

Sum paid by co. to protect its business interest was allowable business exp.: Mumbai ITAT

Summary – The Mumbai ITAT in a recent case of Cowtown Land Development (P.) Ltd., (the Assessee) held that where assessee company purchased development rights of a property from a company and made payment to its shareholders for withdrawal of winding up petition against said company in order to clear title of property since payment was made to protect business interest of assessee and to safeguard assessee from losses, same was to be allowed as business expenditure

Facts

- The assessee-company was engaged in business of land development and construction of building. The assessee purchased/obtained development rights of a property *vide* agreement with a company, SIPL. Subsequent to the agreement the assessee-company came to know that there were disputes among the shareholders of SIPL and such shareholders had filed petition before the High Court for relief and winding up of SIPL. In the event of winding up of SIPL, it would have affected the business rights of the assessee over the property and in order to clear the title of the property from these legal entanglements, the assessee made payments through account payee cheque to various shareholders. The assessee claimed said amount as business expenditure.
- The Assessing Officer disallowed the said claim of expenditure.
- On appeal, the Commissioner (Appeals) held that the payment was made to various shareholders of the SIPL in order to ensure the withdrawal of various litigations and suits filed before the High Court so that the development of the said property could be undertaken by the assessee without any hindrance. Therefore, the assessee had rightly claimed it as business expenditure towards the cost of land/premium for development rights as these payments were made to protect the business interest of the assessee and to safeguard itself from the losses, following the disputes from the shareholders.
- On revenue's appeal to the High Court:

Held

- There is no dispute that the amount was made to seven litigating shareholders even the Assessing Officer has not disputed the payments. There is uncontroverted finding of the impugned order that supporting documents were duly filed during assessment stage as well as First Appellate Stage, which includes copies of letters acknowledging payments, wherein, such recipients were satisfied with the sale deed of property and one of the recipient namely NS (on behalf of NSIL and other petitioners) filed affidavit before the High Court requesting to withdraw the application. The assessee also filed copy of deed of pledge, wherein, the pledgee agreed to land and advance to pledgers a sum of Rs. 5 crores to several persons who agrees to pledge shares of SIPL with the pledges, followed by a declaration cum indemnity with respect to pledge shares *vide* deed of pledge

and addendum to pledge. The assessee before the revenue authorities including First Appellate Authority and also before this Tribunal copy of the order of the High Court setting aside the order of BIFR and AAIFR recommending winding up of SIL. The totality of facts clearly indicates that the payment was made to various shareholders of SIPL in order to withdrawal of various litigations and suits filed before the High Courts so that development of the said property could be undertaken by the assessee company. In view of this uncontroverted finding, one is in agreement with the conclusion of the Commissioner (Appeal) in allowing the claimed business expenditure towards cost of land/development rights to safeguard its business interest.

- Broadly speaking, where litigation expenses are incurred for the purposes of creating, curing or completing the title of the assessee to the capital, then expenses are in the nature of capital expenditure and if the litigation expenses are incurred to protect the business of the assessee it may be considered as revenue expenditure. Expenditure on civil litigation commenced or carried out by an assessee for protecting the business is admissible as a business expenditure, where the object of the litigation was to secure a declaration that certain orders as so far as they sought to put to restriction upon the rights of the assessee to carry on its business in the manner in which it was accustomed to do so and to prevent enforcement of such orders, the expenditure incurred in that behalf would, without doubt, be expenditure laid out wholly and exclusively for the purpose of business of the assessee.
- 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) of the 1961 Act is to secure uniformity with the language of section 37(1) of the 1961 Act. 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). 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.
- If the issue is analyzed in the light of section 37(1), 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.
- In the cases of defending the criminal litigation, that section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. All that the court has to see is whether the legal expenses were incurred by the assessee in his character as a trader, in other words, whether the transaction in respect of which proceedings are taken arose out

of and was incidental to assessee's business. Further, it is to be seen whether the expenditure was *bona fide* incurred wholly and exclusively for the purpose of the business.

- 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. Criminal litigation may be prosecuted to put pressure on the accused to make good the loss caused to the assessee, and expenditure incurred therefore, if having nexus with the profits or business, are allowable deduction.
- If the observation made in the assessment order, leading to addition made to the total income, conclusion drawn in the impugned order, material available on record, assertions made by the parties and the judicial pronouncements discussed hereinabove, if kept in juxtaposition and analyzed, even the Assessing Officer has not disputed of making the payment or incurring the expenditure to various shareholders of SIPL. One of the objection raised by the Assessing Officer is that the confirmations were not filed on stamp papers. It is not the requirement of law that every transaction has to be confirmed on stamp papers only. The payments were made through account payee cheques and the recipient parties duly acknowledged the receipt of such payments and even NS filed an affidavit on behalf of the petition shareholders before High Court and the application was withdrawn by him. The deed of pledge on behalf of the recipients is available wherein, the impugned amount was received by them. All the recipient has duly put the signatures. So far as, the receipt of the amounts is concerned, the name of the pledgor, amount and the pay order along with date is available and all the recipient have put their signature on the revenue stamp. The declaration cum indemnity of all the recipients/concerned parties is also available. The orders from High Court have also been perused, which clearly indicates that the assessee duly paid the impugned amounts in lieu of the shares of the litigating parties and the expenses were incurred to safeguard the business interest of the assessee, which is permissible under the Act. No evidence in any manner has been adduced by the revenue contradicting the factual finding recorded by the Commissioner (Appeal). It is further noted that the assessee entered into a development agreement with SIPL followed by supplemental agreement and deed of conveyance and the amount was paid to the shareholders in respect of which supporting documents have been duly filed. Even through the affidavit filed by NS on behalf of the SIPL and other petitioner before the High Court requesting to withdraw their applications and the assessee also filed copy of deed of pledge. These parties agreed to pledge 2750 number of share of SIPL with the pledgee followed by a declaration cum indemnity. It is evidently clear that the payment was made to shareholders of SIPL for withdrawal of litigations and suits filed before High Court, so that the development of the said property could be smoothly undertaken without any hindrance, consequently, the expenditure was incurred to protect the business interest of the assessee and further to safeguard the assessee itself for further losses, resultantly, there is no infirmity in the order of the First Appellate Authority. The same is affirmed. The appeal of the revenue is, therefore, dismissed.