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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA No. 215/2017**

Date of decision: 31st October, 2018

PR. COMMISSIONER OF INCOME TAX, DELHI-10 Appellant
Through: Mr. Ajeet Sharma, Jr. Standing Counsel
for Income Tax Department.

versus

M/S INDIAN FARM FORESTRY DEVELOPMENT Respondent
Through: Mr. P. Roy Chaudhari, Mr. Amol Sinha
and Mr. Rahul Kochar, Advocates.

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CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL)

These appeals by the Revenue under Section 260A of the Income-Tax Act, 1961 ('Act' for short) in the case of Indian Farm Forestry Development Cooperative Ltd., relate to the Assessment Years 2008-09 and 2009-10 and

arise from the common order dated 26th July, 2016 passed by the Income Tax Appellate Tribunal ('Tribunal', for short). For convenience we would refer to the facts for Assessment Year 2008-09.

2. M/s Indian Farm Forestry Development Co-operative Limited ('respondent-assessee') is a registered multi-state co-operative society since 1993 under the Multi State Co-operative Societies Act, 1984 with the object of carrying-out social development activities for the village poor by way of undertaking projects in forestry development, developing water harvesting systems, creating job opportunities amongst tribals/poor villagers etc. For undertaking the said objectives the respondent-assessee had received funding from M/s Indian Farmers Fertilizer Co-operative Ltd., foreign agencies and various governmental bodies. The respondent-assessee had also undertaken trade and marketing of fertilizers, again towards the said objective. The respondent-assessee had performed and undertaken these activities as a business organization and not as a charitable institution.

3. Vide assessment order dated 30.11.2010 for the Assessment Year 2008-09, the Assessing Officer held that the expenses incurred by the respondent-assessee towards the said activities under the head "project expenses" were not deductible under Section 37 (1) of the Act for the following reasons:-

"8. The other issue in the case is as to whether the expenditure is laid out wholly and exclusively for the purpose of business.

The word "exclusively" refers to the motive, objective and purpose of the expenditure and gives jurisdiction to the taxing authorities to examine these matters.

Ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the, course of its or his business. Such expenditure may be incurred voluntarily and without any necessity, and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction therefore under section 37(1) even though there was no compelling necessity to incur such expenditure.

The manner to apply the test is to ask the question: "Has the expense been incurred with the sole object or furthering the trade or business interest of the assessee unalloyed or unmixed with any other consideration? If the expense is found to bear an element other than the trade or business interest of the assessee the expenditure is not an allowable one. To arrive at the conclusion that the expenditure was dictated solely by business consideration one has to consider the nature of the business, the way it is conducted and any likelihood of the business being adversely affected or its interest being promoted by the refusal or the incurring of the expenditure, as the case may be.

The case of assessee can be examined on these lines. There is no business expediency in the expenditure. The assessee has incurred the project expenses in implementing various schemes for social upliftment of farmers and weaker section of society. The expenditure is infact in the nature of donation but not covered U/s 80G of the Income-tax Act, 1961. Accordingly, it is an item to be considered below the line and is not an admissible deduction since not laid out wholly and exclusively for the purpose of business.

In view of this, the project expenses of Rs.3,18,74,070/- does not fulfill the condition of section 37(1) and cannot be treated as Revenue Expenditure. The expenses should be claimed by assessee below the line and should not be charged to P&L A/c. Accordingly, the expenses of Rs.3,18,74,074/- is disallowed and will be added in the

income of assessee U/s 37 (1) of the Income-tax Act, 1961.”

4. Assessment order dated 23rd December, 2011 relating to Assessment Year 2009-10 adopts the same reasoning.

5. The Commissioner of Income Tax (Appeals) rejected the aforesaid reasoning of the Assessing Officer. He held that the main objective of the respondent-assessee was to carry-out social development and welfare activities. The respondent-assessee had incurred expenditure for rural development, generation of additional employment, women’s empowerment and in development and construction of water reservoirs to effectuate and in furtherance of these objectives. The respondent-assessee had accordingly provided financial, technical and extension services to Primary Farm Forestry Cooperative Societies Ltd. and Primary Livelihood Development Cooperative Societies Ltd. This expenditure was clearly incurred to carry out the purpose and objective for which the co-operative society was established; and would qualify for deduction under Section 37 of the Act. Expenditure of such nature had been uniformly and consistently allowed under Sections 28 to 43 of the Act since 1993. Accepting that the expenditure was not capital in nature, it was held that the respondent-assessee had not created any tangible capital assets, which were to be utilized by them or assets which had an enduring benefit for them. The expenses incurred pertained to projects awarded by the Central Government, State Governments or foreign agencies for the benefit of the villagers and poor people. The assets belonged to the poor and deprived. They were not assets belonging to or owned by the respondent-assessee. Thus, the question whether the assets created were ‘capital’ in character would be

irrelevant, for the respondent-assessee was not the owner of the said assets. He observed that looking at the nature of the activities of the respondent-assessee the expenses were purely on account of commercial expediency and were incurred in routine business.

6. The aforesaid view and reasoning has been accepted by the Tribunal, who have referred to the object and purpose for which the respondent-assessee was established to hold that the object and purpose would be the relevant consideration for deciding whether or not the expenses incurred would qualify for deduction under Section 37 of the Act. The Assessing Officer had erroneously disallowed the expenditure ignoring the social welfare activities undertaken by respondent-assessee in terms with the objective and purpose for which it was established. They also agreed that the assets created in the form of forests, waste land, check dams, ponds etc. were the properties of the villagers and were managed through village communities. The assets did not belong to and were not owned by the respondent-assessee.

7. The reasons and grounds given by the Commissioner of Income Tax (Appeals) and the Tribunal do not merit interference.

8. Section 37 (1) of the Act reads as under:-

37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.

The word “wholly” in the above provision refers to quantum of expenditure and the word “exclusively” refers to the motive, objective and purpose of the expenditure. The expression “used for the purpose of business” requires that the expenditure should be incurred by the assessee in his capacity as a person carrying on business. The test is whether the money spent or liabilities incurred were laid out “wholly and exclusively for the purpose of business” in the sense they were incurred for the purpose of keeping the trade or business going or with the object of furtherance of trade and business interests. Such expenses are to be allowed as a deduction even if they are incidentally for the said objective and purpose.

9. In ***Ram Bahadur Thakur Ltd. Vs. Commissioner of Income Tax***, (2003) 261 ITR 390 (Kerala), interpreting Section 37 of the Act it was observed:-

"23. The broad principles that can be deduced from the aforesaid discussion on the scope of S. 37(1) of the Act vis-a-

vis the question of law involved in the case can be summarised as follows: (1) In order to constitute an expenditure falling under S.37(1) of the Act the six conditions, viz., (i) the expenditure should not be of the nature described in Ss. 30 to 36, (ii) it should have been incurred in the accounting year, (iii) it should be in respect of a business which was carried on by the assessee and the profits of which are to be computed and assessed, (iv) it should not be in the nature of personal expenses of the assessee, (v) it should have been laid out or expended wholly and exclusively for the purpose of such business and (vi) it should not be in the nature of capital expenditure should concur. (2) Though the expressions “for the purposes of the business” is wider in scope than the expression for the purpose of earning profits” and may comprehend many acts incidental to the carrying on of a business its limits are implicit in it and 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. (3) The expenditure incurred is on the ground of commercial expediency and in order, indirectly, to facilitate the carrying on of the business. (4) The fact that there was no compelling necessity to incur the expenditure on which deduction is claimed is irrelevant to constitute expenditure under S. 37(1) of the Act. (5) Even an expenditure incurred by an assessee in the course of his or its business voluntarily and without necessity can be allowed as a deduction under S. 37(1) of the Act if it is ‘ incurred for promoting the business and to earn profits even though there was no compelling necessity to incur such expenditure (6) If the payment of expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may enure to the benefit of a third party also. (7) In every case it is a question of fact whether the expenditure was incurred wholly and exclusively for the purpose of trade or business of the assessee (8) Where an assessee seeks to deduct from his or its business profits certain items of expenditure the onus of proving that such deductions are permissible is on the assessee. This is

particularly so when the claims are based on facts which are exclusively within the knowledge of the assessee. Thus, it is for the assessee to plead and prove before the authorities that the expenses are incurred wholly and exclusively for the purpose of the business of the assessee. (9) When a claim for deduction of an expenditure under S. 37(1) of the Act is made by an assessee the assessing officer is bound to conduct an enquiry as to whether the assessee satisfied all the requirements of the section before either allowing or rejecting the claim. The officer cannot mechanically either allow the deduction or deny the same. We make it clear that these are not exhaustive and the application of these principles may vary from case to case and will depend on the facts and circumstances of each case."

10. In *Additional Commissioner of Income Tax, Bhopal Vs. Kuber Singh Bhagwandas* (1979) 118 ITR 379 (FB), Full Bench of the Madhya Pradesh High Court had dealt with a factual situation wherein assessee had made donation to Chief Minister's Draught Relief Fund, which was claimed as an expenditure under Section 37 of the Act, being in the nature of expenditure incurred wholly and exclusively for the business of the assessee. Notwithstanding Section 80G of the Act, this judgment holds that the expenditure would be allowable as a deduction when it has direct and immediate connection with the business and was laid out by the tax payer in his character as a trader and was incidental to his business. Mere fact that it was voluntary, in the sense that it was not necessary under the law or that it would benefit a third person or the public at large, would not be a disqualification to disallow the said expenditure under Section 37 when the stipulation of wholly and exclusively for the purpose of business was satisfied. In the said case, it was observed that the object of making donation to the Chief Minister's Relief Fund was a matter of commercial

expediency to facilitate obtaining of permits which were necessary for the trade. Permits were granted in proportion to the donations made and thus, there was a nexus. The contention of the Revenue that the expenditure had dual purpose of business and charity was without merit and it did not matter whether the expenditure had resulted in benefit to a third party or charity. The reason being that the commercial expediency has to be given an expanded and not restricted meaning. Noticeably, while examining the Income Tax Bill, 1961, the Legislature had rejected inclusion of the word “necessarily” in Section 37 (1) of the Act, agreeing with the Select Committee. Thus, the expression “for the purpose of business” is wider in scope than the expression “for the purposes of earning profits”. This decision also refers to case law where political donations have been allowed as a deduction where they were made for the purpose of trade and not when there was no nexus between donation and business of the assessee. Whether expenditure was incurred for the purpose of business is therefore not limited to any existing practice prevailing in any particular trade or business. The expenditure would satisfy the said test if it is for the purposes of business.

11. ***Kuber Singh Bhagwandas*** (supra) was referred to with approval by the Supreme Court in ***Sri Venkata Satyanarayana Rice Mill Contractors Co. V. CIT, A.P.II*** (1996) 6 SCC 611 to hold that money expended even voluntarily on the grounds of commercial expediency in order to indirectly facilitate carrying on of the business should be regarded as expended wholly and exclusively for the purpose of trade. In this case, following passage from ***Atherton v. British Insulated & Helsely Cables*** (1925) 10 TC 155 was quoted :-

“[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 trade....”

12. ***Sri Venkata Satyanarayana Rice Mill Contractors Co.***(supra) had held that contributions made by the assessee to public welfare fund could be allowed as allowable expenditure under Section 37 of the Act where they were directly connected or related to the business of the assessee or had resulted in benefit to the business. It would not matter whether the said expenditure is in the nature of donation, charity, for public cause or results in public benefit, for this would not be good reason to deny the assessee deduction under section 37 of the Act when the payment is for the purpose of the assessee's business.

13. In the facts of the present case, the object and purpose of the respondent-assessee is to engage and work for social and economic upliftment of the rural poor, construct water reservoirs etc. It is established for this purpose and receives grants and donations from third parties with the said objective and purpose. M/s Indian Farmers Fertilizer Cooperative Ltd. had sold and supplied fertilizer that was marketed/sold by the respondent-assessee to earn profit/income, because the respondent-assessee was engaged in social and economic development activities. Association and business relationship with M/s Indian Farmers Fertilizer Cooperative Ltd. was predicated and connected on the respondent-assessee performing and undertaking the social-welfare economic activities. Grants received from government and foreign agencies were to be utilized for the specific purpose

i.e. the object and purpose of social and economic upliftment etc. If the respondent assessee was not engaged in and had not undertaken the aforesaid activities, it would not have received the grants and would not have undertaken sale and marketing of fertilizers. The respondent-assessee was therefore required to incur the said expenditure, in order to run, operate and continue its business.

14. We perceive that there is a degree of contradiction in the plea raised by the Revenue, when they claim that the respondent-assessee was not engaged in 'business' or the expenditure incurred was not on account of business expediency. Income earned by the respondent-assessee has been treated and taxed under the head profits and gains of business and profession. In the given facts, it would be incongruous for the Revenue to urge that the purpose and goal behind the activities undertaken by the respondent-assessee was not commercial but charity as the intent and motive behind them was not to earn profit. The expenditure incurred to carry out social and economic development would in this background constitute a 'business' or 'commercial' activity undertaken by the respondent-assessee. It would be a contradiction in terms, if we hold that the expenditure would be non-deductible expenditure or expenditure without business expediency. Under section 37 of the Act it does not matter whether or not the expenditure was in the nature of donation or Section 80G of the Act was not attracted. The conditions stated in Section 37 of the Act matter and constitute the test. Expenditure incurred in furtherance of and connected with the business and commercial activities for which the respondent-assessee was established cannot be disallowed as expenditure not relatable and incurred for 'business' purposes.

15. On the question of capital expenditure, the assessing officer did not refer to or examine whether the capital assets created were for third party villagers. The respondent-assessee was not the owner of the assets created and developed. The assets created were not capital assets in the hands of the respondent-assessee. The respondent-assessee had contributed, developed, financed and created assets which belonged to third persons. The expenditure incurred therefore would not be 'capital' in nature in the hands of the respondent assessee.

16. Accordingly, the appeal filed by the Revenue has no merit and is dismissed, without any order as to costs.

SANJIV KHANNA, J.

ANUP JAIRAM BHAMBHANI, J.

OCTOBER 31, 2018
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