

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATE : 07.07.2015

CORAM

**THE HONOURABLE MR. JUSTICE R.SUDHAKAR
AND
THE HONOURABLE MS. JUSTICE K.B.K.VASUKI**

**T.C.A. NO. 613 OF 2014
AND
M.P. NO. 1 OF 2014**

M/s.Seven Arts Films
B-9, Brown Stone Apartments
Mahalingapuram
Chennai.

.. Appellant

- Vs -

The Asst. Commissioner of Income Tax
Media Circle - II
Chennai.

.. Respondent

Appeal filed under Section 260-A of the Income Tax Act against the order dated 27.05.2014 passed by the Income Tax Appellate Tribunal, 'D' Bench, made in ITA No.1291/Mds/2013.

For Appellant : Mr.Suhrith Parthasarathy

For Respondents : Mr. M.Swaminathan, assisted by
Mr.K.Sureshkumar & Ms.V.Pushpa

JUDGMENT

(DELIVERED BY R.SUDHAKAR, J.)

Aggrieved by the order of the Tribunal in allowing the appeal filed by the Revenue, the assessee is before this Court by filing the present appeal

raising the following questions of law :-

"i) Whether the Income Tax Appellate Tribunal has erred in considering the payments made by the appellant to M/s.Pyramid Saimira Entertainment Ltd., as capital expenditure and therefore incapable of being allowed as deduction under Section 37 of the Income Tax Act, 1961?

ii) Whether the expenditure incurred by the appellant in paying Rs.1,50,00,000/= to M/s.Pyramid Saimira Entertainment Ltd., under the Settlement Agreement dated 13.09.2008 is a revenue expenditure deductible under Section 37 of the Income Tax Act, 1961?

iii) Whether the Income Tax Appellate Tribunal has erred in concluding that the payments made to M/s.Pyramid Saimira Entertainment Ltd., under the Settlement Agreement dated 13.09.2008 is tantamount to a purchase of goodwill?

iv) Whether the Income Tax Appellate Tribunal has erred in failing to follow the decisions of this Hon'ble Court in Amarjothi Pictures - CIT (69 ITR 75), CIT - Vs - Gobald Motor Services (100 ITR 240) and CIT - Vs - Associated Electrical Agencies (266 ITR 63)?

v) Whether the Income Tax Appellate Tribunal has erred in questioning the genuineness of the payment of Rs.1,50,00,000/= made by the appellant to M/s.Pyramid Saimira Entertainment Ltd., under the Settlement Agreement

dated 13.09.2008, particularly when the same has been attested by the Assessing Officer?

vi) Whether the Appellate Tribunal's findings are perverse and therefore liable to be set aside?"

2. The facts, in a nutshell, are as hereunder :-

The issue relates to print distribution and the subsequent compensation paid due to the loss incurred by the theater owners in exhibiting the films "Kuselan" and "Kathanayakudu" by the assessee/appellant.

3. The appellant is engaged in the business of production and distribution of movies/feature films. For the assessment year 2009-2010, the appellant filed its return of income on 30.09.2009 admitting a total income of Rs.1,40,59,210/=, which was processed under Section 143 (1) of the Income Tax Act (for short 'the Act'). On 24.3.2011, the appellant filed a revised return admitting a total income of Rs.1,33,59,740/=. The case of the appellant was selected for scrutiny and notice under Section 143 (2) of the Act was issued to the appellant.

4. It is the further case of the appellant that during the relevant assessment year, the appellant produced a film 'Kuselan' in Tamil and 'Kathanayakudu' in Telugu, which starred Rajinikanth and others. The rights

of both these films were sold outright to M/s.Kavithalaya Productions Pvt. Ltd. (for short 'KPPL') and M/s.Vyjayanthi Movie (for short 'VM') respectively. While the movie 'Kuselan' was sold to KPPL for a sum of Rs.25.5 Crores, 'Kathanayakudu' was sold to VM for a sum of Rs.14.5 Crores. The sale, insofar as both the movies, included theatrical rights, audio rights, satellite rights and non-theatrical rights. Both KPPL and VM, in turn, sold their respective rights to one M/s.Pyramid Saimira Entertainment Ltd., (for short 'PSEL') which, in turn, was responsible for distributing the films through various distributors and exhibitors.

5. It is the further case of the appellant that the Tamil film 'Kuselan' unfortunately flopped in the box office and caused a huge uproar among distributors and exhibitors, who had incurred huge losses. In order to pacify the distributors and exhibitors, Mr.Rajinikanth offered to compensate them and he brought forth discussions between the distributors, exhibitors and producers in order to arrive at an amicable settlement. Further to the same, an agreement was reached by all the parties, viz., producer, buyers, the actor, Mr.Rajinikanth and the director of the film, Mr.P.Vasu that each one of them would bring forth a specific amount to be paid as compensation. Accordingly, the appellant entered into a settlement agreement dated 13.09.2008 with PSEL to whom KPPL had sold the entire rights over the Tamil film 'Kuselan' and VM had sold the rights of the Telugu Film 'Kathanayakudu'. It is specifically stated in the said agreement that both

these films having not been successful at the box office and the distributors/exhibitors have been making demands for compensation, as a gesture of goodwill, the parties, viz., PSEL and the appellant had held negotiations and had mutually agreed that an amount of Rs.1,50,00,000/= (Rupees One Crore Fifty Lakhs only) would be paid by the appellant to PSEL. It is also stated in the said agreement that the said amount was paid towards refund to compensate the distributors through PSEL for losses incurred by them from the theatrical release of the two films in Tamil Nadu, Andhra Pradesh and Karnataka.

6. In addition to the above, in the course of argument, it has been pointed out by the learned counsel for the Revenue and accepted by the learned counsel for the assessee that VM has also made certain payment to PSEL, vide agreement dated 8.9.08 in a sum of Rs.75 Lakhs as a goodwill gesture citing commercial expediency.

7. During the course of scrutiny proceedings, the Assessing Officer called upon the assessee to explain how the amount paid to PSEL in terms of the Settlement Agreement dated 13.9.08 could be claimed as revenue expenditure in terms of Section 37 of the Act and he sought to disallow the same as a payment made towards goodwill and that the said amount has to be treated as expenses, capital in nature. The assessee gave a detailed explanation to support the said payment as a payment made as goodwill

gesture to save its business and it is a commercial expediency. However, the said explanation was rejected by the Assessing Officer, who disallowed the said amount, vide adjudication order dated 22.12.2011.

8. Aggrieved by the said adjudication order, the assessee preferred appeal before the CIT (Appeals), who held in favour of the assessee stating that it is a case of sales-return invoking Section 9 of the Sale of Goods Act. It was further held by the CIT (Appeals) that the amount was given by way of goodwill gesture and not as goodwill, as held by the Assessing Officer. For better clarity, the relevant portion of the order is extracted hereinbelow:-

"13. Thus it's not that a price of a commodity is as what it is determined at the time of sale and it is a common practice that the price keeps getting reduced by the unfolding of future events. In the event of the goods sold being found defective or delivery not in time or not to the satisfaction of the customer, the seller has and has been always willing to reduce the price to keep himself secured in the business and to keep the good customer at his door step. In this case, even though the agreement dated 25.4.2008 the PSEL has agreed to a sale consideration of Rs.30 Crores for the Kuselan Tamil Film, and 7 Crores for Kathanayakudu Talugu film, since both the films have not done well at the box offices, both the sellers i.e., the assessee company and Mr.C.Aswini Dutt along with producer SAF, Mr.Rajinikanth, actor, Mr.P.Vasu, Director of the film have all agreed to compensate the PSEL by specified amounts. Thus it can be said that the producer and both the sellers, as parties to the renegotiations, have reduced their sale price by means of a discount given as the film did not do well at the

box office. It has been very clearly reduced to writing on page 2 of the said Settlement Agreement that the appellant (being First Part) has agreed to reducing the sale consideration of the film by a sum of Rs.150 lacs. As per Accounting Standard 9 what is received on the recognition of a sale has to be taken as revenue. In this case, the assessee even though has received Rs.40 Crores based on the agreement dated 25.4.2008 but out of the same, Rs.150 lakhs has been returned to PSEL as his share, by virtue of the subsequent unfolding of events and subsequent agreement dated 17-9-2008. Hence it is not correct to say that Rs.150 lakhs is a payment of goodwill. As rightly argued by the AR there is no asset acquired to say that the asset has come along with goodwill. In fact, the payment made to PSEL of Rs.150 lakhs is only a reduction in sale consideration, a payment made to protect the reputation of the assessee and to keep them in good stead in the business. **As rightly urged by the AR, there is a substantial difference between "Goodwill" and "Goodwill gesture". The goodwill gesture is one which results in goodwill over a long period of time whereas a goodwill is a crystallised item, price paid in excess of assets over liabilities. Hence a payment made as a goodwill gesture cannot be equated with goodwill, the former is a revenue item and the latter is a capital item as per the accounting methods and the Income Tax Act.** Since the payment made of Rs.150 lakhs on the commercial failure of the film is only to compensate the buyer PSEL and also to protect the reputation of the producer - appellant, the same cannot be held as a 'goodwill but it is only a sales-return or a discount, as squarely covered by S.9 of the Sale of Goods Act and Accounting Standard 9. Moreover, this is not the first time of such instances in the film industry, there are precedents.

Hence, the AO is directed to delete the addition."

9. On appeal, at the behest of the Department, the Tribunal came to hold that the assessee/appellant had realised a sum of Rs.39.13 Crores from the sale of the two feature films on outright sale to KPPL and VM under agreement dated 16.2.08. Before the Tribunal, the contention of the assessee was that both the movies did not do well in the theaters and the exhibitors suffered huge losses due to lack of collection from the theaters. Therefore, on the basis of mutual discussions between the assessee, distributors, viz., KPPL and VM and the ultimate distributor, PSEL, it appears a series of agreements were signed, which we have referred to above, and on the part of the appellant, a sum of Rs.1.5 Crores has been paid to PSEL on 13.9.08. The Tribunal, on the conspectus of these facts, came to hold that the assessee had made the payments to protect his goodwill in the market. The assessee has not shown on the basis of this agreement dated 10.2.08, or the supplementary agreement dated 28.7.08 that payment is made in accordance with the covenants of the agreement. A perusal of the records as well as the assessee's admission does not show that the payment was made to discharge any legal liability. Accordingly, the Tribunal came to hold that the payment was made either voluntarily or out of pressure from market forces, but certainly not due to business obligation. It also held that the assessee made payment in the form of compensation to stay afloat in the business. The Tribunal, looking into the various decisions of the High

Court further held that the assessee has not been able to show that the payments were actually received by the persons, who suffered the losses and, therefore, this casts a shadow over the genuineness of the payment. The Tribunal further held that if the payment is believed to be genuine, it should be held as capital in nature and cannot be allowed as deduction under Section 37 of the Act. On this premise, the Tribunal allowed the appeal filed by the Revenue against which this appeal is filed by the appellant/assessee.

10. Mr.Suhrith Parthasarathy, learned counsel appearing for the appellant/assessee relied upon the agreement dated 13.9.08 to establish the fact that there was a clear statement in the agreement that those two films have flopped in the box office and PSEL was under compulsion from the theater owners to pay up certain amount and, therefore, based on the discussions between the assessee, the distributors, viz., KPPL and VM and the ultimate distributor, PSEL, the present agreement was signed. For better clarity, the relevant portion of the agreement is extracted hereunder:-

"WHEREAS the party of the First Part represents that they have produced the Tamil feature film "Kuselan" with artists Rajinikanth, Pasupathy, Vadivelu, Meena, Nayantara, etc., and directed by P.Vasu and the Telugu film "Kathanayakudu" with artists Rajinikanth, Jagapathy Babu, Sunil, Meena, Nayantara and sold the distribution cum marketing rights of Tamil film "Kuselan" to M/s.Kavithalayaa Productions Pvt. Ltd. vide an agreement dated 16/02/08 and the Telugu film "Kathanayakudu" to M/s.Vyjayanthi Movies vide an agreement

dated 16/02/2008.

WHEREAS the above said M/s.Kavithalayaa Productions Pvt. Ltd. and M/s.Vyjayanthi Movies have subsequently sold their respective rights to M/s.Pyramid Saimira Entertainment Ltd., vide agreements dated 25/04/2008 and 10th May, 2008 respectively and these sale agreements were confirmed by the party of the second part as the producers. Pursuant to the said agreement, the amount of consideration as agreed to between the parties had been duly paid by the respective parties.

WHEREAS the film "KUSELAN" and "KATHANAYAKUDU" since released for commercial exhibition and has not been successful at the box office and the distributors/exhibitors in the respective states have made demands for compensation and as a goodwill gesture the parties of the First Part and the Second Part held negotiations and has mutually agreed that the Party of the First Part shall, as producers, reimburse an amount of Rs.1,50,00,000/= (Rupees One Crore Fifty Lakhs only) to the second party to settle the issues."

11. It is further submitted by the learned counsel for the assessee that the Tribunal failed to adhere to the well settled proposition of law that what constitutes a revenue expenditure ought to be determined in line with the trade of the assessee. To buttress this argument, reliance was placed on the decision in the case of **CIT - Vs - Dhanrajgiriji Raja Narasingirji (91 ITR 544 (SC))**. Reliance was also placed on the decisions of this Court in **Amarjothi Pictures - Vs - CIT (69 ITR 755)** and **Sanjeevi & Co. - Vs - Commissioner of Income Tax (AIR 1966 Mad 390)**, to impress upon

the fact that the Revenue is confined to decide the reality of the expenditure as to whether it was factually expended and exclusively used for the purpose of business and that the reasonableness of the expenditure could only be gone into for the purpose of determining whether the amount was actually spent.

12. It is the further submission of the learned counsel for the assessee that there is a direct nexus between the payments made by the appellant under the Settlement Agreement to PSEL and the said amounts were paid purely in the ordinary course of business. To drive home this point, learned counsel placed reliance on the decision of this Court in ***CIT - Vs - Gobald Motor Services P. Ltd. (100 ITR 240 (Mad))***.

13. It is further contended by the learned counsel for the assessee that the payment in this case was made pursuant to the Settlement Agreement with PSEL having regard to the commercial expediency and in furtherance of the appellant's business. Reliance was placed on the decision of this Court in ***CIT - Vs - Associated Electrical Agencies (266 ITR 63)***, wherein this Court held that payments made, having regard to commercial expediency need not necessarily have their origin in contractual obligations. If the assessee, carrying on business, feels 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. It has also been held in the said decision that payments made in commercial exigency need not necessarily arise out of contractual obligations.

14. It is the further stand of the assessee that at no point of time the genuineness of the payment made to PSEL has been questioned by the Revenue. A finding in this regard is also found in the order of the Tribunal, which has recorded that the facts have not been disputed and the only dispute is with relation to the nature of the payment made to PSEL.

15. It is the further submission of the assessee that it is common trade practice for producers to compensate exhibitors/distributors when they suffer losses due to poor performance of a film. It is the further submission of the learned counsel for the assessee that the assessee has right to carry on business and any expenditure made by the assessee during the course of business for the purposes of removal of any restriction or obstruction or disability would be on revenue account, provided it does not result in the acquisition of a capital asset. Reliance was placed on the decision of the Supreme Court in the case of ***Bikaner Gypsums Ltd. - Vs - CIT (187 ITR 39)***. Learned counsel vehemently urged the Court to take into consideration the above submissions, and submitted that for the reasons afore-mentioned, the order of the Tribunal is liable to be interfered with.

16. On notice, learned standing counsel for the respondent appeared and reiterated the submissions made before the Tribunal, which prompted the Tribunal to interfere with the order of the CIT (Appeals). It was further submitted by Mr. Swaminathan that there was no necessity for the assessee/appellant to make the payment to PSEL as there is no privity of contract. The assessee sold the film to KPPL and VM, who, in turn, sold the same to PSEL and, ultimately, it was given to the theater owners. There was no legal obligation on the part of the assessee to make the payment to PSEL. Learned counsel tried to justify the stand of the Department that the expenditure claimed is not revenue in nature, but is capital in nature. Therefore, it was vehemently urged that the order of the Tribunal warrants no interference in the facts and circumstances of the case.

17. Heard the learned counsel appearing for the appellant/assessee and the learned standing counsel appearing for the respondent/Department and perused the materials available on record as also the decisions relied on by the learned counsel for the appellant/assessee.

18. At the time of hearing, the settlement agreement dated 8.9.08, entered into between VM and PSEL was sought to be filed before us by the assessee to stress that VM has also paid compensation to PSEL. However, the said agreement has not been filed before the Tribunal. Therefore, we do not propose to look into that agreement as that document has not been

admitted in accordance with law. Nevertheless, we would like to discuss the issue on the legal plea raised by the learned counsel on either side in the following manner.

19. The primary plea raised by the learned counsel for the appellant is on the premise that due to failure of those two movies in the box office, there was great pressure from the theater owners and distributors, which fact is not dispute, the assessee, in order to sustain its goodwill in the market, as a goodwill gesture, had entered into the agreement. All that the authorities unanimously record that there was no legal obligation on the part of the appellant/assessee to pay this amount. On the contrary, it is the finding of the Tribunal that the payment is in the nature of goodwill gesture, but at the same time, the Tribunal also gives a finding that the assessee made payment in the form of compensation to stay afloat in the business. This, according to the learned counsel for the appellant, establish a case of business expediency and to buttress this argument he relied on the following decisions :-

- 1) AIR 1966 SC 1053 :: 1966 (60) ITR 52 (SC);
- 2) AIR 1967 SC 453 :: 1966 (62) ITR 638 (SC);
- 3) AIR 1982 SC 757 :: 1982 (133) ITR 756 (SC);
- 4) 2004 (266) ITR 170 (Mad.);
- 5) 2004 (266) ITR 63 (Mad.) ;
- 6) 2007 (288) ITR 1 (SC).

20. Before proceeding to analyse the merits of the case threadbare to decide the nature of the expenditure made by the appellant, it would be expedient to refer to the decisions relied on by the learned counsel for the assessee as to the law on the subject.

21. In ***India Cements Ltd. - Vs - Commissioner of Income Tax, Madras (AIR 1966 SC 1053 :: 1966 (60) ITR 52 (SC))***, the Supreme Court dealt with a case where the appellant therein had obtained loan and had utilised the same for obtaining assets. The High Court, in the said case, held the said amount to be capital in nature on the ground that the expenditure was incurred to obtain assets of enduring benefit and, therefore, the appellant could not claim the same as deduction under Section 10 (2). However, on appeal, the Supreme Court observed that loan is not an asset or advantage of enduring benefit and that the expenditure is incurred wholly and exclusively for the purpose of business and, therefore, the said expenditure should be regarded as revenue expenditure for the purpose of deduction under Section 10 (2). The Supreme Court specifically dealt with the expression 'for the purpose of the business' and in the said context, held as hereunder :-

"25. The last contention of Mr. Desai is that even if it is revenue expenditure, it was not laid out wholly and exclusively for the purpose of business. Subba Rao J. reviewed the case law in Commissioner of Income-tax v. Malayalam Plantations

and observed as follows:

*"The expression 'for the purpose of the business' 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 rationalisation 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, coercive process or assertion of hostile title**; it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for carrying on of a business: it may comprehend many other acts incidental to the carrying on of a business."*

(Emphasis supplied)

Accordingly, the Supreme Court went on to hold that expenses incurred wholly and exclusively for the improvement of the business and protection of the business is not in the nature of capital expenditure.

22. In ***Commissioner of Income Tax, U.P. - Vs - Nainital Bank Ltd. AIR 1967 SC 453 :: 1966 (62) ITR 638 (SC)***, the Supreme Court considered the status of the amount credited to the account of the borrower by the bank against loss of the pledged jewels and the amount paid by way of compensation. The Supreme Court, in the said case, held that the compensation given by the bank to the borrower is for the purpose of maintaining its goodwill and the same was laid out for the purpose of business within the meaning of Section 10 (2) (xv) of the Act. For better

appreciation, the relevant portion is extracted hereinbelow :-

"7. It was urged by the Commissioner that the bank was under no legal liability to pay to the constituents the value of the jewellery pledged with it. It was said that the bank was, as a pledgee, a bailee of the jewellery and was in law required to take as much care of the pledged jewellery as a person of ordinary prudence would take under similar circumstances of his own jewellery of the same bulk, quantity and value, and the bank having provided an adequate number of watchmen, it was not liable for the loss of the property pledged. Granting that, on proof that it had taken as much care of the jewellery pledged with it as it would have taken if it belonged to it, the bank could enforce its rights and recover the full amount due from the constituents, the question still remains whether in admitting liability for the value of the jewellery pledged, the bank laid out expenditure for the purpose of the business. The question is not about the strict enforcement of the legal rights and obligations between the bank and its constituents. The sole question is whether the bank in incurring the expenditure acted in the interest of and for the purpose of its business. The bank is carrying on banking business and advances loans on the security of jewellery. The credit of a banking business is very sensitive: it largely thrives upon the confidence which its constituents have in its management. To maintain that confidence the management has often to make concessions and thereby to preserve the goodwill of the business and its relations with the clientele. The bank could have, if so advised, taken its stand strictly on its legal obligations, and could have recovered the amounts due by the constituents at the same time denying liability to make any compensation for the loss of jewellery pledged with it. But such a stand might very well have ruined its business, especially in the rural areas in which

it operated. The bank had evidently two courses open: to enforce its rights strictly according to law, and thereby to lose the goodwill it had built up among the constituents, or to compensate the constituents for loss of their jewellery, and maintain its business connections and goodwill. In choosing the second alternative, in our judgment, the bank laid out expenditure for the purpose of its business. Paying to the constituents the price of the jewellery stolen in a robbery or a burglary was therefore expenditure for the purpose of the business. There can be no doubt that the expenditure was wholly and exclusively in the interest of the business. The expenditure was laid out for no other purpose.

8. We hold accordingly that the settlements with the constituents and the consequent posting of entries in the books of account cannot be regarded as forbearance to enforce the claim of the bank to recover the loans advanced. The settlement consisted of two constituent elements--paying by the bank of the value of the jewellery pledged with it against receipt from the constituent the amount which was recoverable by the bank. The first element of the transaction would appropriately be deemed expenditure and such expenditure having been laid out for protecting and furthering the business of the bank was properly admissible under section 10(2)(xv) of the Income-tax Act, 1922."

23. In ***Commissioner of Income Tax, Delhi - Vs - Delhi Safe Deposit Company Ltd. (AIR 1982 SC 757 :: 1982 (133) ITR 756 (SC))***, dealing with the expenditure incurred for the purpose of preserving the name of the firm, the Supreme Court held as under :-

"..... In British Insulated and Helsby Cables Ltd. v. Atherton

[1926] AC 205 ; [1925] 10 TC 155, 193 (HL), Lord Cave observed :

"It was made clear in the above cited cases of Usher's Wiltshire Brewery v. Bruce [1915] AC 433 (HL) and Smith v. Incorporated Council of Law Reporting for England and Wales [1914] 3 KB 674 (KB), that 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 grounds 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;....."

Rowlatt J. in Mitchell v. B. W. Noble Ltd. [1927] 1 KB 719 ; II TC 372, held that the money spent on getting rid of a director and saving the company from scandal was deductible. Affirming the above view, the Court of Appeal (whose judgment appears at p. 731) held that as the payment was not made to secure an actual asset so as effectually to increase the capital of the company but was made in order to enable the directors to carry on the business of the company as they had done in the past unfettered by the presence of the retiring director, which might have had a bad effect on the credit of the company, it must be treated as revenue and not as capital expenditure and was deductible as such for income-tax purposes.

8. 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. In CIT v. Malayalam Plantations Ltd. [1964] 7 SCR 693 ; 53 ITR 140, 150, Subba Rao J. (as he then was)

summarised the legal position, at p. 705, thus :

"The aforesaid discussion leads to, the following result : The expression 'for the purpose of the business' 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 rationalization 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, coercive process or assertion of hostile title ; 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 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."

9. In the instant case, the **assessee incurred the expenditure in question to avoid any adverse effect on its reputation, to protect the managing agency which was an income earning apparatus and for retaining it with the reconstituted firm in which the interest of the assessee was the same as before.** It was likely that but for the expenditure, the fair name of the assessee would have been tarnished or rendered suspicious and the managing agency would have been terminated. **The expenditure incurred on the preservation of a profit earning asset of a business has always been held to be a deductible expenditure by courts.** In the circumstances, it is difficult to

hold that the expenditure incurred by the assessee was either gratuitous or one incurred outside the trading activities of the assessee. The expenditure was, therefore, rightly held to be deductible under s. 37. We, therefore, reject the contention of the revenue that the amount in question could not be claimed as a deduction under s. 37 of the Act."

24. In ***Commissioner of Income Tax - Vs - Madras Refineries Ltd. (2004 (266) ITR 170 (Mad.))***, the assessee, to maintain its goodwill, had incurred expenditure, which expenditure was not for the purpose of earning the income and, therefore, the said expenditure was disallowed. On appeal, this Court held that the monies spent for the purpose of earning the goodwill cannot be considered as being wholly outside the ambit of business concern, as the business can succeed in a greater measure with the aid of such goodwill. In the said context, this Court held as under :-

"5. 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 being wholly outside the ambit of the business concerns of the assessee,

especially where the undertaking owned by the assessee is one which is to some extent a polluting industry."

25. In ***Commissioner of Income Tax - Vs - Associated Electrical Agencies & Anr. (2004 (266) ITR 63 (Mad.))***, while dealing with an expense shared by the assessee under a contractual obligation, this Court held that the payment made in regard to commercial expediency need not have their origin in contractual obligations and once it is accepted and acted in accordance with letter and the payments having been made, the assessee cannot be faulted. In the said circumstances, this Court observed as hereunder :-

"10. The Tribunal ultimately held that on applying the test as to whether the expenditure had been incurred wholly or partly or exclusively for the purpose of the assessee's business it was necessary to find out as to whether the assesseees were acting reasonably in the interest of their own business. The Tribunal accepted the assesseees' case that they were indeed acting in the interest of the business, as their business was primarily that of acting as agents for the sale of the products manufactured by the company, and by agreeing to share any sum of the expenditure which was necessary for the company to incur for promoting the products manufactured by it and marketed by the assesseees they were in effect advancing the cause of their own business. It also accepted the assesseees' claim that the expenditure incurred was commercially expedient for the assesseees. It also accepted the assesseees' case that the expenditure in fact had been incurred as necessary entries had been made in the books of account.

11. The Tribunal also took note of the fact that these amounts had been shown in the books of account of the company and that there had been no disallowance of expenditure by the Assessing Officer. The Tribunal concluded with the finding that the **expenses as claimed by the assesseees were allowable as they were incurred indirectly to facilitate the carrying on of the business or to preserve their existing source of income with a view to safeguarding the business and also increasing their profits in future.**

* * * * *

15. The reasons given by the Tribunal, for taking the view that it did, cannot be said to be arbitrary or irrational, having regard to the facts available on record. It was not the case of the Revenue that any part of the monies agreed to be paid by the assesseees to the company and for which sums credit had been given in the books of the assesseees have subsequently come back to the assesseees in any other manner. While it is no doubt true that there was no legal compulsion on the assessee to agree to pay the sums which are mentioned in the letter of the managing director of the company, **there was also no legal bar to their agreeing to pay a higher price for supplies already received if they felt that it was in their long term interest to pay such a higher price.** It was also open to them to agree to bear a part of the advertising and marketing costs as those costs were incurred with a view to enlarge the market and to improve the sales. Sales effected of the company's product resulted in benefits to the assesseees as they were the selling agents for the company.

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18. 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. While the company in this case may have had difficulty in compelling the assessee to make payments solely on the basis of that letter of March 20, 1992, once the assessee accepted and acted in accordance with what was set out in that letter, the assessee cannot be faulted for having agreed to something which had been set out as a record of a prior agreement, in a letter written to them by the company."

26. In ***S.A. Builders Ltd. - Vs - CIT (Appeals) & Anr. (2007 (288) ITR 1 (SC))***, the Supreme Court had occasion to consider a case where the assessee borrowed certain amount, which was not utilised by the assessee for any business, but advanced the same as interest free loan to its sister concern and that was claimed as revenue expenditure citing commercial expediency. The Supreme Court, while construing the scope and ambit of the expressions "commercial expediency" and "for the purpose of business", had occasion to consider several earlier decisions of the Supreme Court, particularly, ***Madhav Prasad Jatia - Vs - CIT (1979 (118) ITR 200 (SC))***, ***CIT - Vs - Malayalam Plantations Ltd. (1964 (53) ITR 140 (SC))***, ***CIT - Vs - Birla Cotton Spinning & Weaving Mills Ltd. (1971 (82) ITR 166 (SC))***. The terms "commercial expediency" and "for the

purpose of business" were considered in-depth and the Supreme Court came to hold that if the assessee was able to prove that there was a case of commercial expediency, it did not matter whether the expenditure has been incurred for any legal obligation or contractual obligation. If there is an element of commercial expediency established in such a claim, assessee is entitled to claim such a deduction. In the said decision, reliance was also placed on the decision of the House of Lords in ***Atherton (H.M. Inspector of Taxes) - Vs - British Insulated & Helsby Cables Ltd. (1925 (10) TC 155 (HL))*** wherein the House of Lords pointed out that even voluntary payment on the ground of commercial expediency and in order to indirectly facilitate doing of business could be considered as a claim for deduction. That principle has been approved by the Supreme Court in the case of ***Eastern Investments Ltd. - Vs - CIT (1951 (20) ITR 1)*** and ***Chandulal Keshavlal & Co. (1960 (38) ITR 601)***. For better clarity, the said portion is quoted hereunder :-

"21. In Madhav Prasad Jatia v. CIT [1979] 118 ITR 200 (SC) ; AIR 1979 SC 1291, this court held that the expression " for the purpose of business" occurring under the provision is wider in scope than the expression " for the purpose of earning income, profits or gains", and this has been the consistent view of this court.

22. In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income-tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a

subsidiary) as interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.

23. In our opinion, the decisions relating to section 37 of the Act will also be applicable to section 36(1)(iii) because in section 37 also the expression used is " for the purpose of business" . It has been consistently held in the decisions relating to section 37 that **the expression " for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.**

24. Thus in *Atherton v. British Insulated and Helsby Cables Ltd.* [1925] 10 TC 155, it was held by the House of Lords that in order to claim a deduction, **it is enough to show that the money is expended, not of necessity and with a view to direct and money expended, necessity immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business.** The above test in *Atherton's* case [1925] 10 TC 155 (HL) has been approved by this court in several decisions, e.g., *Eastern Investments Ltd. v. CIT* [1951] 20 ITR 1, *CIT v. Chandulal Keshavlal and Co.* [1960] 38 ITR 601, etc.

25. In our opinion, the High Court as well as the Tribunal and other Income-tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.

26. **The expression "commercial expediency" is an**

expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency.

27. No doubt, as held in *Madhav Prasad Jatia v. CIT* [1979] 118 ITR 200 (SC), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under section 36(1)(iii) of the Act. In *Madhav Prasad's* case [1979] 118 ITR 200 (SC), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this court that the interest on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.

28. Thus, the ratio of *Madhav Prasad Jatia's* case [1979] 118 ITR 200 (SC) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under section 36(1)(iii) of the Act.

29. In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.

30. It has been repeatedly held by this court that the expression "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits" vide *CIT v. Malayalam Plantations Ltd.* [1964] 53 ITR 140 (SC), *CIT v. Birla Cotton Spinning and Weaving Mills Ltd.* [1971] 82 ITR 166 (SC), etc." (Emphasis supplied)

27. On the abovesaid reasoning, the Supreme Court in *S.A. Builders case (supra)*, remanded the matter to the Tribunal to consider the issue in the following manner :-

"31. The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done."

28. Learned counsel for the Revenue was at pains to state that the *S.A. Builders case (supra)* may not apply as it has been referred to a Larger Bench in **21 Taxmann.com97 (Addl. Commissioner of Income Tax - Vs - Tulip Star Hotels Ltd. - T.C. Nos.7138 to 7140/2012)**. However, this Court finds that the reference of the *S.A. Builders case (supra)* to the Larger Bench does not in any way affect the facts in issue as the core issue that arises in the *S.A. Builders case (supra)* for reconsideration is *"Whether the assessee in S.A. Builders case has proved commercial expediency in relation to the amounts lent to the sister concern, interest free, and whether such amount could be treated as commercial expediency.* In the present case, we are not dealing with an issue on such fact.

29. The core issue that arise for consideration in this case is *whether the payment made by the assessee to PSEL, by way of compensation as*

goodwill gesture to maintain its goodwill, should be treated as revenue or capital in nature?

30. The main plea of the Revenue is that there is no necessity for the assessee/appellant to make the payment to PSEL as there is no privity of contract. This Court would have accepted the contention of the Revenue had there been little clarity in the order of the Tribunal. But we are afraid that the reasoning given by the Tribunal at paras 7 and 8 of its order appears to be mutually contradictory. For better clarity, the relevant paragraphs are quoted hereinbelow :"-

"7. As regard the nature of payment is concerned, the assessee has tried to explain that the payment is in the nature of goodwill gesture and not goodwill. The assessee has tried to distinguish between goodwill and goodwill gesture by relying on certain decisions. As per the contentions of the assessee, since the payment is in the form of goodwill gesture, it is revenue in nature. In our considered opinion the assessee made the said payments to protect its goodwill in the market. The assessee has to operate and do business in the market in future as well, the assessee had to maintain its goodwill. The assessee has not been able to show from the agreements dated February 16, 2008 or supplementary agreement dated July 28, 2008 that the said payment is made in accordance with the covenants of agreement. A perusal of records, as well as the assessee's own admission make it absolutely clear that the payment was not made to discharge any legal liability. The payment was made either voluntarily or out of pressure from the market forces but it was certainly not out of business

obligation. The assessee made the payment in the form of compensation to stay afloat in the business.

8. The authorised representative in support of his submissions has relied on the judgments of the Hon'ble jurisdictional High Court in the case of Amarjothi Pictures v. CIT [1968] 69 ITR 755 (Mad), CIT v. Gobald Motor Service P. Ltd. [1975] 100 ITR 240 (Mad) and CIT v. Associated Electrical Agencies [2004] 266 ITR 63 (Mad). In all the cited cases, the hon'ble High Court has held that expediency of expenditure should be left to the judgment of the assessee concerned. The Revenue has to confine itself only to decide the reality of expenditure. In the case of CIT v. Associated Electrical Agencies [2004] 266 ITR 63 (Mad), the Hon'ble court has held that commercial expediency need not necessarily have its origin in contractual obligations.

We find that the judgments on which the assessee has placed reliance does not support the case of the assessee. The facts in the present case are distinguishable. The assessee has not been able to show that the payments were actually received by the persons who suffered losses. This casts a shadow over the genuineness of the payment. Even if the payment is believed to be genuine, the same is held to be capital in nature and thus cannot be allowed under section 37 of the Act."

31. The Tribunal holds that payments made by the assessee is to protect its goodwill in the market and even if the payment is believed to be genuine, even then the same has to be held to be capital in nature and, therefore, cannot be allowed under Section 37 of the Act. However, on the

other hand, the Tribunal holds that the assessee had made the payment in the form of compensation to stay afloat in the business. This would satisfy the contention of the assessee that the payment was made for the purpose of staying afloat in the business, made voluntarily and it is a commercial expediency. This finding of the Tribunal, on the face of it, appears to be in support of the assessee that because of commercial expediency, to stay afloat in business, the said amount was paid.

32. The above findings of the Tribunal clearly depicts the dual stand taken by the Tribunal in its order and a paradox. The Tribunal has taken divergent views, one by holding that the expenditure is capital in nature, supporting the department and, on the other hand, has reasoned that it is compensation paid to stay afloat in business, meaning thereby commercial expediency. In any event, the assessee has, under the agreement, shown the reason for payment in question and we have extracted the said reason in the earlier part of the order. However, the said aspect has not been discussed by the Tribunal. It is an issue on fact on which the Tribunal ought to have given its finding as to whether the agreement and the payment justified the plea of commercial expediency to stay afloat in the business.

33. The finding of the Tribunal ought not to be mutually destructive, one that supports the view of the Department and the other leaning on the view of the assessee. We, therefore, hold that on facts the Tribunal should

be called upon to address the issue as to whether the payment made by the assessee, as goodwill, is capital in nature or is it a payment made for the purpose of staying afloat in business as a measure of commercial expediency. This Court is of the considered opinion that the Tribunal has to record its finding on these questions of fact and, therefore, the matter should be remanded to the Tribunal.

34. For the reasons stated above, without going into the questions of law raised, this appeal is disposed of and the matter is remanded to the Tribunal for fresh consideration in the light of the discussion as above. Consequently, connected miscellaneous petition is closed. However, in the circumstances of the case, there shall be no order as to costs.

(R.S.J.) (K.B.K.V.J.)
07.07.2015

Index : Yes/No

Internet : Yes/No

GLN

To

1) The Asst. Commissioner of Income Tax
 Media Circle - II
 Chennai.

2) The Income Tax Appellate Tribunal
 Chennai 'D' Bench, Chennai.

R.SUDHAKAR, J.
AND
K.B.K.VASUKI, J.

GLN

T.C.A. NO. 613 OF 2014

07.07.2015