merely because such expenditure is incurred for purpose of salvaging the capital - *CIT v. Crescent Films (P.) Ltd.* [2001] 118 Taxman 214/248 ITR 670 (Mad.).

2) Test of enduring benefit

A) *Primary test is to see whether any enduring benefit has resulted; if this test is of no avail, test of fixed or circulating capital is to be applied* - If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure. If, on the other hand, it is not made for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence, it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. If it was part of the fixed capital of the business, it would be of the nature of capital expenditure and if it was part of its circulating capital, it would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in the manner indicated above - *Assam Bengal Cement Co. Ltd. v. CIT* [1955] 27 ITR 34 (SC).

B) *'Enduring' does not mean 'everlasting'* - The expression, 'enduring benefit', and 'rights of a permanent nature', are only descriptive and not definite and are relative in meaning not synonymous with 'perpetual' or 'everlasting' - *Devidas Vithaldas & Co. v. CIT* [1972] 84 ITR 277 (SC).

C) *Test of enduring benefit is not a conclusive test* - The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case - *Empire Jute Co. Ltd. v. CIT* [1980] 124 ITR

1 (SC)/CIT v. *Mehta Transport Co.* [1986] 160 ITR 35 (Guj.)/*Saraswati Industrial Syndicate Ltd. v. CIT* [1982] 137 ITR 886 (Punj. & Har.).

D) 'Enduring' does not mean permanent; one-time payment includes payments in instalments –

I) The expression 'enduring advantage' is a relative term, not enduring in the sense of its being permanent, but is sufficiently durable depending upon the nature of the terms upon which it can be acquired. So also the expression 'once and for all', which does not mean payment at one time of the whole amount, but includes payment of a lump sum as distinct from recurrent, distributed in periodic instalments - *Devidas Vithaldas & Co. v. CIT* [1972] 84 ITR 277 (SC)/CIT v. *Coal Shipments (P.) Ltd.* [1971] 82 ITR 902 (SC)/*Silver Screen Enterprises v. CIT* [1972] 85 ITR 578 (Punj. & Har.)/CIT v. *Singareni Collieries Co. Ltd.* [1980] 121 ITR 466 (AP).

II) The settled legal position in relation to the test of 'enduring benefit' is, what is material is to consider the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. By 'enduring' is meant 'enduring in the way that fixed capital endures', and it does not connote a benefit that endures in the sense that for a good number of years it relieves the assessee of revenue payment or disadvantage. The words 'permanent' and 'enduring' are only relative terms and not synonymous with perpetual or everlasting - *Indian Ginning & Pressing Co. Ltd. v. CIT* [2001] 252 ITR 577 (Guj.)

E) *Asset must belong to assessee* - Unless the very asset which had been brought into existence belonged to the assessee, it could not be said that the assessee acquired an enduring advantage for its business - *CIT v. Premier Cotton Spg. Mills Ltd.* [1997] 223 ITR 440 (Ker.).

F) Test of enduring benefit must yield where there are special circumstances leading to contrary conclusion - Lord Cave L.J. in *British Insulated and Helsby Cables Ltd. v. Atherton* [1925] 10 TC 155 (HL) has noted that when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital. This test

enunciated by Lord Cave LJ is undoubtedly a well-known test for distinguishing between capital and revenue expenditure, but it must be remembered that this test is not of 'universal application' and, as the parenthetical clause shows, it must yield where there are special circumstances leading to a contrary conclusion - *L.H. Sugar Factory & Oil Mills (P.) Ltd. v. CIT* [1980] 125 ITR 293 (SC)

3) Once-for-all payment

A) *'Once-for-all payment' is not conclusive test* - There is also no single definite criterion which by itself is determinative whether a particular outlay is capital or revenue. The 'once-for-all' payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and effect, considered in a commonsense way having regard to the business realities. In a given case, the test of 'enduring benefit' might break down - *Alembic Chemical Works Co. Ltd. v. CIT* [1989] 177 ITR 377/43 Taxman 312 (SC).

4) Fixed v. circulating capital

A) *Expenditure connected with fixed capital can sometimes be revenue expenditure* - The distinction between fixed and circulating capital as explained by Lord Haldane in *John Smith & Sons v. Moore* [1921] 12 TC 266, 282 (HL) was : 'Fixed capital as what the owner turns to profit by keeping it in his own possession; circulating capital is what he makes profit of by parting with it and letting it change masters'. So long as the expenditure in question can be clearly referred to the acquisition of an asset which falls within one or the other of these two categories, such a test would be a critical one. But this test also sometimes breaks down because there are many forms of expenditure which do not fall easily within these two categories and not infrequently, the line of demarcation is difficult to draw and leads to subtle distinctions between profit that is made 'out of assets' and profit that is made 'upon' assets or 'with' assets. Moreover, there may be cases where expenditure, though referable to or in connection with fixed capital, is nevertheless allowable as revenue expenditure - *Empire Jute Co. Ltd. v. CIT* [1980] 124 ITR 1 (SC)/*CIT v. Coal Shipments (P.) Ltd.* [1971] 82 ITR 902 (SC)/*CIT v. Craigmore Land & Produce Co. Ltd.* [1977] 110 ITR 730 (Mad.).

5) Nexus with profit-earning process

A) *If expenditure can be regarded as integral part of profit-earning process, it is revenue expenditure* - If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition

of the carrying on of the business, the expenditure may be regarded as revenue expenditure - *Empire Jute Co. Ltd. v. CIT* [1980] 124 ITR 1 (SC)/*CIT v. Hindusthan General Electrical Corpn. Ltd.* [1971] 81 ITR 243 (Cal.)/*CIT v. Oblum Electrical Industries (P.) Ltd.* [1981] 127 ITR 409 (AP).

B) *Mere connection with efficiency will not convert capital expenditure into revenue expenditure*

- Capital expenditure would not become revenue expenditure simply by reason that it was incurred in connection with business activities which ultimately resulted in efficiently carrying on of day-to-day business - *Arvind Mills Ltd. v. CIT* [1992] 63 Taxman 493/197 ITR 422 (SC).

6) Mining leases

A) *Empirical test for deciding whether expenditure is capital or revenue* - In the case of expenditure in respect of mining leases, an empirical test is that where minerals have to be won, extracted and brought to surface by mining operations, the expenditure incurred for acquiring such a right would be of a capital nature. But, where the mineral has already been gotten and is on the surface, then the expenditure incurred for obtaining the right to acquire the raw material, that is, the mineral, would be a revenue expenditure laid out for the acquisition of stock-in-trade - *R.B. Seth Moolchand Suganchand v. CIT* [1972] 86 ITR 647 (SC)/*Gujarat Mineral Development Corporation Ltd. v. CIT* [1983] 143 ITR 822 (Guj.).

SECTION 37(1)

BUSINESS EXPENDITURE - ILLUSTRATIVE CATEGORIES

1) Administrative office, shifting of

A) Expenditure incurred for shifting the administrative office from one city to another city as a result of amalgamation of three companies having a number of activities in various centers is allowable as revenue expenditure, as no enduring advantage can be said to have been received. Mere improvement in convenience and increase in efficiency does not mean a permanent advantage which has to be regarded as falling within the capital field - *CIT v. Madura Coats Ltd.* [2002] 253 ITR 62 (Mad.)

2) Advertisement

A) *Expenditure on advertisement in souvenir* - Advertisement in souvenir published by charitable institutions should, in the absence of any improper or oblique purpose, be held to have been issued to promote the assessee's business and expenditure thereon must be treated as an

allowable business deduction - *British Electrical & Pumps (P.) Ltd. v. CIT* [1977] 106 ITR 620 (Cal.).

- B) *Expenditure incurred by the assessee on advertisement in the souvenir brought by the Indian National Congress would be allowable as business expenditure* - *CIT v. F.C. Sondhi & Co. (India) (P.) Ltd.* [1997] 143 CTR (Punj. & Har.) 178.**

3) Amalgamation of companies

- A) *Professional Charges* -** Where assessee-company paid certain professional charges to solicitors in connection with effecting amalgamation of certain company with it, and Tribunal's finding was that amalgamation of said company with assessee-company was necessary for smooth and efficient conduct of assessee's business, expenditure incurred by assessee towards professional charges of solicitors was deductible as a revenue expenditure - *CIT v. Bombay Dyeing & Mfg. Co. Ltd.* [1996] 85 Taxman 396/219 ITR 521 (SC).
- B) *Legal expenses connected with approval of amalgamation are deductible* - *Addl. CIT v. W.A. Beardsell & Co. (P.) Ltd.* [1981] 130 ITR 159 (Mad.)/*CIT v. Bush Boake Allen (India) Ltd.* [1982] 135 ITR 306 (Mad.)/*Madras Race Club v. CIT* [1985] 151 ITR 675 (Mad.).**
- C) *When the legal expenses are to be paid in connection with the amalgamation of the assessee-company with another company, the liability to pay legal expenses arises in respect of the period when the transferor-company still continues to exist. The effective date of amalgamation in many cases may even be a date prior to the date of sanction of the scheme, but so long as the scheme is not sanctioned, the transferor-company continues to exist. Since the amalgamation is resorted to for the smooth and efficient conduct of the business through the transferee-company, it has to be held that the legal expenses are laid out wholly and exclusively for the purpose of business of the assessee-company, and are hence allowable as deduction* - *CIT v. Akme Electronics & Control (P.) Ltd.* [2004] 267 ITR 396/137 Taxman 263 (Guj.) [See also earlier decisions in *Addl. CIT v. W.A. Beardsell & Co. (P.) Ltd.* [1981] 130 ITR 159 (Mad.)/*CIT v. Bush Boake Allen (India) Ltd.* [1982] 135 ITR 306 (Mad.)/*Madras Race Club v. CIT* [1985] 151 ITR 675 (Mad.). Contrary view taken in *Godfrey Phillips India Ltd. v. CIT* [1993] 71 Taxman 370/[1994] 206 ITR 23 (Bom.) must be confined to the facts of that case].**
- D) *Expenses connected with amalgamation of companies are generally capital in nature* - *Triveni Engineering Works Ltd. v. CIT* [1998] 232 ITR 639 (Delhi)/*Godfrey Philips India Ltd. v. CIT* [1993] 71 Taxman 370/[1994] 206 ITR 23 (Bom.).**

4) Amenities to local residents

A) *Expenditure on providing drinking facilities to local residents is deductible* - The concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Being known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. Monies spent for bringing drinking water as also for establishing or improving the school meant for the residents of the locality in which the business is situated cannot be regarded as actually outside the ambit of the business concerns of the assessee, especially when the undertaking owned by the assessee is one which is to some extent a polluting industry. Hence, expenditure incurred by the assessee for establishing drinking water facilities to the residents in the vicinity of its refinery and for providing aid to the school run for the benefit of the children of those residents was allowable as deduction - *CIT v. Madras Refineries Ltd.* [2004] 266 ITR 170/138 Taxman 261 (Mad.).

5) Annual day celebrations

A) *Expenditure on annual day celebrations is deductible* - The expenditure incurred in connection with the annual day celebration is allowable as business expenditure - *CIT v. Mehsana Distt. Cooperative Milk Producers Union Ltd.* [1994] 207 ITR 140 (Guj.).

6) Annuities

A) *Expenditure on provision of annuity to managing director is not capital expenditure* - Where the assessee set apart certain amounts for securing an annuity to provide pensionary benefit to its managing director, the resulting expenditure was not a capital expenditure - *CIT v. Indian Molasses Co. (P.) Ltd.* [1970] 78 ITR 474 (SC).

7) Arbitrations

A) *Amount paid towards settlement of loan is not deductible* - Where the assessee carrying on business had taken a loan from one of his employees, and after that employee died, his widow took away the books of account of the assessee resulting in a dispute, and later an arbitration award directed the assessee to pay a certain amount to the widow in settlement of the dispute, the amount so paid is not allowable as business expenditure, since the payment was mainly towards repayment of loan, and no part of the award referred to any other payment or expenses - *Rao Narain Singh v. CIT* [2001] 250 ITR 838 (Raj.).

8) Audit Fees

- A) Fees paid to chartered accountant for preparing and filing return of income cannot be considered as an expenditure laid out wholly and exclusively for the purpose of business or for earning income, and hence the same is not an allowable deduction - *Associated Stone Industries (Kotah) Ltd. v. CIT* [2002] 123 Taxman 643 (Raj.).

9) Bad debts

- A) ***Bad debt not allowable under section 36(1)(vii) cannot be allowed under section 37(1)*** - If a claim properly arising under section 36(1)(vii) cannot be upheld under that sub-section, it cannot be brought again under section 37(1) - *Southern Agencies Ltd. v. CIT* [1962] 45 ITR 602 (Mad.).

10) Bonus

- A) ***Provision for bonus after statutory liability has arisen, is deductible*** - Provision made by assessee in its accounts for payment of bonus on actuarial valuation after the statutory liability to pay bonus had arisen is an allowable deduction under section 37(1) - *CIT v. Electric Lamp Manufacturers (India) (P.) Ltd.* [1987] 165 ITR 115 (Cal.).

- B) ***Bonus over and above statutory bonus, paid under agreement to maintain industrial peace, is deductible –***

I) Where as per bipartite agreement with the workers the assessee paid a sum to them as bonus and the said sum was paid over and above the minimum bonus payable under the Payment of Bonus Act, and the finding of the Tribunal was that the payment was made to maintain industrial peace without which the business would have come to a standstill such payment, whatever may be the term used in the agreement, must be held to be wholly and exclusively laid out for the purpose of business and commercial expediency and, thus, was deductible in full - *CIT v. Arcuttipore Tea Co. Ltd.* [1992] 197 ITR 588 (Cal.).

II) Where the assessee-company paid, in addition to statutory bonus under the Payment of Bonus Act, additional bonus under a settlement arrived at with the workers under section 18(1) of the Industrial Disputes Act, the additional bonus paid was deductible under section 37, since it was made on grounds of commercial expediency. The result of entering into agreement with the workers was that there was an enforceable obligation against the assessee to pay an additional sum towards bonus and if for any reason the assessee committed a default in making the payment agreed to under the settlement, the assessee would be facing unrest in the organisation and its production would also be seriously affected - *Kumaran Mills Ltd. v. CIT* [2000] 241 ITR 564 (Mad.).

- C) ***Incentive bonus paid in addition to statutory bonus is deductible*** - Incentive bonus paid in addition, to the regular bonus paid as per the Payment of Bonus Act, is an expenditure laid out wholly and exclusively for the purposes of business and is, therefore, allowable as a deduction under section 37(1) - *CIT v. Sivanandha Mills Ltd.* [1985] 156 ITR 629 (Mad.).

11) Business, concessions in

- A) ***Loss from extra-legal concessions made in business interest is allowable*** - Where an assessee makes concessions in the interest of his business, instead of taking a stand strictly on his legal obligations, loss will be expenditure laid out wholly and exclusively for purpose of business - *CIT v. Nainital Bank Ltd.* [1966] 62 ITR 638 (SC).

12) Business, new line of

- A) ***Expenses on launching new project or initiating new line of business are capital in nature*** - The expenses incurred for the purpose of launching a new project or initiating a new line of business, separate from the existing business cannot be held to be revenue expenditure incurred in connection with the existing business - *Indian Oxygen Ltd. v. CIT* [1987] 164 ITR 466 (Cal.).
- B) ***Pre-operative expenses on new line of business are capital expenditure*** - Where the trader adds to the existing business another new line of business, the pre-operative expenditure for such expansion has to be treated as capital expenditure - *Ashoke Marketing Ltd. v. CIT* [1994] 73 Taxman 126/208 ITR 941 (Cal.).
- C) ***Expenditure on exploring new line unconnected with existing line of business is not deductible*** - Where the assessee, running the business of travel agency, incurred expenditure on exploring the feasibility of setting up of a hotel, it was *held* that travel agency business did not include hotel earnings and, therefore, the expenditure was not deductible - *Trade Wings Ltd. v. CIT* [1990] 185 ITR 267 (Bom.).

13) Business, protection of

- A) ***Expenditure on preventing extinction of business is allowable*** - Any expenditure which was incurred for preventing the extinction of the assessee's business would be expenditure wholly and exclusively laid out for the purpose of the business of the assessee and would be an allowable deduction - *CIT v. Royal Calcutta Turf Club* [1961] 41 ITR 414 (SC).
- B) ***Expenditure on removing restriction/obstruction/disability to business is revenue expenditure*** - Where the assessee has an existing right to carry on a business, any expenditure made by it during the course of business for the purpose of removal of any restriction or obstruction or disability would be on revenue account, provided the expenditure does not acquire any capital

asset. Payments made for removal of restriction, obstruction or disability may result in acquiring benefits to the business, but that by itself would not acquire any capital asset - *Bikaner Gypsums Ltd. v. CIT* [1990] 53 Taxman 279/[1991] 187 ITR 39 (SC).

- C) *Payments for warding off business competition will be capital expenditure if the ensuing benefit is for some length of time*** - Payment made to rival dealer to ward off competition in business would constitute capital expenditure if the object of making that payment is to derive an advantage by eliminating the competition over some length of time. - *CIT v. Coal Shipment (P.) Ltd.* [1971] 82 ITR 902 (SC)/*Gujarat Mineral Development Corpn. Ltd. v. CIT* [1983] 143 ITR 822 (Guj.)/*Coromandel Fertilizers Ltd. v. CIT* [1984] 148 ITR 546 (AP).
- D) *Expenditure on conducting raids on premises of competing traders is allowable*** - Where the assessee, engaged in the business of vending arrack, arranged raids on others who were engaged in illicit manufacture of arrack, the expenditure incurred in connection with such raids is an allowable deduction, since they were incurred out of commercial expediency and in order to carry on the assessee's trade effectively and smoothly - *CIT v. A. Janardhana Shetty* [2002] 254 ITR 281 (Kar.).

14) Business, purchase of

- A)** Where consideration for purchase of business comprises fixed annual sum as well as periodical payments based on future profits, only fixed annual sum is capital in nature - Even if a transaction amounts to a purchase of the business, the consideration if it consists partly of a fixed annual sum and partly a periodical payment on a certain percentage of the profits earned by the assessee from the said business, cannot, in its entirety, be treated as a capital payment. The fixed annual sum paid towards part of the consideration will obviously be a capital payment. The periodical payment of sums which are indefinite depending upon the future profits earned cannot be treated as of capital nature - *CIT v. Sarada Binding Works* [1976] 102 ITR 187 (Mad.).

15) Business, setting up of

- A) *While expenses on setting up new business are capital, expenses on expansion or extension of existing business are revenue*** - If the expenses are incurred in connection with the setting up of a new business, such expenses will be on capital account. But where the setting up does not amount to starting of a new business but expansion or extension of the business already being carried on by the assessee, expenses in connection with such expansion or extension of the business must be held to be deductible as revenue expenses - *Kesoram Industries & Cotton Mills Ltd. v. CIT* [1992] 196 ITR 845 (Cal.).

16) Business, shifting of

- A) *Shifting of head office from one place to another is capital expenditure* - Where the assessee-company shifted its head office from Jamshedpur to Calcutta after its Board of directors resolved that it would be commercially prudent to centralise the registered office of the company at Calcutta and, in connection with the shifting, it incurred huge expenses including a certain payment made to the lawyers, the expenses incurred on this account could not be on revenue account - *CIT v. Jamshedpur Engg. & Machine Mfg. Co. Ltd.* [1986] 157 ITR 730 (Pat.).
- B) *Expenditure on shifting of employees is revenue expenditure* - Expenditure incurred by assessee on shifting of employees to another place consequent on shifting of factory to another site due to labour unrest was allowable as revenue expenditure - *CIT v. Bimetal Bearings Ltd.* [1994] 210 ITR 945 (Mad.).

17) Business, tax on

- A) *Tax paid on business assets as owner-cum-trader is deductible* - If the tax paid on his business assets by the assessee is as owner-cum-trader, and the expenditure is really incidental to the carrying on of his business, it must be treated to have been laid out by him as a trader and is incidental to this business - *Dehra Dun Tea Co. Ltd. v. CIT* [1973] 88 ITR 197 (SC).

18) Business, title to

- A) *Payments for perfecting title or for removing defects in title are capital payments* - It is well established that where money is paid to perfect a title or as consideration for getting rid of a defect in the title or a threat of litigation the payment would be capital payment and not revenue payment - *V. Jaganmohan Rao v. CIT* [1970] 75 ITR 373 (SC).
- B) *Expenditure on legalizing unauthorized constructions is deductible* - Payment made by the assessee to the Government for legalizing certain unauthorized constructions in its business premises, which was used for business purposes, was allowable under section 37 as the assessee gained an extra advantage for his business - *Jaswant Trading Co. v. CIT* [1995] 212 ITR 293 (Raj.).

19) Business, valuation of

- A) *Expenditure on valuation of business is deductible* - Expenditure incurred on valuation of business properties is an allowable expenditure - *CIT v. Commonwealth Trust Ltd.* [1979] 120 ITR 491 (Ker.).

20) Business assets, additions/alterations to

- A) ***Decoration of reception/dining halls in hotels is revenue expenditure*** - Expenses incurred in putting up decorative mirrors in the wall, plaster molded roof, plywood panels, etc., in reception-cum-dining halls of a hotel, in order to keep the place fit and attract customers, is deductible as revenue expenditure - *CIT v. Dasaprakash* [1978] 114 ITR 210 (Mad.).
- B) ***Expenditure on additions/alterations to building is capital, if incurred by owner but revenue if incurred by tenant*** - When an owner incurs expenditure on additions or alterations in a building which enhances its value the expenditure can be of a capital nature. But, if a tenant incurs an expenditure on a building which enhances its value rented building for its renovation or alteration, he does not acquire any capital asset, because the building does not belong to him and, ordinarily, such an expenditure will be of a revenue nature - *Modi Spg. & Wvg. Mills Co. Ltd. v. CIT* [1993] 200 ITR 544 (Delhi).
- C) ***Expenditure on construction of shop on leased land is capital when possession of land will not go to the lesser after certain period*** - Where the assessee was given a plot of land on lease by the municipality and he constructed a shop thereon, and there was no evidence that the possession of the shop was to be handed over to the municipality after a certain period, it was *held* that the expenditure was capital in nature because the building was put up by his own volition and it was not established that the advantage was of any limited nature - *CIT v. Agrawal Trading Co.* [1984] 149 ITR 222 (Bom.).
- D) ***Expenditure on wall-to-wall carpet for office is capital expenditure*** - Expenditure on purchase of wall-to-wall carpet, for being used in the office, has nothing to do with the augmenting, preserving or protecting the turnover or profits of the business and hence it is in the nature of capital expenditure - *Harijan Avam Nirbal Varg Avas Nigam Ltd. v. CIT* [1996] 87 Taxman 390/218 ITR 622 (All.).

21) Business assets, modernization of

- A) ***Expenditure on renovating/replacing parts of machinery necessitated by modernization is revenue expenditure*** - Where the expenditure incurred by the assessee was on renovating and replacing the old and worn out parts of the machinery and the Tribunal found that the need for modernization of the machinery was imperative for the business to run smoothly and effectively, the expenditure so incurred was allowable as revenue expenditure - *CIT v. Sree Bhagavathi Textiles Ltd.* [1994] 207 ITR 826 (Ker.).
- B) ***Expenditure on modernization of machines, aimed at more efficient carrying on of business and updating of facilities, is revenue expenditure*** - Where the expenditure in question incurred

by the assessee was for the better conduct and improvement of the existing business on a scheme of modernization of its machineries and not for a fresh and new venture and the object of modernization was for facilitating the assessee's trading operations and for the conduct of the assessee's business to be carried on more efficiently and to update the facilities on the lines of the modern trends in the business, the expenditure so incurred would be allowable as revenue expenditure - *Vanaja Textiles Ltd. v. CIT* [1994] 208 ITR 161 (Ker.).

22) Car expenses on vehicles given to directors for personal use

- A) Where the directors of the assessee-company were entitled to use the vehicles of the assessee for their personal use as per the terms and conditions of their appointment, the expenditure incurred by the assessee, which is attributable to such personal use is not to be disallowed as an inadmissible business expenditure. The expenditure in question would fall within the meaning of 'remuneration' as defined in the *Explanation* to section 198 of the Companies Act, and once such remuneration is fixed as provided in section 309 of that Act, it is not possible to state that the assessee-company incurred an expenditure for the personal use of the directors. So far as the assessee was concerned, it was business expenditure and not disallowed as such - *Sayaji Iron and Engg. Co. v. CIT* [2002] 253 ITR 749 (Guj.)

23) Collusive payments

- A) ***Payment found to be collusive is not deductible*** - Where the assessee, a closely-held company having two male directors and two female directors, claimed deduction on payments made to the two directors allegedly for refraining them from carrying on any further business of promotion of companies, and the Tribunal found that the arrangement between the assessee and the two directors was not only not *bona fide* but was of a collusive nature, the said expenditure was not allowable as a business deduction - *B.K. Khanna and Co. (P.) Ltd. v. CIT* [2001] 247 ITR 705 (Delhi).

24) Commission [See also 'Secret Commission']

- A) ***ITO can examine whether commission is properly deductible, even if it is paid under agreement*** - The mere existence of an agreement between the assessee and its selling agents or payment of certain amounts as commission, does not bind the ITO to hold that the payment was made exclusively and wholly for the purpose of the assessee's business. It is still open to the ITO to consider the relevant facts and determine for himself whether the commission said to have been paid to the selling agents or any part thereof is properly deductible under section 37(1) - *Lachminarayan Madan Lal v. CIT* [1972] 86 ITR 439 (SC).

- B) *If assessee has established identities of payees, summons issued by department to them coming back undelivered is not relevant*** - Where assessee had established identities of commission agents to whom it had made payments, the fact that summons sent to them four years later by department came back undelivered would not mean that they were non-existent at time of payment - *Mather & Platt (India) Ltd. v. CIT* [1987] 168 ITR 493 (Cal.).
- C) *Commission agreed to be paid on pending contracts of taken-over concern is capital expenditure*** - Where the assessee-company purchased a going concern with all its assets and liabilities, including pending contracts, subject to payment of commission to the seller on all pending contracts after their completion, the commission paid formed part of the consideration for transfer and was disallowable as capital expenditure - *Western Mechanical Industries (P.) Ltd. v. CIT* [1977] 110 ITR 703 (Bom.).

25) Compensation [See also case under the heading 'Damages']

A) *Compensation paid for premature termination of service is deductible –*

- I)** Where compensation was paid to senior employees whose services were prematurely terminated, so as to reduce administrative cost and to promote juniors, the compensation so paid was an admissible business deduction - *CIT v. Turner Morrison & Co. (P.) Ltd.* [1968] 68 ITR 147 (Cal.).
- II)** Where services are terminated by payment of compensation with the result that a recurring liability is got rid of, the amount paid by way of compensation is in the nature of revenue expenditure. - *Life Insurance Corpn. of India v. CIT* [1979] 119 ITR 900 (Bom.).

B) *Payment made to get rid of a larger liability is not capital in nature* - If there is a payment made on the ground of commercial expediency and if such payment does not result in the acquisition of any capital or in enduring benefit, merely because such payment is made to get rid of the liability which is much large, the outgoing amount cannot be considered as capital in nature - *CIT v. Pioneer Engg. Syndicate* [1988] 38 Taxman 151 (Mad.).

C) *Compensation paid for breach of contract qua purchase of machinery is capital expenditure* - Where the assessee had contracted to purchase textile machinery, but cancelled the contract because of changed circumstances, and paid compensation to vendors for breach of contract, the payment was really made for breach of contract in respect of purchase of textile machinery which would have been a capital asset. Such a payment made was clearly in the nature of capital expenditure and not an expenditure incurred wholly or exclusively for the purpose of the busi-

ness - *Swadeshi Cotton Mills Co. Ltd. v. CIT* (No. 2) [1967] 63 ITR 65 (SC)/*Dalmia Dadri Cement Ltd. v. CIT* [1973] 90 ITR 297 (Punj. & Har.).

D) *Compensation paid for delay in completion of building contracts is deductible* - Delay in completion of contract work is incidental to the business of building contracts. Therefore, the liability to compensation must be contractual as having arisen on account of a delay in the performance of a contract and is not in the nature of a penalty. Therefore, compensation payable by assessee-building contractor on this account is deductible as business expenditure - *CIT v. R.D. Sharma & Co.* [1982] 137 ITR 333 (Bom.).

E) *Computer Software* - Payment made for outright purchase of 'computer software' which was used as technique in mining operations, was in nature of capital expenditure - *CIT v. Arawali Construction Co. (P.) Ltd.* [2002] 124 Taxman 146 (Raj.).

26) Construction Expenses

A) *Expenditure incurred on demolition and reconstruction of premises taken on lease is allowable as revenue expenditure* - Where the assessee took premises on lease for 39 years, and then incurred expenditure on demolition and new construction to suit its business requirements, resulting in considerable savings by way of rent liability, the expenditure is allowable as revenue expenditure, since the asset created by spending the amount did not belong to the assessee but the assessee got the business advantage of using modern premises at a lower rent, thus saving considerable revenue expenditure for the next 39 years - *CIT v. Madras Auto Services (P.) Ltd.* [1998] 99 Taxman 575/233 ITR 468 (SC).

B) *Contributions for bridge construction* - Where, in respect of a bridge constructed by Government, the assessee made a contribution, so that the bridge would facilitate the movement of its workmen to gain access to the assessee's factory and to return home, and also for the movement of the goods over the bridge, the contribution made was allowable as revenue expenditure, as the assessee did not acquire any right of ownership over the bridge in the short-term or in the long run by reason of the contribution - *CIT v. Coats Viyella India Ltd.* [2002] 253 ITR 667 (Mad.).

27) Consultancy Fees

A) *Consulting fee paid to recognised co-ordinating organisation is deductible* - Consultancy fee paid by the assessee to the National Productivity Council, Administrative Staff College and the Engineering Management and Foundry Consultants, Bangalore, for the benefit of increasing the

manufacturing efficiency and formulating incentives schemes would be allowable as revenue expenditure - *CIT v. Praga Tools Ltd.* [1986] 157 ITR 282 (AP).

- B) *Consultancy fee paid for preparation of business reports is capital expenditure*** - Consultancy fee paid towards preparation of a report on diversification of the assessee's new business activity is to be disallowed as capital expenditure - *Vazir Sultan Tobacco Co. v. CIT* [1987] 135 Taxman 406 (AP).
- C) *Consultancy fee paid for restructuring of existing business is deductible*** - Where the assessee, with the intention of bringing about improvements in the way it did business, had sought and obtained reports from consultants, so that the efficiency of the business could be increased by employing better methods and reorganising the business itself to the extent required, the fee paid to the consultants is allowable as revenue expenditure. Merely obtaining a report from a management consultant and paying fees therefor, cannot be regarded as capital expenditure, as such report was not obtained as part of documentation packages, but in a contract covering comprehensive restructuring of the existing business - *CIT v. Crompton Engg. Co. Ltd.* [2000] 242 ITR 317 (Mad.).
- D) *Consultancy charges paid for getting existing mining lease to be renewed is not capital expenditure*** - Where the assessee paid fees towards consultancy and assistance provided for preparation of application for renewing an existing mining lease, the fees so paid could not be said to be a capital expenditure, since the payment was made only to facilitate extension of lease and the renewal of the lease did not result in any benefit of enduring nature to the assessee - *CIT v. Wolkem (P.) Ltd.* [2002] 258 ITR 350 (Raj.).
- E) *Consultancy fee paid by firm to company in which directors are close relatives of partners*** - Consultancy fees paid by firm to company in which directors were close relatives of partners could not be disallowed, when it had been paid in accordance with the contract entered into between the parties, which was proved by evidence of payment by account-payee cheques and there was no evidence that the consultancy charge paid to the consultancy firm was not in conformity with the usual trade practice followed in the area - *Shree Construction & Investment Co. v. Asstt. CIT* [2003] 262 ITR 73/133 Taxman 573 (Gauhati).

28) Copyrights

- A) *Purchase of copyright is capital expenditure*** - Price paid for purchasing copyright of a book by a publisher and seller of books, is capital expenditure - *Hira Lal Phoolchand v. CIT* [1947] 15 ITR 205 (All.).

29) Damages [See also under 'Compensation']*

- A) *General principles*** - Whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure under section 37(1), the Assessing Officer is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find out whether it is compensatory or penal in nature. The authority has to allow deduction under section 37(1) wherever such examination reveals the concerned impost to be purely compensatory in nature. Wherever such impost is found to be of a composite nature, *i.e.*, partly of compensatory nature and partly of penal nature, the authorities are obliged to bifurcate the two components of the impost and give deduction to that component which is compensatory in nature and refuse to give deduction to that component which is penal in nature - *CIT v. Catholic Syrian Bank Ltd.* [2003] 130 Taxman 447/[2004] 265 ITR 177 (Ker.)
- B) *Damages paid for breach of contract are deductible*** - If a contract is not executed because its execution would result in loss, damages paid for its breach are deductible - *CIT v. Sohanlal Kunwar & Sons* [1987] 164 ITR 129 (Raj.).
- C) *Damages paid for breach of contract due to change in Government policy are deductible*** - *Hind Mercantile Corpn. Ltd. v. CIT* [1963] 49 ITR 23 (Mad.).
- D) *Damages paid by non-dealer in shares for breach of agreement to acquire shares are capital expenditure*** - Where the assessee, who was not a dealer in shares, had entered into an agreement to acquire shares, and it stipulated that in the event of the assessee's failure to take delivery by a particular date, the seller would be free to sell the shares and the assessee would be liable for damages, it was *held* that since the assessee's main business was not dealing in shares and the damages paid were due to his default, it would be a capital expenditure rather than a revenue one and, thus, will not be deductible - *Seth R. Dalmia v. CIT* [1977] 110 ITR 644 (SC).
- E) *Damages payable under section 14B of Employees' Provident Funds Act*** - Amount paid by way of damages under section 14B of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, comprises both the elements of penal levy as well as compensatory payment and it will be for the authority under the Act to decide with reference to the provisions of the Employees' Provident Funds Act, 1952 and the reasons given in the order imposing and quantifying the damages, what proportion should be treated as penal and what proportion as compensatory. The entire sum can neither be considered as mere penalty nor as mere interest -

CIT v. Hyderabad Allwyn Metal Works Ltd. [1988] 172 ITR 113 (AP) [approved by the Supreme Court in *Prakash Cotton Mills (P.) Ltd. v. CIT* [1993] 201 ITR 684.]

30) **Demurrage**

- A) ***Demurrage for release of confiscated goods is deductible*** - Demurrage paid to port authorities in connection with release of confiscated goods is not a fine paid for infraction of law and is thus allowable as business expenditure - *Nanhoomal Jyoti Prasad v. CIT* [1980] 123 ITR 269 (All.).
- B) ***Demurrage paid to Railways is deductible*** - The payment of demurrage to Railways is not in the nature of damage or penalty, and it is merely a charge made by the railway administration to compensate itself for keeping the goods of the assessee in its custody beyond a particular time. Therefore, the expenditure on this account could be said to be laid down wholly and exclusively for the assessee's business and was allowable business expenditure - *Mahalaxmi Sugar Mills Co. Ltd. v. CIT* [1986] 157 ITR 683 (Delhi).

31) **Development expenses**

- A) ***Development expenditure relating to manufacturing contracts is revenue expenditure*** - Development expenditure incurred by the assessee for the purpose of preparing and perfecting designs which were required with reference to the execution work of specific manufacturing contracts of relevant year undertaken by the assessee, was in the nature of revenue expenditure - *CIT v. Praga Tools Ltd.* [1986] 157 ITR 282 (AP).

32) **Devaluation loss**

- A) ***Excess paid due to devaluation, qua loans taken for purchase of machinery is capital expenditure*** - Where loan was taken and was repayable in foreign currency for the purchase of plant and machinery, extra amount payable on account of devaluation of the rupees would be capital expenditure - *Union Carbide India Ltd. v. CIT* [1981] 130 ITR 351 (Cal.)/*CIT v. South India Viscose Ltd.* [1987] 163 ITR 674 (Mad.)/*Periyar Chemicals Ltd. v. CIT* [1986] 162 ITR 163 (Ker.)/*Mopeds India Ltd. v. CIT* [1988] 172 ITR 555 (AP)/*Union Carbide India Ltd. v. CIT* [1987] 165 ITR 558 (Cal.)/*CIT v. Cochin Refineries Ltd.* [1988] 173 ITR 461 (Ker.)/*CIT v. Bharat General & Textile Industries Ltd.* [1986] 157 ITR 158 (Cal.).
- B) ***Additional payment on purchase of assets due to exchange rate difference is capital expenditure*** - Additional payment made in terms of rupee on account of difference in exchange rate when the liability was incurred and when the liability was discharged for the purpose of purchasing asset from foreign country, price of which was payable in foreign currency was not allowable as business expenditure. In view of the provisions of section 43A such an increase in

liability is an expenditure of capital nature - *CIT v. Rohit Mills Ltd.* [1996] 85 Taxman 532/219 ITR 228 (Guj.).

33) Direct taxes

- A) *Income-tax and other direct taxes are not deductible*** - Income-tax is not an expenditure laid out for the purpose of the business. It is in fact is paid out of the profits, it is an application of the profits after they have been earned. Thus, taxes such as income-tax, excess profits tax, super-tax, surcharge or surtax being charges on profits, are not deductible - *A.V. Thomas & Co. Ltd. v. CIT* [1986] 159 ITR 431 (Ker.) (FB).
- B) *Discharge of income-tax liability of purchased business is capital expenditure*** - Amount spent in discharging income-tax liabilities of business purchased is a capital expenditure - *Dashmesh Transport Co. (P.) Ltd. v. CIT* [1980] 125 ITR 681 (Punj. & Har.).
- C) *Tax liability of predecessor to business is not deductible*** - Where the assessee took over a business with all its assets and liabilities, and subsequently paid a demand of income-tax raised on its predecessor, the amount so paid is not allowable as a revenue deduction. If it is treated as the assessee's liability, it is a personal liability and hence not deductible. If it is treated as the liability of the predecessor, the same would go as a capital expenditure and hence not allowable as deduction - *CIT v. Hyderabad Race Club* [2001] 116 Taxman 650 (AP).

34) Donations

- A) *Donations are allowable if they satisfy the 'expenditure' test*** - If the contribution by an assessee is in the form of donations of the category specified under section 80G, but it could also be termed as an expenditure of the category falling under section 37(1), then the right of the assessee to claim the whole of it as allowance under section 37(1) cannot be denied - *Mysore Kirloskar Ltd. v. CIT* [1987] 166 ITR 836 (Kar.).
- B) *Donation to political party for non-business considerations is not deductible*** - *CIT v. Scindia Steam Navigation Co. Ltd.* [1980] 125 ITR 118 (Bom.)/*ITAT v. B. Hill and Co. (P.) Ltd.* [1983] 142 ITR 185 (All.).
- C) *Donations to public welfare funds are deductible*** - Any contribution made by an assessee to a public welfare fund which is directly connected or related with the carrying on of the assessee's business or which results in the benefits to the assessee's business has to be regarded as an allowable deduction under section 37(1). Such a donation, whether voluntary or at the instance of the authorities concerned, when made to a Chief Minister's Drought Relief Fund or a District Welfare Fund established by the District Collector or any other Fund for the benefit of the public

and with a view to secure benefit to the assessee's business, cannot be regarded as payment opposed to public policy. - *Sri Venkata Satyanarayana Rice Mill Contractors Co. v. CIT* [1996] 89 Taxman 92 (SC).

D) *Donation not proved as relatable to carrying on of business* - Where there was nothing on record to establish that the donation made by the assessee to the Chief Minister's Relief Fund was directly connected with and related to the carrying on of the assessee's business, the said donation was not allowable as business expenditure - *CIT v. Industrial Development Corporation of Orissa Ltd.* [2001] 249 ITR 401 (Ori.).

35) Dust extraction plant

A) Where the assessee installed a dust extraction plant in its factory in order to protect the health of its workmen who would otherwise be injuriously affected by the dust arising from the operation of the carding machine, the expenditure incurred on such installation was allowable as revenue expenditure - *CIT v. Sakthi Textiles Ltd.* [2002] 120 Taxman 268 (Mad.).

36) Effluent discharge

A) Before expenditure can be regarded as incidental to the business carried on by the assessee, there must be a link demonstrable as between the business carried on and the subject-matter on which the expenditure had been incurred. Thus, where a manufacturer of sugar incurred expenditure on discharging of effluents outside the factory premises and diverting the effluents to its own lands for cultivation purposes, the expenditure incurred on discharging the effluents from the factory to the outside was allowable as business deduction, but the expenditure on diverting the effluents to its lands for agricultural operations was not an allowable deduction - *CIT v. Sun Paper Mills Ltd.* [2002] 253 ITR 709 (Mad.).

37) Embezzlement loss

A) ***Embezzlement loss is not deductible under section 37(1)*** - A claim for deduction of loss due to embezzlement cannot be admitted under section 37(1) because money which is withdrawn by an employee out of the business without authority and by fraud on the proprietor can in no sense be said to be 'an expenditure laid out or expended wholly and exclusively' for the purpose of the business - *Badridas Daga v. CIT* [1958] 34 ITR 10 (SC)/*Associated Banking Corp'n. Of India Ltd. v. CIT* [1965] 56 ITR 1 (SC)/*Lord's Dairy Farm Ltd. v. CIT* [1955] 27 ITR 700 (Bom.).

38) Ex gratia payments

A) ***Ex gratia payment over and above statutory bonus is deductible*** - *Ex gratia* payment to the workers and employees in excess of the statutory limit of 20 per cent of salary in terms of the

Payment of Bonus Act, 1965, was allowable as deduction - *CIT v. National Engineering Industries Ltd.* [1994] 208 ITR 1002 (Cal.).

- B)** Where the assessee-company made *ex gratia* payment to its labourers and staff with a view to buy industrial peace and save industry from strike and lock-out and to keep a customary practice adopted in business and commercial establishments so as to improve production and to increase revenue for the State (in addition to bonus payable under the Payment of Bonus Act), such *ex gratia* payment is allowable as business expenditure under section 37(1) - *CIT v. Assam Frontier Tea Ltd.* [2001] 117 Taxman 396 (Gauhati).

39) Farm expenses

- A) *Expenses on maintaining demonstration farm are deductible*** - Where the assessee engaged in the manufacture of farm equipment maintained a demonstration farm for training its salesmen and dealers, the expenditure incurred on maintaining the farm is deductible, being incurred wholly and exclusively for the purpose though incurred on agricultural land - *CIT v. Tractors & Farm Equipment Ltd.* [1999] 238 ITR 1042 (Mad.).

40) Feasibility reports

- A) *Expenditure on feasibility report on project which was given up is capital expenditure*** - Where the assessee-company engaged in the manufacture of cement incurred expenditure on the preparation of feasibility report for the construction of a shipyard, but the project was ultimately given up, the expenditure was capital in nature - *CIT v. Shri Digvijay Cement Co. Ltd.* [1986] 159 ITR 253 (Guj.).
- B) *Expenditure on feasibility report for manufacture of raw material is deductible*** - Expenditure on obtaining feasibility report for manufacture of raw material for the assessee's products is a revenue expenditure - *Asiatic Oxygen Ltd. v. CIT* [1991] 190 ITR 328 (Cal.).
- C) *Investigation/research/feasibility study expenses are deductible*** - The expenses incurred in investigation, research and feasibility study are revenue expenditure - *CIT v. Kerala State Industrial Development Corpn. Ltd. (No. 1)* [1990] 182 ITR 62 (Ker.).
- D)** Where the very idea of the assessee was to find out the feasibility for converting the existing plant to the cement plant without much disturbing the existing plant. The expenditure incurred in obtaining the feasibility report was a revenue expenditure and not a capital expenditure - *CIT v. India Carbon Ltd. (No. 2)* [1996] 221 ITR 264 (Gau.).
- E)** Where the assessee incurred expenditure on techno-economic feasibility studies in order to identify projects that may be advantageously taken up in future, and no new line of business was

later initiated by the assessee on the basis of such studies, such expenditure could be treated as incurred with the object of utilising surplus funds profitably and efficiently. The expenditure was revenue in nature and not on capital account - *CIT v. Coromandel Fertilisers* [2001] 247 ITR 417 (AP).

41) Fines

- A) ***Fines paid for traffic offences are not deductible*** - Fines and penalties paid for traffic offences by the assessee-company's truck drivers being penalty for infringement of law, could not be allowed as deduction - *CIT v. Jaipur Golden Transport* [1997] 226 ITR 399 (Delhi).

42) Firm/partner transactions

- A) ***Expenditure by firm on taking out life insurance policies in partners' names is not deductible*** - Expenditure by way of premia paid on life insurance policies of partners taken out by assessee-firm to ensure payment to legal heirs in eventuality of a partner's death was capital in nature - *CIT v. Khodidas Motiram Panchal* [1986] 161 ITR 99 (Guj.).
- B) ***Expenditure by firm on sending partner abroad for higher studies is not deductible*** - Expenditure incurred by assessee-firm for sending one of its partners to USA for higher studies, who got degree in business management, is not allowable as business expenditure since it had no nexus with the assessee's business - *CIT v. Hindustan Hosiery Industries* [1994] 73 Taxman 521/209 ITR 383 (Bom.).
- C) ***Payments to retiring partners towards assignment of share in goodwill and other rights are revenue expenditure*** - Where retiring partners received a lump sum amount from the reconstituted new firm in proportion of their shares in old firm and in lieu thereof transferred goodwill, quota rights and all other rights in movable and immovable properties of the old firm in favour of the reconstituted firm the lump sum paid by the assessee-firm to retiring partners was revenue expenditure - *Sukhbir Parshad v. CIT* [1983] 144 ITR 437 (Punj. & Har.).
- D) ***Payments by firm to outgoing partners are capital in nature*** - Payment made to the outgoing partners would be clearly a payment of capital nature relatable to the settlement of accounts between the partners *inter se*. - *CIT v. Standard Maltings & Allied Products Corporation* [1997] 226 ITR 1 (Guj.).
- E) ***Expenses incurred by partner for dissolution of firm are deductible*** - Legal expenses incurred by a partner for dissolution of firm, rendition of accounts, and also alleging mismanagement of the affairs of firm, are deductible - *Bilasrai Juharmal (HUF) v. CIT* [1983] 141 ITR 915 (Bom.).

F) *Partner can deduct out of his share income expenses on part of dwelling house used for business purpose* - Use of part of dwelling house by a partner for business purpose is expense incurred for earning share income from the firm and is deductible from his share of profits - *CIT v. S.B. Ghose* [1980] 124 ITR 674 (Cal.).

G) *Payments by disabled partner to a person for looking after his interest in firm are deductible* - The amount paid by partner, being physically incapable of handling his work, to another person for looking after his interest in the firm, is an allowable deduction from the taxable income of such partner - *CIT v. Baburam* [1982] 138 ITR 311 (Delhi)/*M.G. Bhatt v. CIT* [1980] 123 ITR 931 (Bom.)/*CIT v. New Digvijaysinhji Tin Factory* [1959] 36 ITR 72 (Bom.).

43) Foreign tour/travel expenses

A) *Foreign travel expenses connected with exploratory missions and finalization of collaboration agreements are revenue expenditure* - Expenditure incurred, in connection with an exploratory mission or a visit intended to finalize the collaboration agreement, in the form of traveling expenses, has to be treated as revenue expenditure where royalty payment for know-how under the agreement has already been allowed as revenue expenditure - *Antifriction Bearings Corporation Ltd. v. CIT* [1978] 114 ITR 335 (Bom.).

B) *Tour expenses connected with survey of new methods or for purchase of machinery are capital expenditure* - A tour undertaken for the purpose of a preliminary survey of new methods of manufacturing, designing or processing and of new machinery with a view to purchase them, even if not immediately but at later stage, would be one for the purpose of bringing into existence a capital asset and such expenditure would, therefore, be capital expenditure - *Ambica Mills Ltd. v. CIT* [1964] 54 ITR 167 (Guj.).

C) *Tour expenses for inspection/trial run of capital equipment are deductible* - Where managing director of a running business incurred foreign tour expenses to inspect and to take trial run of capital equipment, expenses are deductible - *Bralco Metal Industries (P.) Ltd. v. CIT* [1994] 74 Taxman 132/206 ITR 477 (Bom.).

D) *Tour expenses connected with initiation of new business is not deductible* - Expenditure in connection with foreign tour undertaken for initiation of new business is not allowable - *CIT v. Flour & Food Ltd.* [1988] 170 ITR 469 (MP).

E) *Where tour covered both existing business and new venture, proportionate expenses relatable to new venture are capital expenditure* - Where the managing director and chairman of assessee-company went on a foreign tour not only in connection with assessee's existing business but also

in connection with a new venture to be undertaken by the assessee, that part of expenditure incurred on foreign tour which related to new venture was to be disallowed as capital expenditure - *Vazir Sultan Tobacco Co. Ltd. v. CIT* [1987] 35 Taxman 406/175 ITR 55 (AP).

- F) *Expenses connected with setting up new plant are capital expenditure*** - Expenses on travel of foreign expert to help assessee in setting up new plant are capital in nature and hence not allowable as revenue expenditure - *Ciba of India Ltd. v. CIT* [1993] 70 Taxman 505/202 ITR 1 (Bom.).
- G) *Expenses connected with setting up joint ventures abroad are not deductible*** - Foreign tour expenses for setting up new joint venture units in foreign countries are not allowable - *Shahibag Entrepreneurs (P.) Ltd. v. CIT* [1994] 210 ITR 998 (Guj.).
- H) *Tour expenses connected with agreement for obtaining know-how are deductible*** - The amount spent by the assessee on the visit of its general manager to foreign country in connection with an agreement for obtaining know-how from foreign company was allowable as revenue expenditure - *Addl. CIT v. Buckau Wolf New India Engineering Works Ltd.* [1986] 157 ITR 751 (Bom.).
- I) *Tour expenses for attending international conference connected with assessee's business are deductible*** - Where the assessee-owner of a printing press, attended an International Printers' Conference in a foreign country as the delegate of State Printers' Association, it was *held* that the expenditure incurred on the foreign tour could not be characterised as a capital expenditure - *CIT v. S. Krishna Rao* [1970] 76 ITR 664 (AP).
- J) *Tour expenses by professional for studying latest techniques are deductible*** - Where the assessee, a surgeon, spent moneys on tour abroad to study latest techniques in surgery, it was held that the expenditure was allowable as revenue expenditure - *Dr. P. Vadamalayan v. CIT* [1960] 40 ITR 501 (Mad.)/*CIT v. Dr. M.S. Shroff* [1971] 80 ITR 687 (Delhi).
- K) *Tour expenses on spouse* –**
 - I) An assessee cannot claim the expenses if any incurred on the travel of a spouse of its director on his/her business travel abroad, unless the spouse contributes to the business of the assessee, as the income of an assessee is not meant to be frittered away for promoting the pleasure of those who manage it, and such expenditure cannot be considered as commercially expedient. However, in the matters of business, too narrow a view cannot be adopted. It is the realities of the commercial world that should determine the kind of expenditure reasonably required to be incurred, and it is necessary to constantly update the interpretation of the Act with a view to accommodate all such expenditure. The language employed in the relevant**

section is flexible enough to permit such wider interpretation whenever circumstances warrant - *CIT v. Sundaram Clayton Ltd.* [1999] 105 Taxman 545/240 ITR 271 (Mad.).

II) The Assessing Officer as well as the appellate authorities must consider the claim meticulously, keeping in mind the legal principles governing the question whether the expenditure has been wholly and exclusively incurred for the purpose of business. A decision must thereafter be arrived at either way, after affording a reasonable opportunity to the assessee. Of course, the burden is on the assessee to establish its claim that the expenditure on which deduction is claimed falls under section 37(1). Where there was a concurrent finding of fact by the assessing authority, the appellate authority and the Tribunal that no materials were available to establish that the expenditure incurred on the foreign tour of the wife of the director was for the company's business purposes, disallowance of expenditure required no interference - *Ram Bahadur Thakur Ltd. v. CIT* [2002] 257 ITR 289 (Ker.)/*CIT v. Sahibag Entrepreneurs (P.) Ltd.* 1995 Tax LR 133 (Guj.) [See also *CIT v. Autometer Ltd.* [2004] 136 Taxman 562 (Delhi)].

L) *Tour expenses on persons accompanying businessmen on health grounds are not allowable* -

The expenses incurred for availing of the services of an attendant by businessman on his tour abroad for treatment would be only to satisfy or meet the personal need and in that context, it is really immaterial whether the person concerned avails himself of the services of his wife or that of a stranger and tour expenses of such attendant would not be allowable. - *CIT v. T.S. Hajee Moosa & Co.* [1985] 153 ITR 422 (Mad.)/*Bombay Mineral Supply Co. (P.) Ltd. v. CIT* [1985] 153 ITR 437 (Guj.) (App.).

44) Forest leases

A) *Principles for determining whether acquisition of forest leases is capital or revenue* - The question whether lease money paid for acquiring forest leases is capital or revenue expenditure will be determined on the following principles :

I) Whether under a lease of timber-bearing lands there is a duty of instant removal of standing timber, it may be possible to say that there is a case of acquisition of stock-in-trade.

II) Where the right of removal is co-existent with the period of the lease and the cutting and the removal may be postponed till the end of the period of the lease and particularly, in a case the lease is for a fairly long period, it is inevitable that the timber should derive its sustenance and nutriment from the soil and in such a case the acquisition is of an interest in land and not merely of stock-in-trade.

III) Where by reason of the length of the term of the lease and the postponement of the duty of removal till the end of the term of the lease, the additional growths become *ipso jure* the property of the lessee that also indicates that the interest is in land and is not merely in the possession of goods or stock-in-trade.

IV) Where the process of vegetation is over or the parties agree that the things sold shall be immediately withdrawn from the land, the land has to be considered as a mere warehouse of the things sold and the contract of lease a contract for the sale of goods.

V) The broad principles applicable to cases of leases of timber-bearing lands are the same as the principles relating to lease regarding the working of coal mines or nitrate deposits - *Sabalgarh Industries Ltd. v. CIT* [1962] 46 ITR 978 (All.).

45) Foundation ceremonies

A) *Expenditure on foundation-laying of additional factory is revenue expenditure* - The expenditure incurred on foundation-laying ceremony of an additional factory to augment production is allowable - *CIT v. Merck Sharp & Dohme of India Ltd.* [1983] 140 ITR 332 (Bom.).

46) Gifts

A) *Gifts made on marriages in families closely connected with assessee's business are not deductible* - Expenditure on gifts made on the occasion of marriages in the families of directors of the companies with which the assessee has business dealings, friends and relatives, cannot qualify as business expenditure. If the assessee chooses to make such gifts out of the income received by the assessee in the course of his business, he can do so, but cannot claim it as a legitimate expenditure while computing his income for the purpose of taxation - *CIT v. Jeevandas Laljee & Sons* [2000] 245 ITR 719 (Mad.).

47) Goodwill

A) *While acquisition of goodwill is capital in nature, right to use goodwill is revenue in nature* - Acquisition of the goodwill of the business is acquisition of a capital asset, and, therefore, its purchase price would be capital expenditure. It would not make any difference whether it is paid in a lump sum at one time or in instalments distributed over a definite period. Where, however, the transaction is not one for acquisition of the goodwill, but for the right to use it, the expenditure would be revenue expenditure - *Devidas Vithaldas & Co. v. CIT* [1972] 84 ITR 277 (SC)/*Waqf Haji Sheikh Karim Bux v. CIT* [1987] 167 ITR 724 (All.).

48) Gratuitous payments –

- A) Where the assessee-company incurred medical and travel expenses towards medical treatment abroad of its part-time advisor, and the said advisor did not have any expectation nor did he seek to claim the said amount, the expenses so incurred were not allowable as a deduction, since no commercial expediency was established for incurring such expenditure. - *CIT v. Tiam House Service Ltd.* [2000] 243 ITR 695 (Mad.).

49) Gratuity

- A) ***Deductibility of gratuity must be considered only under section 40A (7)*** - For gratuity to be deductible under the Act, it must fulfil the conditions laid down in section 40A (7). The deduction could not be allowed on general principles under any other section of the Act. - *Shree Sajjan Mills Ltd. v. CIT* [1985] 156 ITR 585 (SC).
- B) ***In case of closed units*** - Where one of units was closed and same was transferred to another company R, who took employees of closed unit with continuity of service, gratuity amount paid by assessee at instance of employees to 'R' for benefit of such terminated employees was allowable as expenditure incurred for purpose of business - *W.T. Suren & Co. Ltd. v. CIT* [1998] 97 Taxman 126 (SC).
- C) ***Insurance premium paid under group gratuity scheme is not allowable*** - Insurance premium paid by the assessee to the LIC under the group gratuity scheme cannot be claimed as deduction under section 37, since the said claim which relates to gratuity cannot be allowed under general principles under any provisions of the Act other than section 40A(7) - *CIT v. Coimbatore Premier Corporation (P.) Ltd.* [2000] 244 ITR 753 (Mad.).

50) Guarantee commission

- A) ***Guarantee commission paid to director is deductible*** - When guarantee commission was paid to director for obtaining loan, which could not be obtained without director's guarantee, such commission was allowable - *CIT v. L.H. Sugar Factories & Oil Mills (P.) Ltd.* [1980] 123 ITR 598 (All.) (App.I)/*L.H. Sugar Factories & Oil Mills (P.) Ltd. v. CIT* [1979] 118 ITR 985 (All.) (App. II).
- B) ***Guarantee commission paid to bank is revenue expenditure*** - Guarantee commission paid to bank is revenue expenditure and hence allowable as deduction in computing total income of assessee - *CIT v. Sivakami Mills Ltd.* [1997] 227 ITR 465/95 Taxman 73 (SC).

51) HUF transactions

- A) ***Salary paid by HUF to its members for business purposes is deductible*** - A HUF is allowed to deduct salaries paid to members of the family, if the payment is made as a matter of commercial

or business expediency; but the service must be to the family - *Jitmal Bhuramal v. CIT* [1962] 44 ITR 887 (SC).

- B) Salary paid to a coparcener for services rendered to assessee-HUF, where karta was not well due to old age and bad health, is an admissible deduction - *Sunderlal Nanalal (HUF) v. CIT* [1985] 151 ITR 25 (Guj.).**
- C) *Remuneration paid to karta is deductible within reasonable limits* -** The general view expressed by commentators on Hindu law as well as in decided cases is that even the karta of a family can be paid remuneration for carrying on family business, provided it is under some agreement. If such remuneration is not excessive and is reasonable and is not a device to escape income-tax, then it will be a legitimate deduction in computing the profits of the business. If, on the other hand, the amount paid is unreasonably high and disproportionate to the service rendered by him, then it may be treated as part of the profit of the HUF distributed in a particular manner - *Jugal Kishore Baldeo Sahai v. CIT* [1967] 63 ITR 238 (SC).
- D) *Salary agreed to be paid to single male member for managing business is not deductible* -** Where HUF consisted of single male member and female members, agreement by female members to pay salary to karta for management of business of firms in which HUF was a partner is not valid and salary so paid is not deductible - *Shri Sham Lal Sajdesb v. CIT* [1989] 176 ITR 190 (Punj. & Har.).

52) Illegal payments

A) *Bribes/illegal gratifications are not deductible but tips paid for services rendered is deductible*

- I)** It is the legal expenditure that can be claimed as allowable deduction. No law point would arise regarding expenditure for unlawful acts. Where a transport operator claimed deduction on expenditure incurred on paying mamools, tips, and payments for greasing the hands of employees of the transport department on the ground that the payments were necessitated for smooth running of business, the tips paid might be allowable expenditure on the ground that they were made to persons engaged in the assistance of the business, like loaders and unloaders of goods. On the contrary, greasing the palms of the RTO staff would not only be an illegal act but would amount to illegal gratification. Such illegal gratification could not be allowed to be deducted, since it is also opposed to public policy - *Gwalior Road Lines v. CIT* [1998] 234 ITR 230 (MP).
- II)** Where on paper full export price was received by assessee but part of amount was paid back to purchasing party through illegal channel as per agreement to sell goods below floor price

fixed by Government, payment being against law could not be allowed as deduction - *Maddi Venkataraman & Co. (P.) Ltd. v. CIT* [1998] 96 Taxman 643/229 ITR 534 (SC).

- B) *Payment in violation of Companies Act*** - Infraction by assessee-company of provisions of section 349 of the Companies Act, 1956, in not deducting interest on borrowings, while computing net profit, a percentage of which was paid to managing agent, could not be ignored and remuneration paid to managing agent in excess of what was permissible under section 348, read with section 349 of the Companies Act could not be allowed as business expenditure - *CIT v. India Cements Ltd.* [2000] 108 Taxman 67 (Mad.).

53) Import entitlements

- A)** Expenditure on acquisition of import entitlements is revenue expenditure - *CIT v. Kusum Products Ltd.* [1984] 149 ITR 250 (Cal.).

54) Inaugural functions

- A) *Expenses on inaugural functions are deductible, subject to excluding portion in the nature of entertainment expenditure*** - The inaugural function of a unit is exclusively for the purpose of business and the business normally comes into existence before the inauguration, which is only a formal function. The expenses, which were in the nature of inaugural function, have to be allowed subject to the restrictions imposed by section 37(2) of the Act. The expenditure which was in the nature of entertainment expenditure alone had to be excluded therefrom - *Sunil Synchem Ltd. v. CIT* [1994] 205 ITR 298 (Raj.).
- B) *Expenses on inauguration of new unit are deductible*** - Amount spent by the assessee in connection with the inaugural function of its new unit cannot be said to be in the nature of capital expenditure only because it was incurred before the commissioning of the new unit.- *CIT v. Aluminium Industries Ltd.* 1995 Tax LR 462/80 Taxman 243/214 ITR 541 (Ker.).
- C) *Expenditure on inviting VIPs for inaugural functions is deductible*** - The anxiety to invite persons who are holding important and powerful positions to inaugurate a project, whether it is a new one or expansion of an existing one is widely prevalent. The expenditure incurred by the assessee on inviting VIPs for such functions would be allowable as revenue expenditure - *CIT v. Aluminium Industries Ltd.* [1995] 214 ITR 541/80 Taxman 243 (Ker.).

55) Income-tax [See under 'Direct taxes']

56) Insolvency proceedings

A) *Expenses on insolvency proceedings are deductible* - The expenses incurred by an assessee in connection with insolvency proceedings including the counsel fee, travelling expenses and other legal expenses should be treated as part of the business expenditure within the meaning of section 37(1) - *Seth Champalal Ramswarup v. CIT* [1964] 52 ITR 201 (All.).

57) Insurance bonus

A) *Bonus paid to policy-holders by insurer is deductible* - Where, under a scheme evolved by the assessee-insurer, payment of bonus was to be made to induce the policy-holders to renew their policies with the insurer - *Union Co-operative Insurance Society v. CIT* [1967] 66 ITR 360 (SC).

58) Interest payments

A) *Purpose for which loan was required is irrelevant* - In principle, apart from any statutory provisions, there is no distinction between interest in respect of a loan and an expenditure incurred for obtaining the loan. The nature of the expenditure incurred in raising a loan would not depend upon the nature and purpose of the loan. The purpose for which the loan was required is irrelevant to the consideration of the question whether the expenditure for obtaining the loan is revenue expenditure or capital expenditure - *India Cements Ltd. v. CIT* [1966] 60 ITR 52 (SC)/*S.F. Engineer v. CIT* [1965] 57 ITR 455 (Bom.).

B) *If principal is deductible, interest is also deductible* - If the principal is a permissible deduction, the interest payable thereon would also be a permissible deduction because principal and interest together constitute the assessee's liability - *Kamlapat Motilal v. CIT* [1976] 104 ITR 783 (All.).

C) *Interest on deferred payment for purchase of machinery is revenue expenditure* - Interest on deferred payment for purchase of machinery is allowable as revenue expenditure - *CIT v. Sivakami Mills Ltd.* [1997] 227 ITR 465/95 Taxman 73 (SC).

D) *Interest on liability arising from HUF partition is not allowable in individual business* - Where the assessee, a member of a HUF doing business, was carrying on money-lending business on his own, was indebted to two firms as a result of financial adjustments and distribution of certain assets in a partial partition of the said HUF, and paid interest on such debts, the interest so paid is not allowable as a deduction from his income from money-lending business. The said debt was a personal obligation of the assessee and not the obligation of his business, and the expenditure by way of interest was not for the purpose of carrying on his business, and was hence not deductible - *CIT v. Krishnadas Govindas* [2000] 242 ITR 443 (Guj.).

E) *Interest for failure to pay provident fund contributions is deductible* - Where the assessee failed to pay the contribution under the provisions of the Employees' Provident Funds Act to the

concerned trust and consequently, it had to pay interest thereon, interest so paid by the assessee was not penalty and, therefore, was allowable as deduction - *CIT v. Mysore Electrical Industries Ltd.* [1992] 196 ITR 884 (Kar.).

- F) *Interest on betterment charges is capital expenditure*** - Payment of betterment charges is capital expenditure. Therefore, payment of interest on annual instalments of the betterment charges will have to be regarded as capital expenditure, because it has no direct nexus with the day-to-day running of the business of the assessee - *CIT v. Ahmedabad Mfg. & Calico Printing Co. Ltd.* [1995] 215 ITR 735 (Guj.).
- G) *Interest on borrowals for payment of income-tax is not deductible*** - The interest that is paid by the assessee on any sum borrowed by him for payment of income-tax is not deductible from his net income. - *Mannalal Ratanlal v. CIT* [1965] 58 ITR 84 (Cal.)/*East India Pharmaceutical Works Ltd. v. CIT* [1997] 91 Taxman 185/224 ITR 627 (SC).
- H) *Interest on overdraft, out of which tax was paid is deductible subject to certain conditions*** - Interest paid on overdraft cannot be disallowed on ground that taxes were paid out of overdraft, if net profits of assessee exceeded the tax paid and the profit were deposited into overdraft account in its entirety - *Alkali & Chemical Corpn. of India Ltd. v. CIT* [1986] 161 ITR 820 (Cal.)/*Reckitt & Colman of India Ltd. v. CIT* [1982] 135 ITR 698 (Cal.).
- I) *Interest for late payment of direct taxes is not deductible*** - Interest levied on assessee for delay in filing return would not be allowable as business expenditure - *Bharat Commerce & Industries Ltd. v. CIT* [1998] 230 ITR 733/98 Taxman 151 (SC).
- J) *Interest paid under section 215 for failure to pay advance tax up to statutory percentage would not be allowable as business expenditure*** - *Bharat Commerce & Industries Ltd. v. CIT* [1998] 230 ITR 733/98 Taxman 151 (SC).
- K) *Interest paid under section 220(2) for late payment of income-tax is not deductible as revenue expenditure*** - *CIT v. Ashoka Mills Ltd.* [1996] 88 Taxman 184/218 ITR 526 (Guj.)/*CIT v. Raipur Manufacturing Co. Ltd.* [1996] 135 CTR (Guj.) 248.
- L) *Interest for delayed filing of return is not deductible*** - It cannot be said that interest paid for delay in filing the return has any connection with the business of the assessee. If income-tax is not a permissible deduction under section 37, any interest payable for default committed by the assessee in discharging its statutory obligation under the Income-tax Act which is calculated with reference to the tax or income, cannot be allowed as a deduction - *Orient General Industries Ltd. v. CIT* [1994] 209 ITR 490 (Cal.).

- M) *Interest paid under VDIS*** - Where assessee declared income under Voluntary Disclosure Scheme and tax was paid in instalments with interest, interest paid was not deductible as business expenditure or as interest on borrowed capital - *Bharat Commerce & Industries Ltd. v. CIT* [1998] 230 ITR 733 (SC).
- N) *Interest paid on sales tax arrears is deductible*** - Interest paid by the assessee to the Sales-tax Department on arrears of sales tax is an admissible deduction under section 37(1) - *Lachmandas Mathuradas v. CIT* [2002] 254 ITR 799/122 Taxman 828(SC)/*CIT v. Western India State Motors* [1987] 167 ITR 395 (Raj.)/*CIT v. Western Indian State Motors* [1988] 174 ITR 116 (Raj.).
- O) *Interest on purchase tax arrears is deductible*** - Interest paid to the Government on arrears of purchase tax is deductible - *CIT v. Chodavaram Co-operative Sugars Ltd.* [1987] 163 ITR 420 (AP)/*CIT v. Shri Sarvaraya Sugars Ltd.* [1987] 163 ITR 429 (AP)/*Mahalaxmi Sugar Mills Co. Ltd. v. CIT* [1986] 157 ITR 683 (Delhi).
- P) *Where liability is contractual and not statutory, as in the case of forest royalty, interest is deductible*** - Where the liability to pay interest is not statutory but is contractual, as in the case of belated payment of royalty under a forest lease, such a liability is obviously 'compensation for the deprivation of the use of money', and is an accretion to royalty, and hence payment of such a liability will represent expenditure laid out wholly and exclusively for the purpose of business, and is hence allowable as a deduction under section 37(1) - *CIT v. New Alpine Forests* [2000] 245 ITR 470 (J&K).
- Q) *Interest paid by banks to RBI*** - Penal interest paid by banks to Reserve Bank of India for non-maintenance of cash reserves under section 42(1) of the Reserve Bank of India Act or under section 24(1) of the Banking Regulation Act, in respect of the first default, is not a penalty for infraction of law and is hence an allowable deduction. However, if the payment is by way of penal interest for the second default, such payment will have to be treated as penalty for infraction of law, and it is not allowable as deduction - *CIT v. Catholic Syrian Bank Ltd.* [2003] 130 Taxman 447/[2004] 265 ITR 177 (Ker.).

59) Land acquisition

- A) *Expenditure incurred on providing alternate sites for villagers whose lands were required by assessee is capital in nature*** - Where the assessee incurred expenditure on providing alternate sites to villagers whose lands were required by the assessee for extension of the airport, such

expenditure was capital in nature, since it resulted in bringing into existence an enduring benefit - *International Airports Authority of India v. CIT* [2002] 122 Taxman 611/254 ITR 657 (Delhi).

60) Lease transactions

- A) *Stamp duty, registration charges and legal expenses incurred on taking over running business on long lease, are capital expenditure*** - Where the assessee took over a running hotel business with boarding and lodging facilities, and executed a lease deed in respect of which it had incurred an expenditure by way of stamp duty, registration fee and legal expenses, and the lease was for a period of ten years with option for renewal for another period of ten years, the expenditure by way of stamp duty, registration charges and legal fees would be an expenditure of capital nature - *Hotel Rajmahal v. CIT* [1985] 152 ITR 218 (Kar.).
- B) *Stamp duty, registration and legal charges connected with lease are revenue expenditure*** - Where the assessee incurred expenditure on stamp charges, registration fees and legal expenses in connection with lease for 10 years, it was *held* that irrespective of whether the incidental expenditure was incurred in connection with or was related to capital expenditure, having regard to the nature of the expenditure, which was in connection with the document of lease, it must be treated as revenue expenditure - *CIT v. Hoechst Pharmaceuticals Ltd.* [1978] 113 ITR 877 (Bom.)/*CIT v. Katihar Jute Mills (P.) Ltd.* [1979] 116 ITR 781 (Cal.)/*Sri Krishna Tiles & Potteries Madras (P.) Ltd. v. CIT* [1988] 173 ITR 311 (Mad.)/*Richardson Hindustan Ltd. v. CIT* [1988] 169 ITR 516 (Bom.).
- C) *Brokerage connected with lease is revenue expenditure*** - The brokerage paid by the assessee for obtaining lease of accommodation for locating its factory and also for housing its staff is revenue expenditure - *CIT v. Burroughs Wellcome & Co. (India) (P.) Ltd.* [1982] 133 ITR 37 (Bom.).
- D) *Premium paid for grant of lease is capital expenditure, and periodical rentals paid is revenue expenditure*** - It is well settled that the premium paid by the lessee for the grant of lease, whether payable in lump sum or in instalments over the whole period of the lease along with the rent, is normally capital expenditure. The periodical payment made for a lease is revenue expenditure whereas the payment made to acquire the lease would be an expenditure of capital nature - *CIT v. Muhammad Hussain* [2001] 247 ITR 347 (J&K).
- E) *Lump sum paid for entire period of lease is allowable as revenue expenditure*** - Where the assessee holding leasehold for 48 years chose to pay the rent for 47 years in one lump sum with the consent of the lessor, and got no other advantage by reason of the lump sum payment except the relief of not having to make the annual payment during the period of lease, such lump sum

payment is allowable as revenue expenditure. Had the assessee chosen to pay rent annually for each and every year of lease, such expenditure certainly would have to be regarded as revenue expenditure. The fact that the payment was made in lump sum for the entire duration of the lease did not alter the character of it being a revenue expenditure - *CIT v. Gemini Arts (P.) Ltd.* [2002] 254 ITR 201 (Mad.).

61) Licence fee/Rent

A) *Rent/licence fee based on turnover or profits is deductible* - Periodic payments, particularly those which are based on turnover or profit or which take the form of rent or licence fee and which are not related to any pre-determined lump sum may be deductible as revenue expenditure, even if they are made for the initiation of a business or represent consideration for acquiring a capital asset or an advantage of enduring benefit to the business - *Harijan Evam Nirbal Varg Avas Nigam Ltd. v. CIT* [1996] 87 Taxman 390/218 ITR 622 (All.).

62) Listing fees

A) *Listing fee paid to stock exchange is revenue expenditure* - The expenditure on account of listing fees paid to the stock exchange cannot be said to be capital expenditure, and it shall have to be regarded as expenditure of revenue nature - *CIT v. Alembic Chemical Works Co. Ltd.* [1993] 201 ITR 250 (Guj.).

63) Litigation/legal expenses

A) *No distinction need be made between civil and criminal litigation* - Section 37(1) does not make any distinction between civil litigation and criminal litigation. All that has to be seen is whether the legal expenses were incurred by the assessee in his character as a trade, in other words, whether the transaction in respect of which proceedings are taken arose out of and was incidental to the assessee's business - *CIT v. Dhanrajgirji Raja Narasingirji* [1973] 91 ITR 544 (SC).

B) *Assessee's persistence in pursuing civil proceedings is no ground for disallowing expenditure* - However wrong-headed, ill-advised, unduly optimistic or over-confident in his conviction the assessee might appear, in the light of the ultimate decision, expenditure in starting and prosecuting a civil proceeding cannot be denied as a permissible deduction in computing the taxable income merely because the proceeding has failed, if otherwise, the expenditure was laid out for the purpose of the business wholly and exclusively, that is reasonably and honestly incurred to promote the interests of the business. Persistence of the assessee in launching the proceeding and carrying it from Court to Court and incurring expenditure for that purpose is not

a ground for disallowing the claim - *Sree Meenakshi Mills Ltd. v. CIT* [1967] 63 ITR 207 (SC)/*Dalmia Jain & Co. Ltd. v. CIT* [1971] 81 ITR 754 (SC).

- C) *Mere fact that transaction related to assessee's business will not justify allowance of expenditure on defending directors and employees*** - Where an assessee-company incurs expenditure in defending its directors and employees involved in criminal proceedings, the mere fact that the transaction which has given rise to the prosecution pertains to the assessee's business is not enough. The assessee has to establish that the expenditure in question was incurred purely out of business considerations and not for any other purpose. - *Swadeshi Cotton Mills Co. Ltd. v. CIT* [1975] 100 ITR 59 (All.)(FB).
- D) *Distinction can be made between an expenditure on self-defence and that on defending employees*** - A clear line of distinction can be made between those cases where the assessee concerned has incurred an expenditure in defending himself where the assessee is an individual or a partner of the firm and where the assessee is a registered partnership firm or some person principally concerned with the assessee; there the assessee incurs the expenditure not wholly and exclusively for his business but partly for the purposes of the business and partly for saving himself from punishment that may be imposed as a result of criminal prosecution. On the other side of the line will come those cases where the assessee has incurred expenses in defending one of its employees because, in that case, by defending the employee, the assessee concerned would be protecting its own business interest and thus the expenditure can be said to be wholly and exclusively incurred for the purposes of the business of the assessee - *CIT v. Ahmedabad Controlled Iron & Steel Reg. Stockholders Association (P.) Ltd.* [1975] 99 ITR 567 (Guj.).
- E) *Expenses connected with structure and conduct of business are deductible*** - Litigation expenses incurred by company in defending its structure and conduct of its business are allowable - *CIT v. Muir Mills Co. Ltd.* [1984] 148 ITR 418 (All.).
- F) *Expenses connected with title to assets are capital expenditure*** - The question whether the litigation expenses are of capital or revenue nature, depends on whether the expenses were incurred by the assessee for the purpose of creating, curing or completing the assessee's title to capital or whether they were for the purpose of protecting its business. If it is the former, then the expenses incurred must be considered as capital expenditure - *Dalmia Jain & Co. Ltd. v. CIT* [1971] 81 ITR 754 (SC).
- G) *Expenses for protecting source of income, title to business and preservation/maintenance of assets, are deductible*** - *State of Tamil Nadu v. C.H. Simpson* [1992] 197 ITR 237 (Mad.).

- H) Legal expenses connected with purchase of land which did not materialise are allowable -** *Hindustan Milkfood Manufacturers Ltd. v. CIT* [1989] 45 Taxman 392/179 ITR 302 (Punj. & Har.).
- I) *Expenditure aimed at resisting measures imposing restrictions on trade is deductible, irrespective of final outcome* -** Expenditure incurred to resist in a civil proceeding the enforcement of a measure-legislative or executive, which imposes restrictions on the carrying on of a business, or to obtain a declaration that the measure is invalid would, if other conditions are satisfied, be admissible, under section 37(1) as a permissible deduction in the computation of taxable income - *Sree Meenakshi Mills Ltd. v. CIT* [1967] 63 ITR 207 (SC); *CIT v. Birla Cotton Spg. & Wvg. Mills Ltd.* [1971] 82 ITR 166 (SC).
- J) *Expenses by firm to defend suit for dissolution filed by partner are deductible* -** Legal expenses incurred by a firm to defend a suit filed for dissolution of the firm by one of the partners, with the High Court ultimately directing that the partner who brought the suit should retire from the firm, are allowable as deduction - *CIT v. Card Board Products* [1998] 96 Taxman 282 (Pat.).
- K) *Expenses on defending criminal prosecution are not always allowable* -** It cannot be said that in every case the expenses incurred by a person exercising a trade or profession in defending a criminal prosecution, which arises out of his business or professional activities should be allowed to be deducted in the assessment of his profits or gains for income-tax purposes - *CIT v. H. Hirjee* [1953] 23 ITR 427 (SC).
- L) *Expenses to defend criminal proceedings under Essential Commodities Act are deductible* -** Legal expenses incurred by the assessee in connection with criminal litigation pertaining to criminal conspiracy for commission of offence under Essential Commodities Act, 1955 were allowable as deduction - *Atlas Cycle Industries Ltd. v. CIT* [1989] 47 Taxman 244/[1990] 181 ITR 18 (Punj. & Har.).
- M) *Expenditure incurred by charitable institution on defending its president is deductible* -** Where the assessee was charitable institution, legal expenses incurred by assessee-association for defending president of association against criminal charges connected with carrying out the objects of the association were allowable as a permissible deduction - *Ananda Marga Pracharaka Sangha v. CIT* [1994] 76 Taxman 88 (Cal.).
- N) *Expenditure on defending auditor in disciplinary proceedings initiated by shareholders/union is not deductible* -**

- I) Expenses incurred by assessee-company in defending disciplinary proceedings by shareholders against its auditors are not allowable as decision of such proceedings, one way or other, would not have affected assessee's business - *CIT v. Deccan Sugar & Abkhari Co. Ltd.* [1976] 104 ITR 458 (Mad.).[*Per contra:*]
- II) Expenditure borne by assessee-company to defend a suit by employees' union against auditors appointed by assessee, for certain irregularities in accounts of employees' provident fund, was an allowable expenditure - *CIT v. Ananda Bazar Patrika (P.) Ltd.* [1989] 47 Taxman 446/[1990] 184 ITR 542 (Cal.).
- O) *Legal expenses incurred on defending a claim for payment of higher compensation for land acquired by assessee are not deductible*** - Legal expenses incurred by an assessee for defending a claim for higher compensation in respect of lands acquired by the assessee must be treated as capital expenditure, since the compensation payable in regard to the acquisition of the lands was clearly capital expenditure. The said expenses were not deductible as revenue expenditure - *Ambica Mills Ltd. v. CIT* [1999] 235 ITR 264 (Guj.).
- P) *Legal expenses incurred for recovery of advance made for acquiring a property when the transaction did not materialise are deductible*** - Where the assessee advanced money for acquiring a property and later, when the transaction did not materialise, paid fees to an advocate for recovering the said advance, the fees so paid could not be treated as capital loss, but was allowable as revenue expenditure, since once there was a breach of agreement the expenditure incurred for recovering the advance could not be said to have a direct connection with the acquisition of a capital asset - *CIT v. Gujarat Steel Tubes Ltd.* [2002] 123 Taxman 994/258 ITR 235 (Guj.).
- Q) *Litigation expenses on assisting Enquiry Commission are allowable*** - Legal expenses incurred by a company by engaging an advocate to assist the commission of enquiry appointed by the State to investigate into illegalities committed by officers and directors of the company, were allowable as business expense, since the expenditure is incurred for the purpose of protecting and safeguarding goodwill of the business which is an important business asset of the assessee - *Gujarat Agro Oil Enterprises Ltd. v. CIT* [2002] 125 Taxman 912 (Guj.).

64) Loom hours

- A) *Purchase of loom hours is revenue expenditure*** - Payment made for purchase of loom hours which would enable the assessee to operate the profit-making structure for a longer number of hours than those permitted under the working time agreement would also be part of the cost of

performing the income-earning operations and hence revenue in character - *Empire Jute Co. Ltd. v. CIT* [1980] 124 ITR 1 (SC)/*CIT v. North Brook Jute Co. Ltd.* [1989] 176 ITR 152 (Cal.)/*CIT v. Lansdowne Jute Co. Ltd.* [1989] 175 ITR 110 (Cal.)/*CIT v. Soorajmal Nagarmull* [1990] 181 ITR 340/[1989] 45 Taxman 151 (Cal.)/*Kinison Jute Mills Co. Ltd. v. CIT* [1989] 45 Taxman 366 (Cal.).

65) Loss due to confiscation of assets

- A) Where gold biscuits and jewellery were seized and confiscated by the central excise authorities from the residential premises of the assessee and their value was assessed as the income of the assessee under section 69A, and the assessee had neither reflected the acquisition of any gold in his books of account nor had claimed ownership of the goods in the proceedings before the central excise authorities, it could not be stated that the value of the confiscated goods should be treated as expenditure on the part of the assessee in the course of his business or profession so as to be entitled to deduction under section 37(1). *Bijjala Shivalingam v. CIT* [2002] 253 ITR 105 (AP).

66) Membership fees

- A) ***Initial admission fee paid to become member of organisation is allowable*** - Where the assessee, deriving income from supply of technical know-how to various domestic and foreign concerns, paid initial admission fee towards membership of an organisation which provided technical information to its members, the fee so paid was allowable as revenue expenditure, since mere membership did not *per se* bestow any asset or advantage of an enduring nature to the assessee's business - *CIT v. Engineers India Ltd.* [1999] 239 ITR 237 (Delhi).
- B) ***Subscriptions paid by company to clubs for enrolling its directors as members are deductible*** - Where the Tribunal found that the subscriptions paid by the assessee-company to clubs towards enrolment of its directors as members was incurred for the purpose of promoting the business of the assessee, such expenditure was an allowable business expenditure. The assessee had not spent the money with the object of providing a personal relaxation to the director, but it was incurred to promote its business, since in the commercial world the contact with the right person is vital for an efficient business organisation. In each case, it has to be seen whether the object of the expenditure was to promote the business of the assessee - *CIT v. Sundarm Industries Ltd.* [1999] 240 ITR 335 (Mad.).

67) Memorandum, etc., of companies

A) *Expenditure connected with memorandum/articles of association is deductible* - Expenditure incurred on the drafting and printing of the articles of association of a company is deductible as revenue expenditure - *CIT v. Wyman Gordon (India) Ltd.* [1983] 144 ITR 911 (Bom.).

B) *Expenses for altering memorandum and articles of association are revenue expenditure* - *CIT v. Tata Iron & Steel Co. Ltd.* [1977] 106 ITR 363 (Bom.)/*CIT v. Modi Spg. & Wvg. Mills Co. Ltd.* [1973] 89 ITR 304 (All.).

68) Memorials

A) *Erection of gate and statue of founder-director in municipal garden is capital in nature* - Expenditure incurred in the erection of a gate and the statue of founder-director in a municipal garden was not deductible under section 37(1), even if it was assumed that the expenditure led to an enhancement of goodwill, as it then would be an advantage of an enduring nature and hence, a capital expenditure - *Saru Smelting & Refining Corpn. (P.) Ltd. v. CIT* [1979] 116 ITR 766 (All.).

69) Mining expenses

A) *Expenditure on removal of overburden in coal mining is revenue expenditure* - Removal of overburden for reaching the coal seam is a necessary process in raising coal in an open cast mining. The expenditure incurred therefore is neither for acquiring any right in property nor does it result in any enduring benefit and as such is allowable as revenue expenditure - *CIT v. Katras Jharia Coal Co. Ltd.* [1979] 118 ITR 6 (Cal.)/*CIT v. Rajendra Trading Co. (P.) Ltd.* [1984] 146 ITR 637 (Cal.).

B) *Royalty/dead rent paid for excavation of limestone is revenue expenditure* - Annual payment of royalty/dead rent for excavation of limestone under mining lease is revenue expenditure - *Gotan Lime Syndicate v. CIT* [1966] 59 ITR 718 (SC)/*CIT v. Mazdoor Kisan Sahkari Samiti* [1970] 75 ITR 253 (Raj.)/*Singareni Collieries Co. Ltd. v. CIT* [1967] 66 ITR 553 (AP).

70) Monopoly rights

A) *Acquisition of monopoly rights is capital in nature* - Payment made for obtaining monopoly rights is capital expenditure - *Mewar Sugar Mills Ltd. v. CIT* [1973] 87 ITR 400 (SC).

71) Overdrafts

A) *Expenditure on securing overdraft facilities is revenue, irrespective of its terms and quantum* - Where the assessee-company incurred expenditure for securing overdraft facilities for the purposes of its business, even in the absence of any findings as to the extent of overdraft facility,

the period, if any, for which the facility was granted, and the terms on which the overdraft facilities were secured, the expenditure was of revenue nature and was allowable - *Jeewanlal (1929) Ltd. v. CIT* [1969] 74 ITR 753 (SC).

72) Penalties*

- A) *Penalty paid for infraction of law, even if it be by inadvertence, is not deductible on grounds of public policy*** - If an assessee is penalised under one Act, he cannot claim that amount to be set off against his income under another Act, because that will be frustrating the entire object of imposition of penalty. One exception to this rule which has been recognised by the courts is where the entire business of the assessee is illegal and that income is sought to be taxed by the ITO; then the expenditure incurred in the illegal activities will also have to be allowed as deduction. But if the business is otherwise lawful and the assessee resorts to unlawful means to augment his profits or reduce his loss, then the expenditure incurred for these unlawful activities cannot be allowed to be deducted. Even if the assessee had to pay fine or penalty because of an inadvertent infraction of law which did not involve any moral obliquity, the result will be the same. Even in such cases, deduction will not be permitted of the amounts paid as penalty or fine or of the value of the goods confiscated by the statutory authority as expenditure incurred wholly and exclusively incurred for the purposes of carrying on the trade. In fact, section 37 presumes that the trade will be carried on lawfully.
- B)** Moreover, it will be against public policy to allow the benefit of deduction under one statute, of any expenditure incurred in violation of the provisions of another statute or any penalty imposed under another statute. - *Maddi Venkataraman & Co. (P.) Ltd. v. CIT* [1998] 229 ITR 534 (SC).
- C)** An expenditure is not deductible unless it is a commercial loss in trade and a penalty imposed for breach of the law during the course of a trade cannot be described as such. If a sum is paid by an assessee conducting his business, because in conducting it he has acted in a manner which has rendered him liable to penalty it cannot be claimed as a deductible expense. - *Haji Aziz & Abdul Shakoor Bros. v. CIT* [1961] 41 ITR 350 (SC)/*Suneeta Laboratories Ltd. v. CIT* [1986] 162 ITR 883 (MP)/*Nawabganj Sugar Mills Co. Ltd. v. CIT* [1984] 149 ITR 151 (Delhi).
- D) *Penalty paid under option conferred on assessee under the concerned law or scheme itself is deductible*** - What needs to be done by an assessing authority under the Income-tax Act in examining the claim of an assessee that the payment made by such assessee was a deductible expenditure under section 37, although called penalty, is to see whether the law or scheme under which the amount was paid requires such payment to be made, as penalty or as something akin to

penalty, that is imposed by way of punishment for breach or infraction of the law or the statutory scheme. If the amount so paid is found to be not a penalty or something akin to penalty due to the fact that the amount paid by the assessee was in exercise of the option conferred upon him under the very law or scheme concerned, then one has to regard such payment as business expenditure of the assessee, allowable under section 37, as an incident of business laid out and expended wholly and exclusively for the purposes of the business. If such payment by the assessee is that which is made in exercise of the option given to such assessee by the law or the statutory scheme, there arises no need for assessing authority to go into the question whether the payment could be regarded as that made as a measure of business expediency, for it cannot ignore the fact that the law or the statutory scheme enables incurring of such expenditure in the course of assessee's business - *CIT v. Ahmedabad Cotton Mfg. Co. Ltd.* [1993] 71 Taxman 56/[1994] 205 ITR 163 (SC).

- E) *Statutory payments for defaults are not deductible*** - A payment made under a statutory obligation, because the assessee was in default could not constitute expenditure laid out for the purpose of the assessee's business - *Indian Aluminium Co. Ltd. v. CIT* [1971] 79 ITR 514 (SC).
- F) *Penalty paid by assessee to State Electricity Board on account of late delivery of goods as per contract, would be allowable as business loss*** - Where the assessee paid certain penalty to the State Electricity Board on account of late delivery of goods, under a contractual obligation, the loss was incidental to business, and hence could not be disallowed - *CIT v. Indo Asian Switch-Gears (P.) Ltd.* [1996] 222 ITR 772/[1997] 92 Taxman 86 (Punj. & Har.)
- G) *Penalty for non-payment of sales tax is not deductible*** - The penalty payable for non-payment of the sales-tax within the prescribed time, is not deductible as business expenditure under section 37. - *CIT v. Bharat Steel Tubes Ltd.* [1996] 86 Taxman 358 (Delhi)/*CIT v. Bharat Barrel & Drum Mfg. Co. (P.) Ltd.* [1990] 49 Taxman 149/182 ITR 21 (Bom.)/*CIT v. Rajdev Kirana Stores* [1990] 181 ITR 285 (MP)
- H) *Penalty under Sales Tax Acts*** - Penalty paid under section 10A of Central Sales Tax Act is an admissible deduction - *CIT v. Bharat Printers* [1992] 61 Taxman 125/198 ITR 610 (Kar.).
- I) Amounts payable under the provisions of section 17(3) of the Madhya Pradesh General Sales Tax Act being penalty, are not allowable as expenditure in computation of total income and the amounts payable under the provisions of section 8(2) thereof are allowable as expenditure in the computation of total income only insofar as they are compensatory in character** - *Malwa Vanaspati & Chemical Co. v. CIT* [1997] 225 ITR 383/92 Taxman 537 (SC).

- J) *Penalty under Customs Act, in lieu of confiscation of goods*** - Penalty paid under the Sea Customs Act to avoid confiscation of goods bought in good faith without the knowledge that import of such goods was unauthorised, is an allowable business deduction. - *CIT v. Pannalal Narottamdas & Co.* [1968] 67 ITR 667 (Bom.).
- K)** An amount paid by way of penalty in lieu of confiscation of goods by the customs authorities cannot be allowed as a deduction under section 37(1) since infraction of law cannot be treated as a normal incident of business - *CIT v. Mihir Textiles Ltd.* [1976] 104 ITR 167 (Guj.).
- L)** Where penalty was levied on the assessee under the Customs Act for unauthorisedly importing goods, the amount of penalty is not deductible, since any penalty incurred because of the failure of the assessee himself could not be regarded as wholly laid out for the purpose of business - *Free Wheels India Ltd. v. CIT* [2001] 252 ITR 877 (Delhi).
- M) *Penalty for breach of section 112 of Customs Act is not deductible*** - The assessee is not entitled to the deduction of penalty imposed by the customs authorities for breach of section 112 of the Customs Act - *Garden Silk Weaving Factory v. CIT* [1994] 207 ITR 394/74 Taxman 600 (Guj.).
- N) *Redemption fine under Customs Act in lieu of confiscation of goods is deductible*** - Whereas a result of confiscation of goods under Customs Act for importing it without valid licence, the assessee had to pay redemption fine in lieu of confiscation, such payment being compensatory in nature was allowable as deduction - *CIT v. N.M. Parthasarthy* 1994 Tax LR 785 (Mad.).
- O) *Penalty for default in payment of municipal taxes is not deductible*** - Amount of penalty imposed by Municipal Corporation for default in payment of municipal taxes is not deductible in computation of income of assessee - *CIT v. Dhanraj Mills (P.) Ltd.* [1994] 75 Taxman 337/209 ITR 851 (Bom.).
- P) *Penalty and fine paid under Excise Act are not deductible*** - Penalty and fine in lieu of confiscation of goods levied under rule 173Q of the Central Excise Rules for removal of goods without making entries in the register, are not admissible deductions - *CIT v. Rane Brake Linings Ltd.* [2002] 255 ITR 218 (Mad.).
- Q) *Penal interest paid by bank*** - Penal interest paid by bank under section 24(4) of the Banking Regulation Act, 1949 is not deductible - *CIT v. Syndicate Bank* [2003] 127 Taxman 287/261 ITR 528 (Kar.).
- R) Note :** Refer also *CIT v. Catholic Syrian Bank Ltd.* [2003] 130 Taxman 447 (Ker.).

73) Pension - [See also under 'Retirement benefits']

- A) *Pension paid on humanitarian grounds is not deductible*** - Pension paid to the widows of ex-directors on humanitarian ground is not an allowable expenditure - *ITAT v. B. Hill & Co. (P.) Ltd.* [1983] 142 ITR 185 (All.).
- B) *Pension paid to wife of murdered employee is deductible*** - Payment of pension to wife of an employee who was murdered, was an allowable business expenditure - *Calcutta Landing & Shipping Co. Ltd. v. CIT* [1967] 65 ITR 1 (Cal.).
- C) *Pension paid to widow of director who was sole shareholder is not deductible*** - Pension paid by the assessee-company to the widow of holder of practically all its shares, who was also its managing director, was not allowable as deduction - *CIT v. Amalgamations Ltd.* [1995] 214 ITR 399 (Mad.).
- D) *Pension paid to widow of director under resolution passed while director was in service is allowable*** - Where, during the tenure of a director-employee, the company-employer passed a resolution authorising payment of pension to the director on his retirement and after his death to his widow, pension paid by the company to the widow was deductible, since the money was paid out of commercial expediency and also in order to generate confidence in the mind of the employee that he would be taken care of after his retirement and after his demise his legal heirs would be taken care of - *CIT v. Lucas India Service Ltd.* [1999] 239 ITR 429 (Mad.).

74) Plant/machinery

- A) *Expenses incurred on shifting plant and machinery from one premises to another are capital expenditure*** - Expenditure incurred on dismantling plant and machinery and shifting it from leased premises to assessee's owned premises is of capital nature - *CIT v. Otis Elevator Co. (I.) Ltd.* [1990] 51 Taxman 443 (Bom.)/*CIT v. Bimetal Bearings Ltd.* [1994] 210 ITR 945 (Mad.).
- B) *Plant installed for protecting health of workmen*** - Where the assessee, a manufacturer of textiles, installed a dust inhalation plant in his factory in order to protect the health of his workmen, expenditure incurred on the said plant is to be treated as revenue expenditure - *CIT v. Sakthi Textiles Ltd.* [2001] 250 ITR 449 (Mad.).

75) Pollution control

- A) *Expenditure on plantations as pollution control measure is deductible*** - Expenditure incurred by the assessee on plantations in factory premises and residential quarters of company, with a view to making atmosphere pollution-free was allowable as revenue expenditure - *Hindustan Electro Graphites Ltd. v. CIT* [1996] 218 ITR 688 (MP).

76) Power connections

- A) *Contribution paid for laying cables and transmission lines is deductible*** - The contribution paid by the assessee to the Government for laying cables and other transmission lines, necessary for the installation of its new plant, which remained the property of the Government, would be allowable as a deduction - *CIT v. Gujarat Mineral Development Corpn.* [1981] 132 ITR 377 (Guj.).
- B)** Expenditure in regard to contribution made by the assessee-company to the State Electricity Board towards laying of additional circuit line in order to meet increased demand of company was allowable as admissible expenditure under section 37 or section 28 - *Mafatlal Fine Spg. & Mfg. Co. Ltd. v. CIT* [1993] 69 Taxman 385/[1994] 206 ITR 578 (Bom.).

77) Presentations

- A) *Presentation of gift articles by society to its members is not 'advertisement'*** - Expenditure incurred by the assessee-society on presentation of articles to its members to commemorate its silver jubilee, is not in the nature of advertisement expenditure, but is an admissible expenditure, being primarily intended for generating goodwill for ensuring continuity of business - *CIT v. Dascroi Taluka Co-operative Purchase & Sales Union Ltd.* [1980] 126 ITR 413 (Guj.).
- B) *Expenses on presentations to foreign collaborator are deductible*** - Expenditure on presentation of articles to officers of the foreign collaborator is allowable as deduction - *CIT v. S.L.M. Maneklal Industries Ltd.* [1977] 107 ITR 133 (Guj.).

78) Project reports

- A) *Expenses on obtaining project report for setting up additional unit are capital in nature*** - It is not correct to say that all expenditure incurred for expanding existing business would necessarily have to be considered as revenue expenditure.
- B)** Where the assessee-company incurred expenses on obtaining a project report in connection with setting up another unit at a different place, the expenditure was incurred by the assessee-company would be capital in nature - *CIT v. J.K. Chemicals Ltd.* [1994] 207 ITR 985 (Bom.).
- C) *Expenses on project report for new product are capital in nature, even if the project does not materialise*** - Where the amount spent by the assessee on a project report was not for the purpose of facilitating the assessee's existing trading operations or for the purpose of improving the efficiency or profitability of the existing business, but was connected with the manufacture of a new product, the amount was not deductible, since the expenditure was attributable to capital, having been incurred with a view to bringing an asset or advantage into existence and having

enduring benefit. Merely because the project did not materialise the nature of expenditure would not change to revenue - *Triveni Engineering Works Ltd. v. CIT* [1998] 232 ITR 639 (Delhi).

79) Profit-sharing

- A) *Intention of parties must be ascertained from substance of agreement and not its form*** - A party cannot escape the consequence of law merely by describing an agreement in a particular form though in essence and in substance it may be a different transaction. Thus, whether payment made under an agreement to share net profits was laid out wholly or exclusively for the purpose of business or was only a division of the profits of joint venture depends upon the intention of parties to be ascertained from the substance of the agreement and not the form of it - *CIT v. Panipat Woollen & General Mills Co. Ltd.* [1976] 103 ITR 66 (SC).
- B) *Profits to be shared under agreement prior to the profits becoming divisible or distributable can, on the terms of agreement, be a legitimate charge*** - The amount to be paid by reference to profits can either be that which is paid after the profits become divisible or distributable, or that which is payable prior to such distribution or division to be computed by a reference to notional or as in some decisions what is termed as apparent net profits. In the former instance, it will certainly be a distribution of profits and not deductible as an expenditure incurred in running the business but in the latter case it may, on the facts and circumstances of the case, and the agreement or the nature of the obligation under the particular instrument which governs the obligation, be an expenditure incurred as a contribution to the profit-earning apparatus or, as it is said, incurred at the inception and deductible as an overriding charge of the profit-making apparatus or is one laid out and expended wholly and exclusively for purpose of such business - *CIT v. Travancore Sugars & Chemicals Ltd.* [1973] 88 ITR 1 (SC).
- C) *Annual payments payable by purchaser of business to vendor are not deductible*** - If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business - *Tata Hydro-Electric Agencies Ltd. v. CIT* [1937] 5 ITR 202 (PC).
- D) *Prospecting of mines, expenses for*** - Expenditure incurred by assessee, whose business was not of mining, on acquisition of mining leases, which assessee did not operate at all, would be capital expenditure - *Salgaonkar Mining Industries v. CIT* [1997] 228 ITR 183 (Bom.).

80) Provident fund contributions

- A) Contributions not falling under section 36(1)(iv) can be considered under section 37(1)** - The mere fact that the contribution could not come within the ambit of the provisions of section 36(1)(iv) would not disentitle the assessee to claim the benefit under section 37(1) if the requirements thereunder were satisfied - *Addl. CIT v. Karnataka State Warehousing Corpn.* [1980] 125 ITR 136 (Kar.)/*Decom Marketing (P.) Ltd. v. CIT* [2001] 251 ITR 398 (Guj.).
- B) Contribution to unrecognised fund is deductible** - Contribution made by the assessee to the unrecognised executive staff provident fund is a permissible deduction under section 37 - *CIT v. Aspinwall & Co. Ltd.* [1993] 204 ITR 225 (Ker.).
- C) Accumulated balances in unrecognised fund, when transferred to statutory fund, are deductible** - Where the assessee-company transferred the accumulated balances in unrecognised provident funds to the Employee's Provident Fund by making over the amount to the Provident Fund Commissioner, the said amount was deductible, as a business expenditure - *CIT v. Mysore Spg. & Mfg. Co. Ltd.* [1970] 78 ITR 4 (SC)/*United Mercantile Co. (P.) Ltd. v. CIT* [1969] 71 ITR 678 (Ker.).

81) Public policy, payments opposed to*

- A)** See under 'Penalties' - *Maddi Venkataraman & Co.* case.

82) Puja expenses

- A) Expenses on customary pujas are deductible** - Expenditure incurred on customary Ganesh Puja at the time of opening books of account, is primarily in the nature of advertisement for the assessee's business and is hence a permissible deduction - *Brijraman Das & Sons v. CIT* [1983] 142 ITR 509 (All.).

83) Quality control

- A) Testing/exhibiting/designing expenses on final product are deductible** - The expenditure incurred on testing, exhibiting and designing of scooters are to be allowed as revenue expenditure - *Gujarat Small Scale Industries Corpn. Ltd. v. CIT* [1983] 142 ITR 35 (Guj.).

84) Quota rights

- A) Acquisition of quota rights is revenue in nature** - Expenditure for acquisition of quota right is not a capital expenditure - *M.S. Kandappa Mudaliar v. CIT* [1957] 32 ITR 313 (Mad.).
- B)** It could not be laid down as a proposition of law that until and unless the quota rights are utilised or the goods are sold, the amount spent for the purchase of house quota rights or the goods will not be allowable as deduction. - *CIT v. Kusum Products Ltd.* [1984] 149 ITR 250 (Cal.).

85) Race club facilities

- A) *Maintenance expenses on club house and kiosks by race club are deductible* - Where a race club, being open to its members only, had incurred expenses on the maintenance of club house and kiosks, it was *held* that the expenses so incurred were allowable as business expenses of club - *Royal Western India Turf Club Ltd. v. CIT* [1970] 78 ITR 548 (Bom.).

86) Railway platforms

- A) *Expenditure on construction of railway platform is deductible* - The amount spent by the assessee on the construction of railway platform which was for carrying on its business activities in a profitable way and which was advantageous to the assessee would be allowable as a revenue expenditure - *CIT v. Janak Steel Tubes (P.) Ltd.* [1989] 46 Taxman 183/[1990] 182 ITR 92 (Punj. & Har.).

87) Raw materials

- A) *Payments made for finding means of procuring raw material are revenue expenditure* - Annual payments made to a stranger for his having found the means for the procurement of raw materials, as well as compensation paid to him on the termination of said payments, is revenue expenditure - *CIT v. Dalmia Dadri Cement Ltd.* [1970] 77 ITR 410 (Punj. & Har.).
- B) *Payments for ensuring source of stock-in-trade are capital; payments for obtaining stock-in-trade from known source are revenue* - If the payment was to ensure the source of stock-in-trade then the expenditure incurred for that purpose would be capital expenditure. If, on the other hand, payments are made to obtain stock-in-trade under a source arranged for, then such payments would be payments for the supply of stock-in-trade and for carrying on the business - *CIT v. Rishabh Investment Ltd.* [1979] 117 ITR 962 (Cal.).

88) Registration charges

- A) Where the agreement between the assessee-builder and the allottees provided that registration charges are to be borne by the allottees only, any provision made by the assessee for payment of registration charges, not being an admitted liability, is not allowable as a deduction - *CIT v. Pragati Construction Co.* [2002] 123 Taxman 77 (Delhi).

89) Remuneration [See also under 'Salary']

- A) *Even if payment of remuneration is under agreement, ITO has powers to examine its deductibility* - It is erroneous proposition to contend that as soon as an assessee has established two facts, viz., the evidence of an agreement between the employer and the employee and the

fact of actual payment, no discretion is left to the ITO except to hold that the payment was made wholly and exclusively for the purposes of the business. It is manifest that the ITO is entitled to examine the circumstances of each case to determine for himself whether the remuneration paid to the employee or any portion thereof was properly deductible under section 10(2)(xv) - *Swadeshi Cotton Mills Co. Ltd. v. CIT* [1967] 63 ITR 57 (SC).

- B) *Though ITO cannot substitute his own view about reasonableness, he can disallow if payment is not real or is unconnected with business*** - Indisputably, an employer in fixing the remuneration of his employee is entitled to take into consideration the extent of his business, the nature of the duties to be performed, the special aptitude of the employee, the future prospects of the business and other related circumstances and the taxing authorities cannot substitute their own view as to the reasonable remuneration which should have been agreed to be paid to the employee. But the taxing authority may disallow an expenditure claimed on the ground that the payment is not real or is not incurred by the assessee in the course of his business or that it is not laid out wholly and exclusively for the purpose of his business - *Bengal Enamel Works Ltd. v. CIT* [1970] 77 ITR 119 (SC).
- C) *In the absence of specific material pointing out that payment was for extraneous consideration revenue cannot substitute its own view about quantum*** - What the revenue should find out is specific material on the basis of which it is possible for a reasonable person to come to a conclusion that the payment has been made for extraneous considerations such as relationship of the employee to the proprietor or some such thing. Unless it is possible of spell out on some specific material that the said employee received payment for such reasons it is not permissible for the revenue to substitute its own ideas of what a person should be paid and what would be a proper payment for a particular person - *Smt. Devayaniamma v. CIT* [1969] 71 ITR 140 (Ker.).
- D) *Production of resolution and vouchers cannot prevent ITO to examine whether payment was wholly and exclusively for business purpose*** - Resolution of the assessee fixing the remuneration to be paid to an employee and production of vouchers for payment together with proof of rendering service do not exclude an enquiry whether the expenditure was laid out wholly and exclusively for the purpose of the assessee's business. - *Bengal Enamel Works Ltd. v. CIT* [1970] 77 ITR 119 (SC).
- E) *Quantum of remuneration cannot be determined by Tribunal*** - It is not the function of the Tribunal to determine the remuneration which in their view should be paid to an employee of the

assessee - *Aluminium Corpn. of India Ltd. v. CIT* [1972] 86 ITR 11 (SC)/*J.K. Woollen Mfrs. v. CIT* [1969] 72 ITR 612 (SC).

F) *Tax authorities can disallow payment if found to be for extra commercial consideration* -

Where an amount paid to an employee pursuant to an agreement is excessive because of 'extra commercial consideration', the taxing authority has jurisdiction to disallow a part of the amount as expenditure not incurred wholly and exclusively for the purpose of the business - *Bengal Enamel Works Ltd. v. CIT* [1970] 77 ITR 119 (SC).

G) *There is no rule that only increase in profits can justify increase in remuneration* - The rule that increased remuneration can only be justified if there be corresponding increase in the profits of the employer is erroneous - *CIT v. Walchand & Co. (P.) Ltd.* [1967] 65 ITR 381 (SC).

H) *Remuneration paid for attending to work outside assessee's line of business cannot be disallowed* - High remuneration paid to an employee for attending to work outside assessee's line of business, which though profitable required special organisation, cannot be disallowed - *CIT v. Chari & Chari Ltd.* [1965] 57 ITR 400 (SC).

I) *Availability of another person on lesser salary or production of trading result on lesser expenditure are not the relevant tests* - In considering the reasonableness of remuneration paid to an employee, whether another employee would have been available on a lesser salary or whether the assessee could have managed to produce the same trading result with lesser expenditure is not the true test. The revenue authorities have no jurisdiction to substitute their own views of reasonableness for those of the assessee - *D.N. Sinha (P.) Ltd. v. CIT* [1976] 102 ITR 491 (Cal).

J) *Remuneration paid for promoting a company is not deductible* - Expenditure incurred for remunerating the person who have promoted a company is not in law a revenue expenditure admissible under section 37(1) - *Lakshmiratan Cotton Mills Co. Ltd. v. CIT* [1969] 73 ITR 634 (SC).

K) *Remuneration paid by parent company to directors of its subsidiaries is not deductible* - Where the assessee-company had 16 subsidiaries in which it held shares, with common directors, and in order to overcome the ceilings on managerial remuneration fixed under company law, paid the managerial remuneration to the directors of the subsidiaries, the expenditure so incurred cannot be said to be expenditure incurred in carrying on the business of the assessee-company of holding its investments. The managerial remuneration so paid is hence not allowable as the

business expenditure of the assessee-company - *CIT v. Amalgamations (P.) Ltd.* [1997] 92 Taxman 132/226 ITR 188 (SC).

90) Rent

- A) ***Rent not allowable under section 30 is not deductible*** - Where the expenditure incurred on rent is not allowable under section 30, it cannot be allowed under section 37 as section 37 does not apply to any expenditure of the nature described in sections 30 to 36 - *Noshirwan & Co. (P.) Ltd. v. CIT* [1970] 77 ITR 822 (MP).
- B) ***Lease rent*** - Where for excavation purposes assessee took on lease a land on monthly rent for 15 years and assessee was required to pay in advance rent for entire lease period in form of guarantee deposit which was adjustable against rent of each month, advance rent paid by assessee was not actually a yearly payment but a capital expenditure for achieving enduring benefit over years and, therefore, would not be allowable as revenue expenditure - *Aditya Minerals (P.) Ltd. v. CIT* [1999] 106 Taxman 337/239 ITR 817 (SC).

91) Repairs/replacements*

- A) ***Repairs to building can be capital or revenue, depending on nature of change brought about*** - So long as the repair does not bring into existence an additional advantage or benefit of an enduring nature or change the nature, character or the identity of the building itself, the expenditure must be regarded as a revenue expenditure. On the other hand, if it does, it will be in the nature of a capital expenditure - *CIT v. I.C.I (India) (P.) Ltd.* [1983] 139 ITR 105 (Cal.).
- B) ***Replacement of asset as a whole is not 'repairs'*** - There can be no quarrel with the proposition that even where substantial repairs are carried out in order to put to use an existing asset, the same could still be termed as a revenue expenditure. But where there is replacement 'as a whole', it amounts to reconstruction and not repairs. (A compound wall was totally demolished with its foundation and a new compound wall was constructed in this case). It is pertinent that the asset in its old form must continue to exist to say that the expenditure involved in improving the asset is revenue expenditure. Where effacement takes place and a new asset comes into being, then the expenditure involved would become a capital expenditure - *Senapathy Synams Insulations (P.) Ltd. v. CIT* [2001] 248 ITR 656 (Kar.).
- C) ***Repairs for converting godown into administrative office*** - Where the assessee incurred expenditure on repairs to a godown used for business purpose so as to convert it into an administrative office, the expenditure was allowable as revenue expenditure, since the business asset had retained its character and only its use had changed, and the use at both points of time,

i.e., before and after the expenditure was incurred, related to the business of the assessee without there being any addition to or expansion of the profit-making apparatus of the assessee - *Indian Ginning and Pressing Co. Ltd. v. CIT* [2001] 252 ITR 577 (Guj.).

- D) *Quantum of expenditure is not decisive to find whether repairs to machinery are capital or revenue*** - It cannot be taken as a matter of assumption that merely because a large sum is expended on repairs to machinery it must necessarily amount to reconstruction making the expenditure capital in nature - *C.R. Corera & Bros. v. CIT* [1963] 49 ITR 188 (Mad.).
- E)** Where the assessee incurred expenditure of over Rs. 9 lakhs on converting the godown premises taken by it on hire into office premises, the expenditure was allowable as revenue expenditure, since the assets created by spending the amount did not belong to the assessee but the assessee got the business advantage of using modern business premises at a low rent, thus saving considerable revenue expenditure for a considerably long period - *CIT v. Hede Consultanry (P.) Ltd.* [2002] 258 ITR 380 (Bom.).
- F) *Remodelling of furniture in retail outlet is revenue expenditure*** - The expenditure incurred by the assessee-company towards the remodelling of furniture in its various retail depots which was necessitated by changes in design, was deductible as revenue expenditure - *CIT v. Delhi Cloth & General Mills Co. Ltd.* [1981] 131 ITR 641 (Delhi).
- G) *Repair/replacement of false ceiling in cinema building is revenue expenditure*** - Expenditure on repair and replacement of false ceiling in cinema building owned by the assessee was allowable as revenue expenditure, since it was incurred for keeping the business running - *CIT v. Bharat Cinema* [1980] 121 ITR 165 (Punj. & Har.).
- H) *Replacement of electric wiring in cinema building is revenue expenditure*** - Expenditure incurred by the assessee, running cinema houses, on replacing the old electric wiring was allowable as revenue expenditure - *CIT v. Eagle Theatres* [1987] 165 ITR 93 (Delhi).
- I) *Expenditure on large-scale repairs which are overdue for a number of years, is allowable as revenue expenditure*** - Even where a sum of money is spent for repairs in a particular year because of the fact that regular repairs are allowed to fall into arrears and repairs on an extensive scale have to be undertaken to remedy the effect of several years' negligence, the expenses for such arrears repairs are allowable. - *Cultural Enterprises Corporation v. CIT* [1992] 196 ITR 488 (Cal.).
- J) *Expenditure on replacement of a physically, commercially and functionally inseparable part of an entire asset (like motor engine) is revenue expenditure*** - Where a replacement is made of

a physically, commercially and functionally inseparable part of an entire asset, the expense incurred in relation to such transaction must be treated as an admissible revenue expenditure - *CIT v. Tea Estate (P.) Ltd.* [1992] 198 ITR 535 (Cal.).

K) *Expenses on repairs to car damaged during riots are deductible* - Expenditure to repair damage to car in which director of assessee-company was travelling to the business premises, as a result of riot in the company's premises, was allowable as business expenditure - *CIT v. Southern Publications Ltd.* [1995] 211 ITR 397 (Mad.).

L) *Expenditure on renovation and modernisation of hotel premises is revenue expenditure* - Expenditure incurred solely for repairs and modernising the hotel and replacing the existing components of the building, furniture and fittings, with a view to create a conducive and beautiful atmosphere for the purpose of running of a business of a hotel, will fall under the category of revenue expenditure only, and is hence deductible - *CIT v. Ooty Dasaprakash* [1999] 237 ITR 902 (Mad.).

M) *In case of mines* - Where assessee holding mining leases from State Government had not incurred any expenditure towards restoration of lands to their original condition, estimated liability for restoration charges could not be allowed as deduction - *New India Mining Corporation (P.) Ltd. v. CIT* [2000] 243 ITR 640/111 Taxman 632 (SC).

92) Retirement benefits*

A) *Pension/gratuity/voluntary payments are deductible if one of the three specified tests are satisfied* - Expenditure incurred in connection with payment of pension, gratuities and other voluntary payments to employees are deductible provided it is established that the payments were made for sound commercial purposes and with the object of facilitating the carrying on of the business. The fact that a third party other than the assessee is also benefited by the expenditure would not make it an expenditure not deductible under section 37(1). It should, however, be established that the payment was made in pursuance of a scheme for payment of such amounts, or the payment was made as a matter of practice which affected the quantum of salary of the employee or the employee was having an expectation of getting the said payment, or the said payment was made on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. These tests have to be read disjunctively. An assessee will accordingly be declared eligible for the deduction of the payment aforesaid as an expenditure falling under section 37 provided he successfully establishes any one of the tests mentioned above - *CIT v. Commonwealth Trust Ltd.* [1987] 166 ITR 732 (Ker.).

- B) *Any terminal benefit to employees will fall under section 37(1)*** - It is too late in the day now, whatever may have been the position about two decades ago, to treat the expenditure incurred by a management in paying reasonable sums by way of gratuity, bonus, retrenchment compensation or compensation for termination of service as not business expenditure. Such expenditure would ordinarily fall within the scope of section 37(1) - *Sassoon J. David & Co. (P.) Ltd. v. CIT* [1979] 118 ITR 261 (SC).
- C)** Where the assessee-company took over another company along with its employees, and later paid retirement compensation to those employees by taking into account the services rendered by them under the former company such retirement compensation is allowable as revenue expenditure. Provision of gratuity to the employees for the continuous services rendered to the company taken over cannot be said to be either unusual or unnecessary. The workmen had come to expect such provision or their legitimate due, and in the instant case had in fact filed application before the payment of gratuity authority. The resolution of the board of directors also accepted their legitimate dues while making it clear that it should not create financial burden beyond legal provision on continuity of service - *CIT v. Sinnar Bidi Udyog Ltd.* [2002] 257 ITR 216/123 Taxman 559 (Bom.).

93) Retrenchment compensation

- A) *Compensation paid under section 25FF of Industrial Disputes Act is not deductible*** - Deduction on account of retrenchment compensation paid to employees under section 25FF of the Industrial Disputes Act is not a permissible deduction - *CIT v. Gemini Cashew Sales Corpn.* [1967] 65 ITR 643 (SC)/*Nathalal Asharam v. CIT* [1992] 194 ITR 110 (Guj.).
- B) *Liability for compensation under section 25F of Industrial Disputes Act is deductible*** - Payment of accrued liability to pay retrenchment compensation under section 25F of Industrial Disputes Act, is an allowable deduction as business expenditure. - *CIT v. J.C. Budharaj & Co.* [1993] 204 ITR 656 (Ori.).
- C) *Others*** - Where assessee carried on business of processing cashew nuts in ten units four of which were situated in Kerala and according to Tribunal's finding these four and all other units outside Kerala formed one business, payments made by assessee to workmen of Kerala Units which had to be shut down because of some labour problems, were to be allowed as deduction under section 37 - *K. Ravindranathan Nair v. CIT* [2001] 114 Taxman 53/247 ITR 178 (SC).

94) Roads

- A) Contribution made for construction of road is capital expenditure** - An assessee's contribution towards the cost incurred on construction of a new road to serve assessee's factory is capital expenditure - *Travancore-Cochin Chemicals Ltd. v. CIT* [1977] 106 ITR 900 (SC).
- B) Contribution for construction of road, to facilitate supply of raw material, is revenue expenditure** - Contribution made by sugar mill under a statutory obligation towards construction of Government-owned roads, which would facilitate supply of sugarcane to factories, is revenue expenditure - *Lakshmiji Sugar Mills Co. (P.) Ltd. v. CIT* [1971] 82 ITR 376 (SC).
- C) Non-obligatory contribution for construction of road is not deductible** - Where the assessee had made a contribution towards the construction of a road, when it was under no obligation to make this contribution and the contribution was made long after the road was constructed and there was nothing to show that this road was in any way advantageous to the assessee or that the contribution had anything to do with its business the impugned amount was not deductible as expenditure - *L.H. Sugar Factory & Oil Mills (P.) Ltd. v. CIT* [1980] 125 ITR 293 (SC).
- D) Outright grant to Government by the assessee-exporter of ore for development of roads and port damaged by rains was not business expenditure, since not even an incidental connection between the expenditure and the assessee's business was brought on record** - *State Trading Corpn. of India Ltd. v. CIT* [1974] 94 ITR 496 (Delhi).
- E) Expenditure on construction of road bridge as safety measure is deductible** - Expenditure incurred in connection with construction of road bridge over railway track near assessee's factory, for the safety of workers, is deductible - *Panyam Cements & Mineral Industries Ltd. v. Addl. CIT* [1979] 117 ITR 770 (AP).
- F) Expenditure on black-topping of existing road is revenue expenditure** - Construction of a new road would produce a new asset. Where, however, there is either a direct expenditure or a contribution by way of reimbursement for black-topping of the road already laid out, as in the case of painting a house, the expenditure is of a revenue nature - *CIT v. Tractors & Farm Equipments Ltd.* [1982] 133 ITR 147 (Mad.).
- G) Expenditure on repairs/resurfacing of roads inside factory is revenue expenditure** - Expenditure incurred by the assessee on repairs of approach roads and resurfacing of kaccha roads inside its factory premises, was allowable as revenue expenditure - *CIT v. Chemaux Ltd.* [1994] 74 Taxman 201 (Bom.).
- H) Expenditure on converting kaccha road into pucca road is capital expenditure** - Converting a kaccha road into a pucca road could by no stretch of imagination be regarded as restoration of

the kaccha road to its original state and thus the expenditure incurred on it had to be disallowed being in the nature of capital expenditure - *Modella Woollens Ltd. v. CIT* [1979] 120 ITR 726 (Bom.).

- I) ***Expenditure on construction of temporary roads is allowable as revenue expenditure*** - Where the assessee set up an industrial unit in a backward area, and constructed temporary roads linking the temporary quarters built for its labourers, the expenditure on construction of such roads is allowable as revenue expenditure. Even if such expenditure is treated as capital in nature, the assessee was entitled to 100 per cent depreciation, in view of the admitted position that the road was a temporary structure - *CIT v. Industrial Cables (India) Ltd.* [2002] 254 ITR 267/121 Taxman 720 (Punj. & Har.).

95) Route permits

- A) ***Expenses on obtaining new route permits are not deductible*** - The expenses incurred in obtaining a new route permit under the Motor Vehicles Act are not expenses laid out for the purpose of a business carried on by the assessee because there can be no business before a permit is obtained and, therefore, such expenses are not deductible - *Erode Transports (P.) Ltd. v. CIT* [1969] 71 ITR 283 (Mad.).

96) Royalties

- A) ***Nature of royalty payment depends on nature of trade and quality of payment*** - The determining factor whether royalty paid is capital or revenue expenditure will depend largely on the nature of the trade in which the asset is employed and the quality of the payment therefore. On the facts of each case it will have to be determined whether a particular expenditure is a capital expenditure or a revenue expenditure - *Mewar Sugar Mills Ltd. v. CIT* [1973] 87 ITR 400 (SC).
- B) ***Royalty for use of trademark is deductible*** - Royalty paid by the assessee for user of trademark of another company is allowable as revenue expenditure - *CIT v. Raipur Manufacturing Co.* [1996] 132 CTR (Guj.) 63/*CIT v. Raipur Mfg. Co. Ltd.* [1996] 135 CTR (Guj.) 248.

97) Salary [See also under 'Remuneration']

- A) ***ITO cannot question the reasonableness of salary paid*** - The reasonableness of the salary, when no part of it has been paid on account of motives other than business considerations and the whole of it has been paid exclusively for purposes of the business, cannot be questioned by the income-tax authorities and is a matter for the assessee himself to decide. - *S. Veeriah Reddiar v. CIT* [1960] 38 ITR 152 (Ker.).

- B) *Salaries paid to near relatives who had neither the qualifications nor experience are not deductible*** - Where the assessee-company paid high salaries to the wife and son of its top executive, when the son and wife had neither requisite qualifications nor any experience to discharge the duties entrusted to them, and no internal evidence was produced to substantiate that they rendered services commensurate with high salaries, the said salaries were not deductible as business expenditure - *Birla Jute Mfg. Co. Ltd. v. CIT* [1981] 128 ITR 235 (Cal.).
- C) *Salary to pujari of temple situated inside business premises is deductible*** - Where assessee maintained a temple within mills premises and had employed a pujari in connection with said temple and said temple was not maintained for personal benefit of any person, salary paid by assessee to pujari was allowable as business expenditure - *Commercial Ahmedabad Mills Co. Ltd. v. CIT* [1994] 72 Taxman 203/204 ITR 505 (Guj.).

98) Sales tax

- A) *Sales tax is an admissible deduction*** - Sales tax is deductible as a business expense before arriving at the taxable profits - *S.R.V. G. Press Co. v. CEPT* [1956] 30 ITR 583 (AP)/*A.V. Thomas & Co. Ltd. v. CIT* [1986] 159 ITR 431 (Ker.)(FB).

99) Secret commission

- A) *Secret commission not proved as actually paid is not deductible*** - Where the assessee claimed deduction of secret commission allegedly paid to promote its sales but refused to furnish the names and addresses of the payees as required under section 133(4), it was *held* that the burden of proving that the amounts were actually expended lay on the assessee and since it had not discharged the same, its claim for deduction was not tenable - *Goodlas Nerolac Paints Ltd. v. CIT* [1982] 137 ITR 58 (Bom.).
- B) *Allowability of secret commission must be readjudicated under Explanation to section 37(1)*** - In view of the insertion of *Explanation* to section 37(1) with retrospective effect from the inception of the Act, where the Tribunal allowed deduction earlier in respect of secret commission, the matter requires to be readjudicated in the light of the aforesaid *Explanation* in order to satisfy that the said secret commission was not incurred by the assessee for any purpose which is an offence or which is prohibited by law - *CIT v. Taraporvala Sons Co. (P.) Ltd.* [1999] 239 ITR 319 (Bom.).

100) Settlement with workers

- A)** Whether the assessee, processing cashewnuts in ten units, closed some of the units in the wake of labour disputes, and carried on the business in the remaining units, the expenditure incurred

under a settlement with the trade union representing the workers was allowable as business expenditure, since it was incurred in connection with the industrial health of the business as a whole - *K. Ravindranathan Nair v. CIT* [2001] 247 ITR 178 (SC).

101) Sham transactions

- A) *Payments to agency firm in which director's close relatives were partners, under a sham agreement, are not deductible*** - Where the assessee-company claimed deduction of payments made to an agency firm in which its directors' close relatives were partners, and the Tribunal found that the relevant agency agreement was sham and was a mere device to siphon off the profits of the assessee to the directors' close relatives, it was held that the said payments were not deductible - *Niemla Textile Finishing Mills (P.) Ltd. v. CIT* [1975] 100 ITR 611 (Punj. & Har.).

102) Share capital/debenture issue

- A) *Expenses for public issue*** - Expenditure incurred for public issue of shares is capital expenditure - *CIT v. Kodak India Ltd.* [2001] 171 CTR (SC) 187.
- B) *Expenditure on raising additional share capital is capital expenditure*** - The expenditure incurred for raising additional capital by issue of ordinary shares is a capital expenditure - *Vazir Sultan Tobacco Co. Ltd. v. CIT* [1988] 41 Taxman 7/174 ITR 689 (AP).
- C) *Expenditure on changing capital structure to meet FERA requirements is capital expenditure*** - Where the expenditure was incurred for the purpose of changing the capital structure of the company to suit the requirements of the Foreign Exchange Regulation Act, 1973, by obtaining shares held by foreigners and transferring them to Indian citizens, thereby converting what was a non-resident company to a resident company, the expenditure was not deductible as a business expenditure - *CIT v. Commonwealth Trust Ltd.* [1987] 167 ITR 365 (Ker.).
- D) *Fees paid for increasing share capital are capital expenditure*** - Fee paid to Registrar of Companies for increasing authorised capital will result in an advantage of enduring nature and is capital expenditure - *Mohan Meakin Breweries Ltd. v. CIT (No. 2)* [1979] 117 ITR 505 (HP)/*Groz-Beckert Saboo Ltd. v. CIT* [1986] 160 ITR 743 (Punj. & Har.)/*Union Carbide India Ltd. v. CIT* [1987] 165 ITR 678 (Cal.)/*Bharat Carbon & Ribbon Mfg. Co. Ltd. v. CIT* [1981] 127 ITR 239 (Delhi)/*CIT v. Aditya Mills* [1990] 50 Taxman 120 (Raj.)/*Alembic Glass Industries Ltd. v. CIT* [1993] 202 ITR 214 (Guj.)/*CIT v. Tungabhadra Industries Ltd.* [1994] 207 ITR 553 (Cal.)/*Hindustan Machine Tools Ltd. (No. 3) v. CIT* [1989] 175 ITR 220 (Kar.)/*CIT v. Multi Metals Ltd.* [1991] 188 ITR 151 (Raj.)/*Wood Craft Products Ltd. v. CIT* [1993] 204 ITR 545 (Cal.).

- E) *Expenditure incurred by a company on issuing share to increase its share capital would not be allowable as revenue expenditure*** - Though the increase in the capital results in expansion of the capital base of the company and incidentally that would help in the business of the company and may also help in the profit-making, the expenses incurred in that connection still retain the character of a capital expenditure since the expenditure is directly related to the expansion of the capital base of the company. Therefore, expenditure incurred on issuing shares to increase its share capital by a company would not be allowable as revenue expenditure - *Punjab State Industrial Corporation Ltd. v. CIT* [1997] 93 Taxman 5/225 ITR 792 (SC)/*Brooke Bond India Ltd. v. CIT* [1997] 91 Taxman 26/225 ITR 798 (SC).
- F)** Where assessee claimed having increased its share capital at RBI's direction, so as to reduce its non-residential holding to 40 per cent, it was held that where object of assessee was to increase its share capital, either to continue to do business after RBI directive or otherwise, expenditure incurred for public issue of shares was capital expenditure - *CIT v. Kodak India Ltd.* [2002] 120 Taxman 498 (SC).
- G) *Fee paid to Registrar of Companies for enhancement of capital is a capital expenditure*** - The fee paid to the registrar for expansion of the capital base of the company is directly related to the capital expenditure incurred by the company and although incidentally that would certainly help in the business of the company and may also help in profit-making, it still retains the character of a capital expenditure since the expenditure is directly related to the expansion of the capital base of the company - *Punjab State Industrial Development Corpn. Ltd. v. CIT* [1997] 225 ITR 792/93 Taxman 5 (SC).
- H) *Discount on issue of bonds must be spread over the period of bonds and deducted*** - In the case of issue of bonds at a discount, the same principles as are applicable in the case of issue of debentures at discount would be attracted. The amount of discount in effect represents deferred interest. Looked at as a loss, a proportionate amount of discount can be written off out of revenue every year during the period the bonds would remain outstanding. - *M.P. Financial Corpn. v. CIT* [1987] 165 ITR 765 (MP).
- I) *Expenses on issue of bonus shares are on capital account*** - Expenses incurred by the assessee in connection with the issue of bonus shares are expenditure of a capital nature - *CIT v. Ajit Mills Ltd.* [1994] 210 ITR 658 (Guj.)/*CIT v. Mihir Textiles Ltd.* [1994] 206 ITR 112 (Guj.)/*Gujarat Steel Tubes Ltd. v. CIT* [1994] 210 ITR 358 (Guj.)/*Vazir Sultan Tobacco Co. Ltd. v. CIT* [1990] 48 Taxman 366/184 ITR 70 (AP).

- J) *Application fee for issue of bonus shares is deductible*** - Application fee paid for issue of bonus share is not a capital expenditure - *Wood Craft Products Ltd. v. CIT* [1993] 204 ITR 545 (Cal.).
- K) *Legal fees connected with bonus shares are deductible*** - Payment made by assessee-company by way of legal and consultation fee in connection with issue of bonus shares is expenditure of revenue nature - *Warner Hindustan Ltd. v. CIT* [1988] 171 ITR 224 (AP).
- L) *Printing/stationery, etc., expenses connected with bonus shares are deductible*** - Expenses on printing, stationery, postage and telegrams and legal expenses in connection with issue of bonus shares are of revenue nature - *Bombay Burmah Trading Corpn. Ltd. v. CIT* [1984] 145 ITR 793 (Bom.).
- M) *Expenses on issue of right shares are capital expenditure*** - When share issue expenses are treated as capital expenditure, there cannot be any good ground to hold that expenses for issue of additional shares by way of right shares can be treated in any other way. Any issue of additional shares and the expenditure incurred thereon can only have the character of share expenses and capital expenditure only and cannot be anything different - *CIT v. Motor Industries Co. Ltd.* [1988] 173 ITR 374 (Kar.)/*Shree Digvijay Cement Co. Ltd. v. CIT* [1982] 138 ITR 45 (Guj.).
- N) *Discount on debenture*** - Where a company issues debentures at a discount, the liability to pay discounted amount is an 'expenditure' allowable under section 37(1) - *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 91 Taxman 340/225 ITR 802 (SC).
- O) *Where assessee-company issued debentures at a discount, assessee was entitled to proportionate deduction of discount spread over period for which debentures would remain outstanding, and assessee's claim for deduction of entire amount of discount in year of issue itself could not be allowed*** - *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 91 Taxman 340/225 ITR 802 (SC).
- P) *Stamp duty/registration/legal fees incurred for issue of debentures are revenue expenditure*** - Expenditure incurred on stamp duty, registration fee, lawyer's fee, etc., in respect of the issue of debentures by a company to secure a loan, is admissible deduction as revenue expenditure - *Premier Automobiles Ltd. v. CIT* [1971] 80 ITR 415 (Bom.).
- Q) *Debenture premium is revenue expenditure*** - Where debentures were redeemable at a premium on expiry of certain number of years after allotment, debenture premium was allowable as revenue expenditure - *CIT v. Tungabhadra Industries Ltd.* [1994] 207 ITR 553/76 Taxman 185 (Cal.).

A) ***Expenditure on organising sports tournaments is allowable*** - Organising annual sports tournaments will advertise the name of the assessee and will inevitably give publicity to products marketed by the assessee. Consequently, expenditure incurred on holding such tournaments would qualify as an admissible business deduction - *Addl. CIT v. Delhi Cloth & General Mills Co. Ltd.* [1983] 144 ITR 275 (Delhi)/*Addl. CIT v. Delhi Cloth & General Mills Co. Ltd.* [1983] 144 ITR 280 (Delhi)(App. I)/*Addl. CIT v. Delhi Cloth & General Mills Co. Ltd.* [1983] 144 ITR 283 (Delhi) (App. II)/*Delhi Cloth & General Mills Co. Ltd. v. CIT* [1986] 158 ITR 64 (Delhi)/*CIT v. Delhi Cloth & General Mills Co. Ltd.* [1978] 115 ITR 659 (Delhi).

104) Staff incentives

- A) ***Incentive wages paid for better performance are deductible*** - Amount paid as incentive wages to its employees for better performance is allowable - *CIT v. Machinery Mfg. Corpn. Ltd.* [1992] 198 ITR 559 (Cal.).
- B) ***Expenditure on presentation of wrist watches to employees as an incentive and goodwill gesture, is deductible*** - Where it was found that the presentation of wrist watches was in the nature of an incentive to encourage the employees to attend work punctually and was incurred also to keep the employees happy and to earn their goodwill towards the company as an employer, the expenditure on account of such presentation to the employees was an expenditure wholly and exclusively laid out for the purpose of its business - *CIT v. Hayward Waldia Refinery Ltd.* [1994] 209 ITR 159 (Cal.).
- C) ***Lump sum paid to employee for barring him from private practice is deductible*** - Payment of lump sum amount to an employee barring his private practice is an allowable expenditure - *Champion Engg. Works Ltd. v. CIT* [1971] 81 ITR 273 (Bom.).
- D) ***Work incentives to staff found to be disproportionately high can be disallowed*** - Where, after taking over of running business from a firm, a company paid in the first year itself work incentives to some members of the staff, and such incentives were disproportionately high when compared to the salaries paid to those members, and there was no scheme for making such payments and no such payments were made by the predecessor-firm, the Tribunal would be justified in disallowing the amount paid as work incentives, as having not been expended wholly and exclusively for the purpose of the business of the company - *Jaipur Electro (P.) Ltd. v. CIT* [1997] 223 ITR 535 (Raj.).

105) Staff welfare expenses

- A) **The following items of expenditure were held as deductible:**

- I) Expenditure on levelling land meant as playground for workers and staff - *Teksons (P.) Ltd. v. CIT* [1979] 120 ITR 745 (Bom.).
- II) Donations for setting up schools for benefit of employees' children - *ITAT v. B. Hill & Co. (P.) Ltd.* [1983] 142 ITR 185 (All.).
- III) Contribution to local panchayat for upgradation of school - *CIT v. India Radiators Ltd.* [1999] 236 ITR 719 (Mad.).
- IV) Payment to hospital for providing air-conditioned cabin and other hospitalization facilities to employees - *CIT v. Belpahar Refractories Ltd.* [1977] 109 ITR 667 (Ori.).
- V) Contributions to State Housing Board for constructing tenements for workers - *CIT v. Bombay Dyeing and Manufacturing Co. Ltd.* [1996] 85 Taxman 396/219 ITR 521 (SC).
- VI) Expenditure on construction of workers' quarters, where ownership of quarters does not vest in the assessee - *CIT v. Mysore Cements Ltd.* [1990] 51 Taxman 219/183 ITR 367 (Kar.).
- VII) Expenditure on laying colony roads, drains, water tanks etc. under a housing scheme meant for employees - *Palani Andavar Mills Ltd. v. CIT* [1977] 110 ITR 742 (Mad.).
- VIII) Expenditure on transporting dead body of chairman who dies while on tour - *CIT v. Supreme Motors (P.) Ltd.* [1972] 84 ITR 1 (Delhi)/*CIT v. Karam Chand Thapar & Bros. (P.) Ltd.* [1986] 157 ITR 212 (Cal.)/*CIT v. Modipon Ltd. (No.2)* [1991] 189 ITR 478 (All.).
- IX) Maintenance expenses of temple constructed for the benefit of employees - *Atlas Cycle Industries Ltd. v. CIT* [1982] 134 ITR 458 (Punj. & Har.).
- X) Payments to employees for abstaining from strikes - *Cheran Engineering Corporation Ltd. v. CIT* [1998] 148 CTR (Mad.) 595.
- XI) Contributions to Death Relief Fund and provision of assistance to employees for acquiring houses - *CIT v. E.I.D. Parry India Ltd.* [1999] 105 Taxman 153/240 ITR 253 (Mad.).

106) Statutory reserves

- A) Contingency reserve, development reserve and tariff and dividend control reserve made out of profits by electricity supply company to comply with terms of the Electricity (Supply) Act, 1948 could not be allowed as deduction - *Vellore Electric Corpn. Ltd. v. CIT* [1997] 93 Taxman 401/227 ITR 557 (SC).

107) Subsidy

- A) *Amount paid by SBI to its subsidiaries as subsidy towards opening of new branches was allowable* - The expenditure incurred by SBI in giving subsidies to its subsidiaries under section

48(1) of the State Bank of India (Subsidiary Banks) Act, 1959 towards opening of new branches represented revenue expenditure and was allowable. What may be a capital receipt in the hands of the payee, need not necessarily be a capital expenditure in relation to a payer - *CIT v. State Bank of India* [2003] 129 Taxman 683/261 ITR 82 (Bom.)/*CIT v. State Bank of India* [2003] 129 Taxman 409/262 ITR 662 (Bom.).

108) Survey fees

- A) ***Survey fee for inspection of new machinery is deductible*** - Survey fee paid to an expert to ascertain whether machines were in accordance with specification or terms of contract, was a revenue expenditure - *CIT v. Vallabh Glass Works Ltd.* [1982] 137 ITR 389 (Guj.).

109) Tailoring expenses

- A) A tailor would normally incur expenditure towards wages for stitching the clothes, lining cloth, buttons and other tailoring materials and the claim of the assessee in respect of the same cannot be brushed aside. The skill and reputation of the tailor may be an added factor for getting some more customers and in any event the tailor has necessarily to incur expenditure referred to above, and hence necessary deductions have got to be given. In the absence of any rules and guidelines given in this matter, deduction to the extent of 25 per cent may be given in this respect - *V. Gopal v. CIT* [2002] 120 Taxman 531 (Mad.).

110) Tax proceedings

- A) ***Expenditure on tax proceedings is deductible*** - The expenditure which the assessee incurs in persuading the taxing authorities in making a reasonable and legitimate assessment is an expenditure laid out wholly and exclusively for the purpose of the business. - *Binodiram Balchand v. CIT* [1963] 48 ITR 548 (MP)/*R.B. Bansilal Abirchand Spg. & Wvg. Mills v. CIT* [1971] 81 ITR 34 (Bom.)(FB)/*Addl. CIT v. India United Mills Ltd.* [1983] 141 ITR 399 (Bom.)/*Modi Sugar Mills Ltd. v. CIT* [1973] 90 ITR 201 (All.).

111) Technical know-how

- A) ***General*** - Where assessee claimed deduction of royalty paid under a technical know-how agreement as revenue expenditure and Tribunal and High Court, after analysing technical know-how agreement had concluded that assessee set up a new business and foreign company not only furnished technical know-how to manufacture products but also rendered valuable service in setting up factory itself and as such assessee acquired enduring benefit, disallowance of part of royalty paid for same as capital expenditure was justified even though payment was required to be made on certain percentage rate of gross turnover.

- B)** The question as to whether a particular payment made by an assessee under the terms of the agreement forms a part of the capital expenditure or revenue expenditure would depend upon several factors, namely, whether the assessee has obtained a completely new plan with a complete new process and completely new technology for manufacture of the product or the payment is made for the technical know-how which is for the betterment of the product in question which is already being produced; whether the improvisation made is the part and parcel of the existing business or a new business is set up with the so-called technical know-how for which payments are made, whether on expiry of the period of agreement, the assessee is required to give back the plans and designs which are obtained, though the assessee can manufacture the product in the factory that has been set up with the collaboration of the foreign firm; the cumulative effect on a construction of the various terms and conditions of the agreement : whether the assessee derives benefits coming to its capital for which the payment is made - *Jonas Woodhead & Sons (India) Ltd. v. CIT* [1997] 91 Taxman 1/224 ITR 342 (SC).
- C)** Where under an agreement for supply of technical know-how foreign company had not sold any information, process or invention to assessee Indian company and no advantage of enduring nature had been obtained by Indian company, amount paid by Indian company under collaboration agreement was revenue expenditure - *CIT v. Indian Oxygen Ltd.* [1996] 218 ITR 337 (SC).
- D)** Where the assessee did not, under the agreement, become entitled exclusively, even for the period of the agreement, to the patents and trade-marks of the company but had mere access to the technical knowledge/experience which the foreign company commanded, the payments to foreign company were deductible - *CIT v. Ciba of India Ltd.* [1968] 69 ITR 692 (SC).
- E)** Technical fee may be treated as revenue expenditure and if it is treated as capital expenditure, assessee would be entitled to depreciation - *CIT v. Warner Hindustan Ltd.* [1999] 239 ITR 566 (SC).
- F)** ***Payment made for obtaining technical know-how in the medical field on once-for-all basis is revenue expenditure*** - Where under an agreement with foreign firm assessee obtained technical know-how, sub-cultures, etc., on 'once-for-all' payment for increasing yield of penicillin in its existing plant with a proviso to keep said know-how confidential, payment made would constitute revenue expenditure - *Alembic Chemical Works Co. Ltd. v. CIT* [1989] 177 ITR 377/43 Taxman 312 (SC).

- G) *Expenditure on technical know-how, even if of enduring character, is revenue expenditure if its impact is on the running of business - CIT v. Madras Rubber Factory Ltd. [1983] 144 ITR 678/[1984] 17 Taxman 333 (Mad.).***
- H) *Use of technical know-how even after expiry of agreement does not mean that it is a capital asset - CIT v. Tata Engineering & Locomotive Co. (P.) Ltd. [1980] 123 ITR 538 (Bom.).***
- I) *Where knowledge/information is available for indefinite period and, there is no effect on capital, expenses are deductible - CIT v. Chemicals & Plastics (I.) Ltd. [1989] 45 Taxman 79/179 ITR 269 (Mad.).***
- J) *Expenditure on know-how connected with techniques of production is revenue expenditure - Premier Automobiles Ltd. v. CIT [1984] 16 Taxman 202/150 ITR 28 (Bom.).***
- K) *Expenditure on acquiring technical know-how is revenue if it is for existing lines of business, and capital if it is for new venture - CIT v. Suhrid Geigy Ltd. [1996] 132 CTR (Guj.) 102.***
- L) *Payment for licence for use in existing business is revenue expenditure - S.R.P. Tools Ltd. v. CIT [1999] 237 ITR 684 (Mad.).***
- M) *Where only right to use know-how is obtained, expenditure incurred is deductible - CIT v. Kirloskar Tractors Ltd. [1998] 231 ITR 849 (Bom.).***
- N) *Others* - Where under an agreement assessee made a payment to its foreign collaborator for documents such as manufacturing drawings, processing documents, designs, charts, plans and other literature as specified in said agreements, expenditure incurred by assessee was to be treated as capital expenditure - *Scientific Engg. House (P.) Ltd. v. CIT [1985] 23 Taxman 66 (SC).***
- O) Where under an agreement with foreign company assessee was granted exclusive licence to use patents and design for 10 years with option to extend or renew agreement and assessee was not to disclose documents to third parties, payment made by assessee to foreign company was to be treated as revenue expenditure - *CIT v. I.A.E.C. (Pumps) Ltd. [1998] 232 ITR 316 (SC).***
- P) Value of shares allotted to foreign collaborator in consideration for supply of technical know-how towards share capital contribution could not be treated as expenditure - *Eimco K.C.P. Ltd. v. CIT [2000] 109 Taxman 151/242 ITR 659 (SC).***

112) Tenancy rights

- A) ***Acquisition of tenancy rights is capital payment*** - Payment made by the assessee for the purpose of acquiring tenancy rights in a shop is an expenditure of a capital nature - *CIT v. Mihir Textiles Ltd.* [1994] 206 ITR 112 (Guj.).

113) Trademark

- A) ***Expenditure on registration of trademark is not capital expenditure*** - The advantage derived by the owner of the trademark by registration falls within the class of maintenance of the capital asset. The fact that a trade mark after registration could be separately assigned, and not as a part of the goodwill of the business only, does not also make the expenditure for registration a capital expenditure - *CIT v. Finlay Mills Ltd.* [1951] 20 ITR 475 (SC)/*Erode Transports (P.) Ltd. v. CIT* [1969] 71 ITR 283 (Mad.).
- B) ***Licence fee paid for use of trade mark for 5 years is revenue expenditure*** - Where the assessee was merely granted a licence to use trade mark for a period of five years on payment of licence fee determined on the basis of a formula laid down in the agreement licence fee paid for the use of capital asset which belonged to someone else, was revenue expenditure - *CIT v. M.B. Umbrella Industries* [1984] 145 ITR 292 (MP).

114) Training of staff

- A) ***Expenditure on training of staff is deductible*** - The fact that a portion of the expenditure was incurred during the pre-production stage is not conclusive and decisive of the matter, whether the expenditure is capital or revenue. Where the assessee had incurred expenditure on the training of some of its staff, the whole expenditure was revenue expenditure - *Hindusthan Aluminum Corpn. Ltd. v. CIT* [1986] 159 ITR 673 (Cal.).
- B) ***Tour expenses on providing technical training to employee for new business are not deductible*** - Where assessee had undertaken a new business activity and sent its employee abroad for obtaining technical training in new activity so undertaken by assessee, expenses were not deductible - *CIT v. Century Spg. & Mfg. Co. Ltd.* [1994] 210 ITR 783 (Bom.).

115) Tubewells

- A) ***Construction of tubewell is capital expenditure*** - Expenditure incurred by assessee-company on boring tubewell would be capital expenditure even though tubewell became useless as water obtained therefrom was not found suitable - *Shree Digvijay Woollen Mills Ltd. v. CIT* [1993] 204 ITR 398 (Guj.).

SECTION 37(1)

BUSINESS EXPENDITURE - YEAR IN WHICH DEDUCTIBLE

- 1) Accounting period is the unit** - For the purpose of computing yearly profits and gains for assessment to income-tax each year is a separate and self-contained period of time, and losses and expenses incurred before its commencement or after its expiry cannot be the subject of any allowance in assessing the income of that particular year. In making the assessment for any particular year, deductions can therefore be permitted only in respect of expenses, which are found to have been incurred in the relevant accounting period. In adjudging the admissibility of a claim for deduction, the determination of the question whether the assessee had incurred the expenditure during the relevant accounting period is an indispensable preliminary step - *Seshasayee Bros. (Travancore) (P.) Ltd. v. CIT* [1971] 82 ITR 442 (Ker.).
- 2) Accrued liabilities** - If a liability has accrued during the accounting year but was to be discharged at a future date, the amount to be expended in the discharge of that liability would have to be estimated in order that under the mercantile system of accounting the amount could be debited before it was actually disbursed. The difficulty in the estimation thereof would not convert an accrued liability into a conditional one - *Calcutta Co. Ltd. v. CIT* [1959] 37 ITR 1 (SC).
- 3) Contingent liabilities –**

 - a) Even if the liability is a contingent liability, provided its discounted present value is ascertainable, it can be taken into account, if profits cannot be properly estimated without taking them into account. An estimated liability under a scheme of gratuity if properly ascertainable and its present value is discounted, is deductible from the gross receipts while preparing the profit and loss account. This is recognised in trade circles - *Metal Box Co. of India Ltd. v. Their Workmen* [1969] 73 ITR 53 (SC).
 - b) The decision of the Supreme Court in the *Metal Box* case cannot be stretched to the extent of saying that a liability or expenditure which could be claimed in relation to a particular assessment year can be kept in suspense and claimed in a subsequent year - *Mysore Tobacco Co. Ltd. v. CIT* [1978] 115 ITR 698 (Kar.).
- 4) Contractual liabilities –**

 - a) In the case of a statutory liability the quantification or ascertainment cannot postpone its accrual, but if the liability is based upon some contractual obligation, it arises only when it is ascertained - *Swadeshi Cotton Mills Co. Ltd. v. CIT* [1980] 125 ITR 33 (All.).

- b) A contractual liability crystallises only when the assessee agrees to pay - *CIT v. Oriental Motor Car Co. (P.) Ltd.* [1980] 124 ITR 74 (All.).

5) Disputed liabilities –

- a) A statutory liability of an assessee following the mercantile system, is allowable in the year in which it arises even though it is disputed by assessee - *CIT v. Central Provinces Manganese Ore Co. Ltd.* [1978] 112 ITR 734 (Bom.)/*CIT v. Dalmia Dadri Cement Ltd.* [1992] 195 ITR 290 (Delhi).

- b) Where a liability arising out of a contractual obligation is disputed, the assessee is entitled to claim a deduction in the assessment year relevant to the previous year in which the dispute is finally adjudicated upon and settled - *CIT v. Phalton Sugar Works Ltd.* [1986] 162 ITR 622 (Bom.).

- 6) **Leave encashment** - Deduction of provision for liability towards leave encashment would be allowable - *Bharat Earth Movers v. CIT* [2000] 112 Taxman 61/245 ITR 428 (SC).

- 7) **Remuneration** - Remuneration paid to directors for services rendered in earlier years is allowable in the year in which the resolution authorising the payment is passed - *CIT v. Karamchand Premchand (P.) Ltd.* [1985] 152 ITR 94 (Guj.).

- 8) **Dearness allowance** - In the case of an employer following the mercantile system of accounting, the liability to enhanced dearness allowance would arise only when it was finally settled amicably or by industrial adjudication, and deduction can be allowed only in the year when the liability under the award is finally determined. Any claim based on the proceedings pending before the Labour Appellate Tribunal at the time of assessment cannot be allowed - *CIT v. Amrit Banaspati Co. Ltd.* [1966] 59 ITR 388 (All.).

- 9) **Gratuity** - Liability towards gratuity which has accrued during the year under the mercantile system of accounting is allowable even if the assessee did not actually pay these amounts during these years but merely transferred them to the Employees Gratuity Fund. The fact that the assessee continued to have the control and dominion over the amounts in question would not make any difference - *Delhi Flour Mills Co. Ltd. v. CIT* [1974] 95 ITR 151 (Delhi).

- 10) **Litigation expenses** - In the case of litigation expenses, the actual amount of expenditure is determinable only after the completion of litigation and therefore it can be claimed in the accounting year in which the litigation ends even though the expenditure is spread over a certain period - *Boorugu Nagaiah Rajanna v. CIT* [1978] 114 ITR 350 (AP).

11) Damages - Where the liability to pay damages is under dispute, such liability would accrue only when the settlement of the dispute is made, even if the assessee is following the mercantile system of accounting - *CIT v. Soorajmull Nagarmull* [1981] 129 ITR 169 (Cal.).

12) Excise duty –

- a) Excise duty demand which is disputed by assessee and eventually dropped, cannot be allowed as deduction - *Indian Smelting & Refining Co. Ltd. v. CIT* [2001] 248 ITR 4/116 Taxman 606 (SC).
- b) Deduction of excise duty cannot be claimed merely on account of show-cause notice issued by Excise Department - *CIT v. Morarji Goculdas Spg. & Wvg. Co. Ltd.* [2000] 108 Taxman 502/243 ITR 37 (Bom.).

13) Sale of business - Where a business is sold, loss will not accrue or arise to the assessee until the price is settled - *Karam Chand Thapar & Bros. (P.) Ltd. v. CIT* [1969] 74 ITR 26 (SC).