

In the High Court of Judicature at Madras

Dated: 08.03.2017

Coram

The Honourable Mr.JUSTICE RAJIV SHAKDHER
and
The Honourable Mr.JUSTICE R.SURESH KUMAR

Tax Case (Appeal) No.137 of 2017

Principal Commissioner of Income Tax
No.121, Mahatma Gandhi Road,
Chennai - 34.

.... Appellant

Vs.

M/s.Managed Information Services Pvt. Ltd.,
"Pottipati Plaza", 5th Floor,
No.77, Nungambakkam High Road,
Chennai - 600 034.

.... Respondent

APPEAL filed under Section 260A of the Income Tax Act, 1961 against the order dated 11.08.2016 made in I.T.A.No.566/Mds/2011 on the file of the Income Tax Appellate Tribunal, 'B' Bench, Chennai for the assessment year 2006-2007 and against the order of the Commissioner of Income Tax (Appeals) V, Chennai dated 23/12/2010 made in ITA.No.148/2008-2009 and order of the Assistant Commissioner of Income tax, company circle-IV(1) Chennai-34, dated 12/11/2008 made in GI.No/Pa.No.MA.500/PACCM 768011 for the assesment year 2006-2007.

For Appellant : Ms.R.Hemalatha
Standing Counsel for Income Tax

For Respondent: Mr.S.Sridhar

J U D G M E N T

(Judgment of the Court was delivered by RAJIV SHAKDHER,J.)

1. This appeal is directed against the judgment of the Income Tax Appellate Tribunal (in short 'the Tribunal'), dated 11.08.2016, qua the Assessment Year (A.Y) 2006-07.

2. The only issue, which arose for consideration, before

the Tribunal was, whether the order of the Commissioner of Income Tax (Appeals) [in short, 'the CIT(A)'], dated 23.12.2010, was required to be sustained.

3. The CIT(A) vide order dated 23.12.2010, had reversed the findings of the Assessing Officer, with regard to the disallowance of the expenditure, claimed by the Assessee qua legal fee and the expenses incurred towards Professional Indemnity Insurance.

3.1. To be noted, the Assessee had paid a sum of Rs.1,93,90,452/- towards legal fees, as also, a sum of Rs.1,81,327.50 towards Professional Indemnity Insurance to its legal adviser, one Hammonds, U.K.

3.2. The aforementioned amounts were arrived by the Assessing Officer, after applying the then prevalent rate of exchange qua expenses incurred by the Assessee in Pound Sterling.

4. According to the Assessing Officer, the Assessee could not claim deduction qua the aforementioned payments, under Section 37 of the Income Tax Act, 1961 (in short, 'the Act'). The reasons supplied by the Assessing Officer qua the legal fees was, that it was exorbitant and far in excess to the compensation received in the matter from the entity, which had infringed its rights in the registered software qua which, advice was received from its aforementioned legal adviser, i.e., Hammonds, U.K.

5. Notably, the compensation received by the Assessee Company was a sum of Rs.80,16,570/-, whereas, the legal fees, paid to Hammonds, U.K., after it had been converted to Indian Rupees, by the Assessing Officer, was a sum of Rs.1,93,90,452/-, as is indicated herein above.

6. In so far as the claim for deduction towards payment on Professional Indemnity Insurance was concerned, the Assessing Officer took the view that insurance, under the U.K. law, had to be taken out by the legal adviser, and, therefore, the deduction claimed could not be allowed, as it was incurred for business purpose.

7. The record shows that, the appellant, being aggrieved by the assessment order, carried the matter in appeal to the CIT (A). The CIT(A) reversed the view taken by the Assessing Officer and returned the following findings of fact, and allowed the expenses incurred, both towards legal fee and Professional Indemnity Insurance, under Section 37(1) of the Act.

"....7.1 The first finding of the Assessing Officer namely, incurring of expenditure of Rs.1.93 Crores towards legal fees to recover Rs.80,16,570/- is misconstrued on the facts of the case. The expenses

according to the Appellant were incurred to protect the source of income and hence the comparison attempted by the Assessing Officer is not correct. The expenses incurred to protect and maintain the title to the capital assets as well as to protect the source of income is on the revenue field and based on the citations given by the Appellant, I hereby hold that the first facet of the finding of the Assessing Officer is hereby reversed.

7.2. On the second facet, the Assessing Officer had held that there was no material on record about the details of the work carried out by the UK legal firm and in this regard, it was established by the Appellant that the payment was made to the legal firm their professional work as confirmed by them. Therefore, the said finding of the Assessing Officer is misplaced in the facts and circumstances of the case.

7.3. In so far as the quantum of legal fees paid and claimed in computation of taxable total income, the Assessing Officer committed a mistake in converting the foreign currency into Indian Rupees. According to me, the Officer ought to have considered the claim with reference to the UK Standards and in terms of the UK Standards, the incurring of expenditure under consideration was reasonable.

7.4. The other facet raised by the Assessing Officer while making the disallowance of legal expenses is with regard to the payment of such fees through Mr. Brijnath Personal Account and not from the Appellant's bank account. In this regard, I agree with the Appellant that the modus operandi is not relevant to consider the claim of deduction under consideration and the only consideration is on the genuineness of the transaction which according to me is proved beyond doubt by the Appellant."

8. A perusal of the aforesaid extract from the order of the CIT(A) would show that before him, an additional ground appears to have been taken by the Revenue, which was, that the payment of legal fee, in the first instance, had been made to Hammonds U.K., by the Director of the Assessee company, one, Shri. Brijnath via his personal account.

9. This aspect of the matter was also gone into by the CIT (A), who affirmed the genuineness of the transaction and allowed the deduction qua legal fee by holding that the "modus operandi" of payment was not relevant.

10. The Revenue, being aggrieved, carried the matter in appeal to the Tribunal. The Tribunal, in turn, sustained the view of the CIT(A).

11. Before us, Ms.Hemalatha, learned counsel for the Revenue raises the very same ground to assail the order of the Tribunal. It is the submission of the learned counsel for the Revenue that, since, the legal fee paid was far in excess to the compensation received, the same cannot be allowed as a deduction under Section 37(1) of the Act.

12. According to us, what has been lost sight of by the Revenue by advancing this argument is, that the Assessee company was protecting its rights in a registered software. The registered software was a property of the Assessee Company, which, one would assume, could earn the Assessee, revenue from time to time, as and when, it licenced its use by third parties. Therefore, to compare the value of compensation paid by the infringer of the right, (which was an entity by the name "Hanover Outsourcing", based in Pakistan), with the expenses incurred on legal fees, would be fallacious, to say the least.

12.1. Furthermore, as rightly held by the CIT(A), the Revenue, if, at all, ought to have compared the fees paid to Hammonds, with the fees demanded by a professional working out of U.K., qua a similar kind of work.

12.2. It is important to note that the CIT(A) has categorically held that the transaction between the Assessee and its legal adviser, i.e., Hammonds U.K., which, included the amount paid towards fee was genuine. If, that be the case, surely, this argument cannot be sustained.

13. We may also note that, though, this is not a submission, which was pressed before us, the amount paid towards Professional Indemnity Insurance, by the Assessee to Hammonds U.K., was also in order, as even though, Hammonds, was required to take out an insurance under the U.K. law, the legal adviser was entitled to recover the same from his client, i.e., the Assessee.

13.1. Therefore, on both counts, according to us, there is no flaw in the judgment of the Tribunal, as also that of the CIT (A).

14. Before we conclude, we may only indicate that the test to be employed for examining as to whether or not a particular expenditure incurred by an Assessee, be allowed, is that, which is, provided in Section 37 itself. Therefore, what is required to be ascertained is, whether or not, the expenditure in issue is laid out or incurred wholly and exclusively for the purpose of business, and that, it is not an expenditure, which is described under Sections 30 to 36 of the Act, or an expenditure

in the nature of capital expenditure or, if, an Assessee is an individual, it involves defrayment of personal expenses.

14.1. In ascertaining as to whether the expenditure has been laid out or expended wholly and exclusively for the purpose of business, what is to be borne in mind, is that, it is incurred on account of commercial expediency of the Assessee. The fact that the expenditure incurred by an Assessee is not propelled on account of any legal obligation, or that, it benefits a third party, would not come in the way of it being allowed, as long as it is incurred due to commercial expediency.

14.2. As to what is commercial expediency is to be looked at by Income Tax Authorities by placing themselves in the shoes of a prudent business person.

14.3. Further, the fact that a particular expense does result in a profit for the Assessee in the immediate proximity cannot form the basis of its disallowance. In incurring an expense, a business person could have a short and a long term perspective. The fact that in the short term the expense incurred does lead to a profit, cannot rule out the possibility of accretions of profits to the Assessee in the long run. These are business decisions best left to the wisdom of those who run and manage the business. Therefore, as long an expense is incurred, wholly and exclusively for the purpose of the business carried on by the Assessee, it ought to be, ordinarily, allowed under Section 37 of the Act. (See Sassoon J. David & Co. (P) Ltd., V. CIT, (1979) 118 ITR 261).

14.3. Thus, if, the aforesaid principles are applied, it is clear that notwithstanding the fact that the legal fee paid was more than the compensation received by the Assessee, the same, was amenable for deduction under Section 37 of the Act. Likewise, in so far as the expense incurred towards Provisional Indemnity Insurance was concerned, it could not have been disallowed, merely, by reason of the fact that Hammonds, U.K., was required to take out the insurance.

15. The appeal is, accordingly, dismissed, as according to us, there is no merit in the same.

16. There is no question of law, which arises for our consideration much less a substantial question of law. However, there shall be no order as to costs.

-s/d-

Assistant Registrar(CS II)

True Copy

Sub-Assistant Registrar

To

1.The Income Tax Appellate Tribunal,
'A' Bench, Chennai.

2.The commissioner of Income Tax (Appeals)-V
121, Mahatma Gandhi Road,
Chennai-34.

3.The Assistant Commissioner of Income Tax,
Company Circle IV (1)
Chennai-34

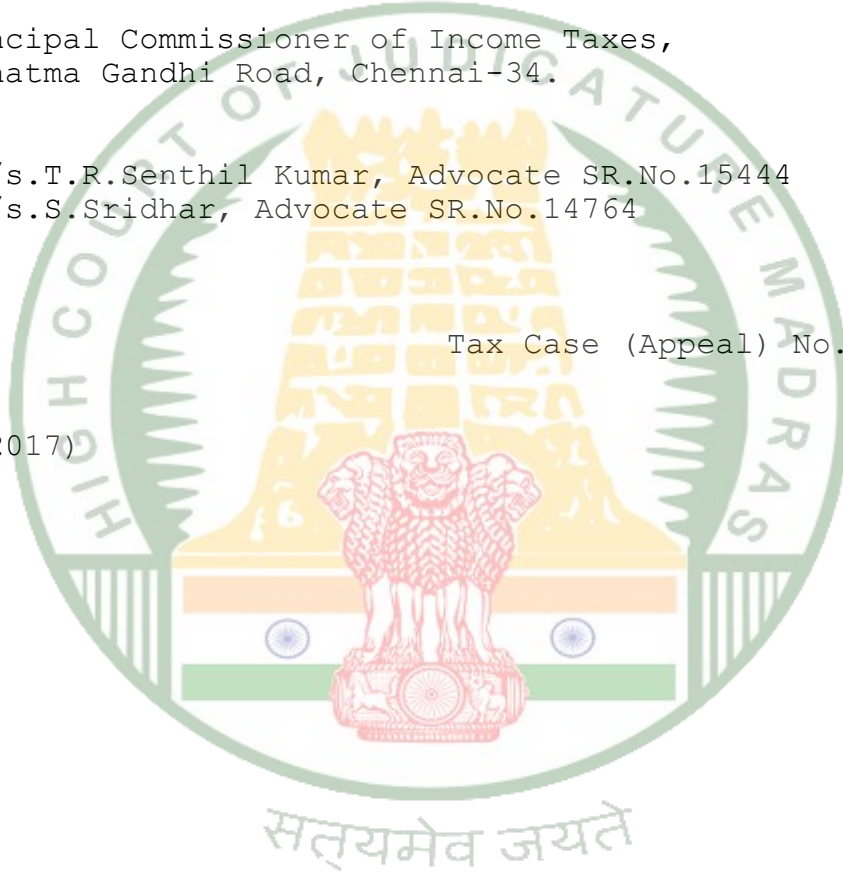
4.The Principal Commissioner of Income Taxes,
121, Mahatma Gandhi Road, Chennai-34.

+1cc to M/s.T.R.Senthil Kumar, Advocate SR.No.15444

+1cc to M/s.S.Sridhar, Advocate SR.No.14764

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GMI (CO)
GN(03/04/2017)



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