

DALMIA JAIN & CO. LTD.

v.

COMMISSIONER OF INCOME-TAX,
BIHAR & ORISSA, PATNA

July 29, 1971

B

[K. S. HEGDE AND A. N. GROVER, JJ.]

Income Tax—Litigation expenses—Capital expenditure or Revenue expenditure—Tests for determining.

The appellant—assessee, one of whose business activities was quarrying lime-stone, was working a quarry as agent of the government with an understanding that the quarry would be leased out to the assessee if the government succeeded in the litigation in respect of it. When the assessee was in possession, a company instituted a suit against the government for specific performance of an agreement to lease the quarry. The assessee was made a party to the suit and a claim for damages was made against the government as well as the assessee. This Court granted a decree for damages and the assessee was also made liable to pay damages. On the question whether the litigation expenses incurred by the assessee constituted expenditure laid out wholly and exclusively for the purpose of the assessee's business or whether it was incurred for the purpose of acquiring a new asset,

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HELD : (i) Where the expenditure laid out for the acquisition or improvement of a fixed capital asset is attributable to capital, it is capital expenditure but if it is incurred to protect the trade or business of the assessee, it is a revenue 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. [965A-966B]

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(ii) In the present case the expenditure was incurred for the purpose of protecting the assessee's business and, therefore, was revenue expenditure. The assessee was dragged into the litigation and a claim for damages was made against the assessee also. The litigation came to be instituted against the assessee because the assessee was working the quarry and it was working the same at the time of the litigation. Therefore, the only reasonable inference that could be drawn was that the assessee resisted the suit in order to protect its business and not with a view to safeguarding its prospects of getting a new lease. [966G]

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Shree Meenakshi Mills Ltd. v. Commissioner of Income-Tax, Madras, 63 I.T.R. 207, referred to.

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CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1812 of 1967.

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Appeal from the judgment and order dated January 13, 1966 of the Patna High Court in Misc. Judicial Case No. 665 of 1962.

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A *M. C. Chagla and R. Gopalakrishnan*, for the appellant.

Jagadish Swarup, Solicitor-General, B. B. Ahuja and B. D. Sharma, for the respondent.

The Judgment of the Court was delivered by

B **Hegde J.**—This appeal arises from the decision of the High Court of Patna in a reference under s. 66(1) of the Indian Income tax Act, 1922 (to be hereinafter referred to as the Act). In that reference several questions of law were referred to the High Court for its opinion. In this appeal we are concerned with only one of those questions and that question is :

C “Whether on the facts and circumstances of the case the Tribunal was justified in holding that litigation expenses of Rs. 1,29,994/- incurred by the assessee for the assessment year 1951-52 constitute expenditure laid out wholly and exclusively for the purpose of the assessee’s business”?

D The relevant facts as found by the tribunal may now be briefly stated. The litigation expenses in question relate to the protracted litigation in respect of Murli Hills. Those Hills were owned by the State of Bihar. On April 1, 1928, the State Government gave a lease of those Hills to Kutchwar Lime Company

E for 20 years for the purpose of quarrying limestone therein. In the lease deed entered into between the parties, there was a clause preventing the lessee from assigning its rights to any third party without the consent of the lessor. In January 1933, Kutchwar Lime Co. went into voluntary liquidation and the liquidators assigned the lease-hold right to Subodh Gopal Bose in September 1933 without the permission of the State Government. The

F assignee took possession of the property on March 9, 1933 but was stopped from working the quarry by the Government. The Government forfeited the lease of the Kutchwar Lime Company on March 23, 1933 and re-entered into possession. The Government granted a fresh lease of those Hills to Kalyanpur Lime Company for a period of 20 years with effect from April, 1934. On

G September 24, 1934 the Kutchwar Lime Co. sued the Government for a declaration that the lease granted to it in 1928 had not been validly forfeited and for an injunction restraining the respondent from granting Murli Hills on lease to anyone else. The suit was decreed by the High Court on February 7, 1936 and the decree was affirmed by the Privy Council on November 19, 1937. The

H Kalyanpur Lime Co. vacated the quarry in April 1936 after the Kutchwar Lime Company started contempt proceedings. Kutchwar Lime Company got possession of the Murli Hills and remained in possession until the lease expired on March 31, 1948. The

Government then re-entered into possession. Thereafter Kalyanpur Lime Company repeatedly asked the Government to execute the lease as agreed to by it in 1934. The Government refused to do so and informed the Kalyanpur Lime Company on June 2, 1949 that the Government has decided to lease Murli Hills to the assessee. The Government leased the Murli Hills to the assessee for one year from September 22, 1949 to September 22 1950. Thereafter the Government appointed the assessee as the agent of the Government for working in the quarry with an understanding that the Murli Hills will be leased out to the assessee if the Government succeed in the litigation. When the assessee company was in possession of the Murli Hills as an agent of the Government, the Kalyanpur Lime Company filed a suit for specific performance. In the alternative it claimed damages. In that suit the Kalyanpur Lime Company impleaded the State of Bihar as well as the assessee as defendants. It is necessary to remember that in that suit a claim for damages was also made in the alternative. That suit was resisted by the State Government as well as by the assessee. That suit was dismissed by the High Court. The appeal of the Kalyanpur Lime Company was allowed by this Court and the suit decreed against both the defendants. But as by that time the term of the lease agreed upon between the State Government and the Kalyanpur Lime Company had come to an end this Court instead of granting a decree for specific performance granted a decree for damages. Under that decree, the assessee company was also made liable to pay damages—see the decision by this Court in Civil Appeals Nos. 1170 and 1171 of 1965.

From the facts stated above, it is clear that Kalyanpur Lime Company claimed damages not only from the State Government but also from the assessee company which in the course of its business was acting as the agent of the Government, no doubt with the prospect of getting a lease of the Murli Hills if the Government succeeded in the litigation. In the judgment of this Court it was observed that the assessee had no *locus standi* to resist the suit of Kalyanpur Lime Company.

The question for decision is whether the litigation expenses incurred by the assessee were for the purpose of creating, curing or completing the assessee's title to capital or whether it was for the purpose of protecting its business. If it is the former then the expenses incurred must be considered as capital expenditure. But on the other hand if it is held that the expenses were incurred to protect the business of the assessee then it must be considered as a business loss. The principle which has to be deduced from decided cases is that where the expenditure laid out for the acquisition or improvement of a fixed capital asset is attributable to

- A** capital it is capital expenditure but if it is incurred to protect the trade or business of the assessee then it is a revenue 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 the capital expenditure; if it is the latter, it is the revenue expenditure.

- B** The Income-tax Officer as well as the Appellate Assistant Commissioner came to the conclusion that the expenditure in question was incurred for the purpose of acquiring a new asset. Their orders are not clear as to what is the new asset intended to be acquired by the assessee. Possibly they were of the opinion, as was urged by the learned Solicitor-General on behalf of the Revenue that the expenditure was incurred for securing the assessee's prospect of getting a lease of the Murli Hills if and when the Government succeeded in the litigation. But the appellate tribunal took a different view of the matter. It came to the conclusion that the expenditure in question was incurred to protect the business of the assessee. On the other hand, the High Court agreed with the view taken by the Income-tax Officer and the Appellate Assistant Commissioner.

- C** The salient facts that could be gathered from the material before the tribunal are : (1) one of the business activities of the assessee was to quarry lime stone; (2) the Murli Hills had been leased out by the Government to the assessee for a period of one year from September 22, 1949 to September 22, 1950; (3) Thereafter the assessee was working the quarry in question as the agent of the Government; (4) in the suit filed by the Kalyanpur Lime Company, the assessee had been made a party; and (5) in that suit a claim for damages was made both against the Government as well as against the assessee.

- D** What has been overlooked by the High Court is that the assessee did not get into the litigation of its own accord. It was dragged into the litigation by the Kalyanpur Lime Co. Further the Kalyanpur Lime Company had made a claim for damages against the assessee also. This litigation came to be instituted against the assessee because the assessee was working the Murli Hills. It was working the same at the time of the litigation. From these facts, the only reasonable inference that can be drawn is that the assessee resisted the suit in order to protect its business as opined by the tribunal and not with a view to safeguard its prospects of getting a new lease. At any rate the view taken by the tribunal on the facts before it that the assessee incurred the expenditure in question to protect its business interest cannot be

considered as a unreasonable view. As observed by this Court in *Shree Meenakshi Mills Ltd. v. Commissioner of Income-tax, Madras*⁽¹⁾ that deductibility of expenditure incurred in prosecuting a civil proceeding depends upon the nature and purpose of the legal proceeding in relation to the assessee's business and the same cannot be affected by the final outcome of that proceeding. 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 had 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 interest 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.

In this case the assessee stands on a better footing. It did not initiate the proceeding. It merely defended the claim made against it. The claim was made against it because it was working the Murli Hills though as an agent of the Government. Therefore the civil proceedings were launched against it because of one of its business activities. Under those circumstances we are of opinion that the High Court was not right in holding that the expenditure in question was not a revenue expenditure.

For the reasons mentioned above we revoke the answer given by the High Court to the question referred to it for its opinion and in its place we answer that question in the affirmative and in favour of the assessee. The assessee is entitled to its costs both in this Court as well as in the High Court.

K.B.N.

Appeal allowed.