

Mumbai ITAT allowed deduction of legal expenses incurred to safeguard business interest

Summary – The Mumbai ITAT in a recent case of Hiranandani Akruti JV, (the Assessee) held that Legal expenses incurred by assessee to safeguard its legal rights with respect to business activities carried out by it were to be allowed as deduction under section 37(1)

Facts

- During relevant year, assessee incurred certain expenses towards defending the legal rights with respect to the business activities carried out by it.
- The Assessing Officer as well as the Commissioner (Appeals) rejected assessee's claim for deduction of said expenses holding that no business activity was carried out by the assessee during the relevant period.
- On second appeal:

Held

- It is found from records that expenses disallowed were broadly with respect to legal and professional fees relating to legal proceedings/appeals and the same were incurred towards defending the legal rights with respect to the business activities carried out by the assessee. From records, it is found that the assessee generated revenue from the business operation to the tune of Rs. 1,96,99,410/- and other income to the tune of Rs. 9,800/- as on 31-03-2011, which was not possible without doing any business activity. Further, there was opening inventory and the assessee was having stock and revenue was also generated during earlier year relevant to year under appeal which was offered for taxation. The disallowances made by the Assessing Officer cannot be said to be inflated and are legal/professional expenses incurred to safeguard the interest of the business of the assessee, being legal and professional fees.
- Even otherwise, section 37(1) of the Act speaks about 'any expenditure' (not being expenditure in the sections 30 to 36) and not being in the nature of capital expenditure or personal expenses of the assessee but laid out or expended wholly and exclusively for the purpose of business of the assessee.
- Now, question arises, whether the payment of legal fee is an allowable deduction? The obvious reply is 'yes'. Section 57 speaks about income chargeable under the head 'Income from Other Sources', which shall be computed after making the deductions mentioned therein.
- If the provision of the Act, which is corresponding to the section 12(2) of 1922 Act, used in this context, the expression 'incurred solely for the purposes of making or earning such income', the use of expression 'laid out or expended wholly and exclusively' in section 57(iii) is to secure uniformity with the language of section 37(1). At the same time, the expression, 'for the purposes of business

or profession' has a wider implication than the expression "for the purposes of making or earning income" used in section 57(iii) of the Act. The purpose contemplated by section 57(iii) is more specific in character. So far as, reasonableness of the expenditure envisaged by section 57(iii) depends upon the facts of particular case.

- The Court in *CIT v. New Savan Sugar & Gur Refining Co. Ltd.* [\[1990\] 185 ITR 564/\[1991\] 55 Taxman 189 \(Cal.\)](#) held that it is for the Tribunal to decide whether the expenditure is wholly incurred for the purpose of keeping the assessee company in operation and earning income in as much as the concept 'wholly' pertains to quantum of the money expended. Even if a particular expenditure is unremunerative, such expenditure is nonetheless a proper deduction, if such expenditure is made wholly and exclusively for the purposes of earning such income.
- If the issue is analyzed in the light of section 37(1) of the Act, broadly speaking, where litigation expenses are incurred for purposes of creating, curing or completing the assessee's title to the capital, then the such expenses are in the nature of capital expenditure. On the other hand, if the litigation expenses are incurred to protect the business of the assessee, it must be considered as revenue expenditure. To be more precise, the type of litigation, object or purpose of the litigation has to be ascertained from the facts of each case. If the object or purpose is to defend or maintain existing title to the capital asset of the business of the assessee, the expenditure would be of revenue in nature.
- So far as, issue of quantum of the expenditure to be incurred is concerned, it is for the assessee to decide how best to protect his own interest. It is not open to the department to prescribe what expenditure an assessee should incur and in what circumstances he should incur that expenditure.
- In the instant case, it is found that the assessee did business activity, therefore, in the absence of any contrary material, this ground is allowed as the legal expenses/fees were incurred by the assessee wholly and exclusively to safeguard its business interest.
- In the result, the appeal of the assessee is allowed