PETITIONER:
M/S AMALGAMATION PVT. LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX,MADRAS

DATE OF JUDGMENT: 25/04/1997

BENCH:
S.C. AGRAWAL, K.S. PARIPOORNAN

ACT:

HEADNOTE:

JUDGMENT:
W I TH
CIVIL APPEALS NOS. 7-11 OF 1980
JU D G ME N T
S.C. AGRAWAL, J. :-

These appeals, by certificate of fitness granted by the Madras High Court under Section 66(A)(2) of the Income Tax Act, 1922(hereinafter referredto as 'the 1922 Act') and Section261 of the Income Tax Act, 1961(hereinafter referred to as'the 1961 Act') read with Article133 of the Constitution of India,are directed against the Judgment of the Said High Court dated March 1, 1976 in Tax CasesNos. 160 of1969 and 239 of1971 (References Nos. 52 of 1969 and 1 of T.C. No. 160 of 1969

"(1) Whether, on the facts and in the circumstancesof the case, the Tribunal was rightin upholding the basis of valuation adopted by the Income-taxofficer for the shares inMessrs. Sri Rama Vilas Service (Private) Ltd. as on January 1, 1954?

(2) Whether, on the facts and in the circumstancesof the case, the Tribunal was right in holding that the proviso to section 12B(2) has noapplication in regard to the sale of shares to M/s Simpson & Company Ltd ?"

T.C.No. 239 of 1971

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the proviso to section 12B(2) has noapplication in regard to the sale various sharesby the assessee-company to M/s Simpson & General Finance Co. (Private) Ltd. and that the assessee wasentitled toa capital loss of Rs. 9,47,541/- inthe assessment year 1958-59?

(2) Whether, on the fact and in the circumstancesof the case, the Tribunal was right in law in holding that the second proviso to section 12B(2) had no application and that the full value of the consideration accounted for by the assessee should not be altered ?"

These questions arise in the following facts and circumstances.

M/s Amalgamation Private Limited (hereinafter referred to as 'the assessee-Company' )is a company incorporated on December 22,1938 as a private limited Company. The assessee-companyheld shares in several companies, such as simpson and Company Ltd., Addison & Company Pvt. Ltd.,George Oakes (Private) Ltd., Addison Paints & Chemicals private Ltd., India pistons Private ltd., etc. Out of the issued capital of Rs. 7,50,000shares of Rs. 10 in Simpson andCompanyLtd. the assessee-company held, atthe material time, 7,06,933 ordinary shares. Simpson and Company Ltd, hada subsidiary by name simpson and General Finance Company (private)Ltd, Carrying on the business offinancing by way ofhire purchase transactions to outsiders and by wayof loans and advance to the companies of this group. As onJuly 1,1956 a sum of Rs. 1,85,16,000/- was due to Simpson and General Financecompany (Private) Ltd. from the assessee-company. Under Section 295 of the Companies Act,1956 which cameinto force on April1, 1956 no company could, without obtaining the previous approval of the CentralGovernment inthat behalf , directly or indirectly, make any loan to a company, which is its holding company . In sub-section (3) of Section 295 itis provided that where any loan madeby a lending companyand outstandingat the commencement of the companies ace, 1956, could not have been made withoutthe previous approval of the Central Government If that section hadthen been in force,then the lending company had to, within six months from thecommencement ofthe Actor suchfurthertime not exceedingsix months asthe Central Government might grant for thatpurpose, either obtain the approval of the Central Government to the transaction orenforce the repayment ofthe Loan made. The liability of Rs. 1,85,16,000/- to Simpson and General Finance company (Private ) Ltd. by theassessee-company was affected by the aforesaid provision and, therefore, itbecame necessary for the asessee-company to liquidate this liability. Simpson and GeneralFinance Company (Private) Ltd. owed a sum of Rs. 1,05,21,750/- to Simpson and Companyltd. The assessee-companyapproached theGovernment of India for necessary approval to put through certain transactions sale of shares held by it tosimpsonand General Finance Company(Private) Ltd. in liquidation of the liability. Simpson and General FinanceCompany(Private) Ltd.,in its turn, would discharge its liability to Simpson and CompanyLtd. by selling its holdings to simpson and General Finance Company (Private) Ltd. The assessee-company as well assimpsonand General FinanceCompany (private) Ltd. proposed to sell the shares at certain specified price per share and soughtthe approval of theCentralGovernment for such sale .The Central Government, inapproving the sale, fixed its own prices and stated that the said fixationwas without prejudice to any valuation ofsharesfor purposesof capital gains. Thereafter the shares held by theassessee-company in variouscompanies in respect of which approval hadbeen grantedby theCentral Government were transferred by the assessee-company to Simpson and General Finance Company

(Private ) Ltd. with effect from June13,1957at the price fixed by the Company Law Administration andSimpson and GeneralFinance company (Private) Ltd.sold part thereof to Simpsonand Company Ltd. The Transaction between Simpson and GeneralFinance Company (Private) Ltd. andSimpson and CompanyLtd. was also at the same prices.

Insubmitting itsincome tax return for the assessment year 1958-59, the relevantprevious yearendingJune 30,1957, the assessee-company claimed a capital loss of Rs. 4,37,703/- in respect of theabove the transaction. In arriving at this lossthe assessee-company opted for the substitution of the Market Value as on June1, 1954 in respectof shares in (1) S.R.V.S (Private) ltd., (2) Addison & Company Ltd., (3) George Oakes (private Ltd., and (4) India Pistons (Private) Ltd. As regards the rest of the shares,the assessee-company adopted the cost prices. The Income Tax Officer, while making the assessment, proceeded on thebasis that the pricestructure approved by the department of Company Law Administration for the transfer of the aforesaid shares was pure and simple on an add hoc basis and meant to serve the limited purpose of approval to be given under section 372 of theCompanies Act, 1956 andthat the price at whichthe sales took place couldnot, therefore, be taken to represent thefair market value of the Shares. Hetook the break- up value as on January 1, 1954 for the purpose of computation of capital gains and revisedthe sale pricesand arrived at Rs. 6,95,082/- as the net capital gains. Even according to his computation there were certain capital determined by him. In the case of S.R.V.S. (Private) Ltd. the Income Tax Officer took the break-up valueas on January 1,1954 at Rs. 36,35,350/- and their sale value at Rs.21,88,395/- resulting in the capital loss ofRs. 14,46,955/-.

The assessee-company appealed against the assessment of the capital gains to the Appellate Assistant Commissioner. While the saidappealwas pending, the Commissioner, of Income Tax proceeded Under Section 33B of the 1922 Act as he was of the viewthat the order of the Income Tax officer was erroneous and prejudicial to the interest of revenue in so far ashe had wrongly allowed the capital lossamounting to Rs. 14,46,955/- on the sale of thesharesin S.R.V.S. (Private) Ltd.After considering the submission of the assessee-company, the Commissioner held that the appreciation in value of the shares of Simpson and Company Ltd. held by S.R.V.S.(Private) Ltd.should not havebeen taken into account and if the value of the shares held by S.R.V.S.(Private) ltd.in Simpson & Company Ltd. , as on January1,1954had been Rs. 24,38,578/- S.R.V.S. (Private) Ltd. would not have parted withthese shares atcost onJuly 31,1955. The commissioner revised thecapital loss of Rs. 14,46,955/- allowed by the Income Tax Officer and considered that there wascapital gain liable for assessment of Rs. 3,91,579/-. This figure was directed to be substituted and the assessment of capital gainswas revised accordingly.

The assessee-company appealed against the said order of he Commissioner to the Tribunal contending that thesale value fixed bythe Company law Administration represented the correct value of the shares and the transactionswere withoutany motive toavoid capital gain and they hadbeen necessitated by the various provisionsof the Companies Act which prohibited inter-companyloans and that the method adoptedby theIncomeTax officer, viz., the secondary valuation, wasproper.The said appeal was allowed by the Tribunal and the order of the Commissioner of Income Tax was set aside and the method adopted by the Income Tax Officer

of Secondary Valuationwas held to be proper, The Appellant Assistant Commissionertook upthe appeals of the assessee-companyfor this and other years subsequent tothe order of the Tribunal and following the Tribunal's order he worked out the Capital loss in respect of the othershares under consideration and in effect accepted the assessee-company's claim of capital loss of Rs. 4,37,703/-. The said order led to appeals both by the assessee-company and the Revenue to the Tribunal.The assessee-company's appeal related to computation of the capital loss of Rs. 4,37,703/- as emerging from the order of theAppellate Assistant Commissioner instead of Rs. 4,90,244/- whichwould be the correctfigure. The Revenue contested the acceptance of the Claim of the assessee-company with reference to the capital loss of Rs. 4,37,703/-as shown in thereturns.

Onthe first occasion when the matter come before the Tribunal; it remanded the case to the Appellate Assistant Commissioner and called for aspecific finding whether the sales under consideration were effected with the object of avoidance of tax or reductionof liability totax andalso Wanted the full value of considerationto be worked out, in case the first proviso to section 12B(2) of the1922 Act was held to be applicable.The Appellate AssistantCommissioner observed that there wasample evidence to show that thesale of shares was aforced one and that theassessee-company had no option but to comply withthe statutory provisions and that the evidence produced clearly established the assessee-company's contention that the sale wasnot motivated by any desire to avoid capital gainsand that the Revenue had not proved by any conclusive evidence that the motive underlying the transaction was the avoidance or reduction of the liability to capital gains tax.He worked out the figures in accordance with the rules framed under the wealth Tax Act and found that thepricesfixed by theCompany Law Administration were notvery much different from the figures worked out byhim. After receivingthe report of the Appellate Assistant Commissioner, theTribunal considered the matter again and held that the proviso to Section 12B of the 1922 Act could not be invoked in the instant case as there was no evidenceto support theview that the sales were effected with a view to avoid the provisions of Section 12B. The Tribunal accepted the contention of the assessee-companyand held thatthe Revenue was not justified in computing the capital gains anddisturbing the figures fixed by theGovernment of India. The two questions referred in T.C. No. 160 of 1969 arise outof proceedings under Section 33B of the 1922Act, while questions Nos. land 2 referred in T.C. No. 239 of 1971 arise outof the order ofthe Tribunal in theappeal againstthe order of the Appellate Assistant Commissioner inrespectof the assessment year 1958-59.

Since thesecond question in T.C. No. 160 of 1969 and questions Nos.1 and 2 in T.C. No. 239 of 1971 raisedmore or less the same issue, they were taken up together by the High Court. After referring to the provisions of Sections 12b (2) and more particularly the first proviso to thesaid sub-section, the High Court has observed that the first requisite for the applicationof the said proviso, namely, that the person to whom the sale is made should be a person with whom the assesseeis directly or indirectly connected, was satisfied in the present case because the sale of shares to a subsidiaryof a subsidiaryis one to a person withwhom the assessee-company isdirectly or indirectly or indirectly connected. As regards the second requirement ofthe proviso, as to whether the sale was effected with the object of avoidance or reductionof theliability of the assessee-

companyunder that Section, the High Court has pointed out that the object with which the transaction was put through was the avoidance or reduction of the liability to capita gains. According to theHigh Court, such a finding of taking the result as if it was the object would not satisfy the requirement ofthe first proviso to Section 12B(20 of the 1922 Act. The High Court was of the view thatthe tribunal had rightly called fora finding on this pointspecifically from the appellate Assistant Commissioner. After referring to the finding recorded by theAppellate Assistant Commissioner, which was accepted by the Tribunal, that the Object of the transaction wasnot toavoid or reducesuch liability to capital gains tax, that the saleswas a forced case since theassessee-company had no optionand that the prices had beenfixed by the company law Administration, the High Court held that the first proviso to Section 12B(2) cannot be attracted tothe present case. The High Court did not accept thecontention urged on behalf of the Revenue that the sale price had beenfixed by thecompany law Administration on ad hoc basisand, inthis context, it has observed that the letter dated May 18of 1957(Annexure G. VII. At the remand report of theAppellate Assistant Commissioner) clearly shows that the company Law Administration worked out the figures in consultation.with the Central Board of Revenue and whenthe assessee-company sold the shares at those prices, itcould not be validly contended thatthe assessee-company transferred the shares at certain prices withthe object of avoidanceor reduction of liability to capital gains. On that view the High Court answered the second question in T.C. No.160 of1969 and the second question in T.C.No. 239 of 1971 in the affirmative and against theRevenue.

Asregards the first question inT.C. No. 160 of1969 which raises the question of valuation, the High Courtfelt that onthe view it hadtaken as regards the second question it would not survive for considerationbecausethe question of valuation would be materialonly ifthe proviso applied. The High Courthas, however, considered the said question and hasindicated the answer tothat question also. TheHigh Court has expressed the view that this is a case of substantial holding andthat there is textual backing to the method adoptedby theIncomeTax officer and that the Commissioner had foundfault with it without any valid reason. The High Court, therefore,answered the first question in T.C. No. 160 of 1969 inaffirmative and in favour of the assessee-company.

Asregards the first question in T.C. No.239 of 1971, the High Courtfelt that it did not require any independent treatment in view of the answer given with regard to second question in T.C. No. 160 of 1969 which would answerthat question also. Therefore, that questionalso was answered in the affirmativeand in favour of the assessee-company.

Wehave heard Shri K.N. Shukla,the learned senior counselappearing for the Revenue in support of the appeals in respect of the answers given by the High Court to these questions,. Having considered the submissions of the learned counsel, we are of the view that the High Court to these questions, Having considered the submissions of the learned counsel, we are of theview that the High Court has rightly construed the provisions contained in the proviso to section 12B(2) of the 1922 Actand, inview ofthe finding recorded by theAppellate Assistant Commissioner , which finding was accepted by theTribunal, that the object of the transaction was not to avoid or reduce the liability to capital gains, the said proviso was not attracted. In our opinion, thesaid

findingof theHigh Court does not suffer from any legal infirmity and there is no ground tointerfere with the judgment of theHigh Court on this aspect of the case .

Wemay now take up the appealsof the Revenue in respectof questions Nos. 4, 5 and 6 in T.C. No. 239 of 1971.

The said questions were as follows:-

"(4) Whether, on the facts and in the circumstancesof the case, the Appellate Tribunalwas right in law inholding that the loss sustained by the assessee on account of standing guarantee to sembiam Saw Mills (Private) Std. (in voluntary liquidation) should be allowed in 1962-63 assessment after taking into account the amountsreceived from theliquidators during the years 1959-60 to 1962-63 ?

(5) Whether, on the facts and in the circumstances of the case , the Tribunal was right in law in deleting the receiptsof Rs. 1,41,000/-, Rs.2,29,627/-, Rs. 1,10,500/-and Rs.4,381/-from the liquidators of Sembiam Saw Mills (Private) Ltd. (in voluntary liquidation), from the assessments for 1959-60, 1960-61,1961-62 and 1962-63 respectively?

(6) Whether, on the facts and in the circumstancesof the case, the Appellate Tribunalwas right in law inholding that an amount of Rs. 4,23,256/- representing the real loss sustained bythe assessee on account of standing guarantee of Sembiam Saw Mills (Private) Ltd. (in voluntary liquidation) should beallowed in the assessment year 1962-63?"

There was a company by name Sembiam Saw Mills (Private) Ltd. (for short'SSM'),which was originally a subsidiary of Addison& company (Private) Ltd. On and from February 1, 1954, the assessee-company purchased all the shares of SSM from M/s Addison & company (Private)Ltd, and SSMthus became the direct subsidiary of the assessee-company. SSM had borrowed monies from the National Bank of India Ltd, and the assessee-company had guaranteed theloan tosaid company by thesaid Bank. SSMwent into liquidationsome time in 1995. For the purpose of overdraft facilities SSM executed a promissory note in favour of the assessee-company which was endorsed by the assessee-company to the Bankalong with a separate guarantee letter in favour of the Bank. When SSM went into liquidation,the assessee-company, as guarantor, was required to clearthose overdrafts in accordancewith the terms of the guarantee. After adjusting the amount recovered from the liquidators,the sumdue to the assessee-companyfrom the liquidated company on account of thesaid overdraft was Rs. 9,08,764/-.The assessee-company claimed this amount asa losswhich arose in the Course of and incidental to its business inthe assessment for the 1958-59. There werereceipts by the assessee-company in the course of the liquidation of SSM in the later years, The

total amount received came toRs. 4,58,508,28 spreadover the relevant accountingyears for the assessment years 1959-60 to 1962-63.The assessee-company relied on the clause in the memorandumof associationauthorising it to be the guarantor for the loans and contended that thetransactions in question sprang out of normal business transactions and hence the losswas an allowable deduction in the assessment for 1958-59. The Income Tax Officer held that the loss in question did not arise during the course of or incidental to the business of the assessee-company and in his view it was at best a capital loss which did not come within the scope of Section 12Bof the1922 Act. In making the assessments for the years 1959-60to 1962-63 theIncomeTax officer treatedthe receipts from theliquidator as income as a protective measure. In appeal theAppellate Assistant Commissioner did not accept the claim of the assessee-companyfor allowance of the loss in1958-59as he was of the view that it was not a loss which arose during the course of or was incidental to its business. But the appeals for the years 1959-60to 1962-63 wereallowedin so far as they related to thequestion of the receipts in the respective years from the liquidator. As the guaranteeloss had not beenallowed as adeduction in 1958-59, the Appellate Assistant Commissioner heldthat the subsequent recoveries could not be included in the total income in the later years. The assessee-company as well asthe Revenue Preferred appeals against thesaid order of the Appellate Assistant Commissionerbefore the Tribunal. The Tribunal held that the assessee-company had guaranteed the loan in the course of carrying on its own business and that theloss was clearly admissible as a deduction. But since the assessee-company had received the lastof the paymentsfrom the liquidator in the previous year relevant to the assessment year 1962-63 it washeld that the balance of Rs. 4,23,256/- remaining unrecoverable represented thereal business loss allowable for the assessment year 1962-63. At the instance of the Revenuethe Tribunal referred the aforementioned questions Nos. 4,5 and6 for the opinion of the High Court.

The High Court, while dealing with said questions, has observed that the real pointin issue waswhether the guarantee that was executed in favour of the Bank in respect of theloan toSSM, the subsidiary of the assessee-company, was done in the course of itsown business. The High Court has referred to its earlier judgmentin Amalgamations P. Ltd. V. Commissioner of Income Tax, (1969)73 ITR380, whereinthe nature ofthe business ofthe assessee-company has been considered andit has been held that the provisions of Section 23Aof the1922 Act were applicable to the assessee-company since the assessee-company's business includes furnishing guarantee to debts borrowed by subsidiary companies. The HighCourt has held that thesaid findinggiven in thatcase is clearly applicable to the questions under consideration before it and that the assessee-company had incurred the loss in carrying on its own business which includes furnishing guarantees to debts borrowed by its subsidiary companies. According to theHigh Court, the loss was allowable as a deduction in the year in which it came to be ascertained and inthe instant case the High Court held that the assessee-company couldhave ascertained whether there wasloss in the transaction of guarantee only at the stage of final payment by the liquidators which was received in the relevant previousyear for the assessment year 1962-63 and that theTribunal was right in allowing it in that year, TheHigh Court,

therefore, answered questionsNos. 4, 5 and 6 in the affirmative andagainstthe Revenue.

After hearing Shri Shukla on theappealsfiled by the Revenuein respect of these questions, we are unable tohold that the judgment of the High Court in respect of these questions suffers fromany legal infirmity. We, therefore, affirm the answer given by theHigh Court to questionsNos. 4,5 and 6 referred to it . In the circumstances, it must be held that Civil Appeals Nos. 139-142of 1980filed by the Revenueare liable to be dismissed.

Wewould now come to Civil Appeals Nos.7-11 of1980 filed by the assessee-company in relation to questionNo.3 in T.C.No. 239of 1971, which was as under :-

"(3) Whether, on the facts and in the circumstancesof the case, the Appellate Tribunalwas right in law inholding that the sums of Rs. 437,066/-, Rs. 90,896/-, Rs. 1,08,978/-, Rs. 1,18,102and Rs. 1,11,740/- are admissible as a deduction in the assessments of the assessee for the assessment years 1958-59 to1962-63respectively ?"

The assessee-company was a bulk shareholder in several companies and in therelevant yearthere were sixteen companies. The assessee-companywas rendering certain common services to its subsidiaries by having (1) a finance committee: (2)a liaison office in Delhi; (3) an export promotion department; and (4) an internal audit department. The expenditure on account of maintenance of liaison office in Delhi andthe departments of export promotion and internal auditwas borne by the assessee-company and was recovered fromthe subsidiaries. The finance committee was workingin an advisory capacity to the various subsidiary companies to help them to carry on their businessmore efficiently. All purchase requisitions for the purchase of capitalequipment beyond Rs. 500/- of each purchase and Rs. 2,500/-with referenceto purchase of raw materialswere submitted to the finance committee for their approval. The purposeof such control was tojudiciously usethe funds of the company tothe best advantage of each company. Various data were gathered before such sanction wasaccorded or refused, Technical matters orother matters of management were also referred tothe members of the finance committee who were experienced intheir respective fields. The finance committee went through the financial position ofeach companydaily.The directors of the assessee-companywere also Directors/managers in thesubsidiary companies. As per the service agreements between them and the concerned subsidiary company they were entitled to payment of remuneration and also acertainpercentage of the profits as commission. Similar service agreements had been entered by other directorsof the subsidiary companies whowere not the directors of the assessee-company. In view of the provisions of Section 198of the Companies Act, 1956, fixing a ceiling on theoverallmanagerial remuneration at 11% of the net profits of the company, itwas not possible for the subsidiary companies to pay the contracted remuneration to the persons concerned. On April 4,1959 the Board of Directors ofthe assessee-company passed a resolution wherebyit wasresolved that the remuneration payable to nine directorsof the subsidiary companies would be paid to them in full in accordance with the terms ofthe contract respectively entered into by them and the amount in excess of themaximumamountpermissible under the CompaniesAct,

1956 would be met by the assessee-company. Out of thesenine directors three were directors of theassessee-company and out of these three directors two were members of the finance committee, Noneof the other six directors of the subsidiary companies was a member ofthe finance committee. In accordance with the said resolution the assessee-company paid diverse amounts to thesaid directors. The total amountsso paid to the several persons for the different years are mentioned in question No.3.The assessee-company claimedthe said amounts as deductionunder Section 10 (2) (XV) of the 1922 Act for theassessment years 1958-59 to 1961-62and under Section 37of the 1961 Act for the assessment year 1962-63. Before the Income Tax Officer it was not disputed thatthese paymentswere in respect of services rendered by respective persons tothe various subsidiary companies of whichthey were directors/managers and that no part of the payment could be related to any servicedirectly rendered by them to the assessee-company. It wassubmitted thatthough the services were rendered by them to other companies, theyshouldbe deemed tohave rendered the service to the assessee-company in view of the nexus between the holding company and its subsidiaries, The Income Tax officer did not accept this submission andheld that the excess remuneration over and above what was admissible under Section 198 ofthe Companies Act, which was not borne by the respective companiescould not be allowed as deduction under Section 10(2)(XV) of the1922 Act and Section37 ofthe 1961 Actas expenditure wholly and exclusively incurred for the purpose of the business of the assessee-company. It was alsostressed that the resolution of the Board ofDirectors of the assessee-company was passed on April 4, 1959, after the previous years relevant to the assessment years 1958-59 and 1959-60, On appeal the Appellate Assistant Commissioner tookthe same view, The matterwas remanded by theTribunal to the Appellate Assistant Commissionerfor consideration and submission of report on the points mentioned in theorder of remand. The Appellate Assistant Commissioner after taking further evidence submitted his report wherein he reportedthat deduction may be allowed in respect of remuneration paid to personswho were directors of the assessee-company andwere membersof thefinance committee, butsuch deduction could not beallowedin respect of remuneration paid by the assessee-company in respect of the persons who wereonly directors and employees of the subsidiariesbut neither directors of the assessee-company nor members of the finance Committee. TheTribunal was ofthe view that looking to the nature of the business of the assessee-company of holding shares of a number ofsubsidiary companies and that it was lookingafter the interest and welfare of those companies with aview toearn dividends,the whole of the expenditure referable to the remunerationpaid bythe assessee-company was admissible as a deduction.

Rejecting the contention urged on behalf of the Revenue that the assessee-company wasnot carrying onany business becausemerelyholdingof investmentswould not constitute business, the High Court has held that in view of Section 23A ofthe 1922 Act holding of investments, in appropriate cases, would equally be a business as dealing in them and what is required is that there must be a real substantial and systematicor organised course of activity or conduct with the set purpose ofearningprofit which isthe test for a business. The High Court has observed that the assessee-companyis nota mereinvestor in a single company but has investments in sixteen companies and had taken active

Interest in thebusiness of these companies as is clearfrom the services that hadbeen rendered in the shape of export promotion, liaison office at Delhi and internalaudit and it also rendered consultation inrespectof finance by its directors meeting every day with reference to the needs and requirements ofeach company and that it is nota case where the assessee-company contenteditself with merely making an investment and looking for the dividend, The High Courthas, therefore, held that there was a business activity in the matter of holding of investments. While dealing with the question whether the expenditure that has beenincurred was wholly and exclusivelylaid out for the purpose of the assessee-company's business, the HighCourt has negatived the contentionthat the said question is purely factual becausein order to be deductible the expendituremust satisfytwo tests: (1) the expenditure must be uncurred by the assessee in his capacity as a trader; and(ii) itmust be incidental to the carryingon of his business. TheHigh Court was of the view that there must be a nexus between the expenditure andthe business ofthe assessee. Applying these tests the HighCourt has held that the purpose of the paymentin thepresent case was only to take out the subsidiary from an inconvenient situation in which it found itself as a result of statutory change restricting the remuneration payableto itas director and that the expenditure had not been incurred wholly and exclusively for thebusiness of theassessee-company and itcould not be allowedas deduction. The alternativeclaim put forward on behalfof the assessee-company that at any rate the expenditure incurred bythe assessee-company inremunerating its own directors whowere also members forthe finance committee should be allowed as deduction as there is a nexus betweenthe expenditure and the business of the assessee-companyin rendering servicesto its subsidiaries, was not accepted by the High Court for the reason that the resolution passed by the assessee-company doesnot saythat the expenditurewas incurred for the purpose ofremunerating its own directors is so far asthey rendered services to it as members of the finance committee. The High Court has observed that the resolution treated the directors, whether they be the members of the finance committee or notas a class and with reference to allof themthe assessee-company incurred the expenditure onlybecausethey could not be remunerated tothat extent bythe subsidiary companies and the fact that they weremembersof the finance committee had not been takeninto account intaking over theremuneration payableto them, Question No. 3 was, therefore, answered in the negative and against the assessee-company.

The amounts paid by the assessee-company to the directors of its subsidiary companies can be admissibleas a deduction under Section 10(2)(XV)of the 1922 Act exclusively for the purposes of the business" of the assessee-company, Thisexpression was also used in the IncomeTax Act, 1918 in U.K. In Atherton V. British Insulated and Helsby Cables Limited, (1925) 10 TC 155(HL), Viscount Cave, L.C., has thus explained thesaid expression:-

> "..a sum of moneyexpended, not of necessity and with a view to a direct andimmediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitatethe carrying on of the business,may yet beexpended

wholly and exclusivelyfor the purposes of the trade."
[p.191]

These observations have been referred to with approval by thisCourt while construing Section 10(2)(XV) of the1922 Act. [See : Eastern Investments Ltd.V. Commissioner of Income Tax, V. Chandulal Keshavlal & Co., (1960) 38 ITR601]

InTravancore Titanium Products Ltd. V. Commissioner of Income Tax, Kerala, (966) 60 ITR 227, thisCourt while construing theexpression " for the purpose ofbusiness" in Section10(2) (XV) of the 1922 Act, hassaid :-

"The expenditure must be incidental to the business and must be necessitated or justified by commercialexpediency. Itmust be directly and intimately connected with the businessand belaid out bythe taxpayer inhis character as atrader. To be a permissible deduction,there must bea direct and intimate connection between the expenditure and the business i.e. between the expenditureand the characterof the assessee as a trader, and not asowner of assets, even if they are assets of the business."

InThe Indian Aluminium Co. Ltd. V. Commissioner of Income Tax, (1972) 84ITR 735, decided by aConstitution Bench of this Court, the aforementioned testlaid down in Travancore Titanium Products ltd. V. Commissioner of Income Tax, Kerala (supra), was qualified in these terms :-

"In our view, the test adopted by this Court in TravancoreTitanium case that to be a permissible deduction,there must bea direct and intimate connection between the expenditure and the business; i.e., between the expenditureand the characterof the assessee as a trader, and not asowner of assets, even if they are assets of the business' needs to be qualified by startingthat if the expenditure islaid out by the assessee as owner-cum-trader, and the expenditure is really incidental to the carrying on ofhis business, it must be treated to have been laid out by him as a trader and as incidentalto hes business."
[p.747]

The High Court, in our opinion, has rightly proceeded on the basis that theremust bea nexusbetween expenditure and business ofthe assessee.

Shri T. A. Ramachandran,the learned senior counsel appearing for the assessee-company, has submitted that the said test is satisfied in the present case since the purpose of thepaymentof remuneration to the directors of the subsidiary companies was to enable these companies toearn higher profitswhich would bepassedon to the assessee-companyas and by way of dividends. The learned counsel has placed strong relianceon the decisionof Bombay High Court in J. R. Patel and Sons (P) Ltd. V. Commissioner of Income Tax, Gujarat, 69 ITR 782, and has urged that the High Court

has committed an error in distinguishing these cases on ground that they related to managingagentswhereas the present caserelates to holding company and its subsidiaries, Shri Ramachandran hascontended that the principle laid down in thesaid decisions is equally applicable to acase ofholdingcompany.

Weare unable toacceptthis contention. TheHigh Court, in our opinion, has rightly pointedout that the business of the assessee-company is the holding of investments any expenditure had been incurred that could have been allowed as deduction. The expenditure incurred in paymentof managerial remuneration tothe directors of the subsidiary companies cannot be said to be expenditure incurred in carrying onthe business ofthe assessee-company of holding itsinvestments. The assessee-company couldhold its investments and earn its dividends the entire profits earned on account of their managerialremuneration paid by the assessee-company and the assessee-company wasonly entitled to dividend from the subsidiary company as andwhen declared, it cannot be said that there was a direct and immediate connection between the expenditure incurred and the business of the assessee-company. The decisions inTata Sons Ltd. V. Commissioner of Income Tax, BombayCity (supra) and J.R. Pateland Sons (P) Ltd. V. Commissioner of Income Tax, Gujarat (supra) ar not applicablein the facts ofthis case.

InTata sons Ltd. V. Commissioner of Income Tax, Bombay City (supra) the assessee was the managing agent of another companyand under the managingagency agreement the asessee was tobe paid a commission at a certain ratewhich was to be computed upon the net profits of the managed company. During the relevant years the assessee paid voluntarily certainsums as half share of the bonus which the managed company paid to some of its officers and it claimed deduction of the said amounts underSection10(2)(XV) of the 1922 Act. The Bombay High Court upheld theclaim of the assessee for such a deductionon theview that from the point of view of commercial principles what theassessee had done was something which had as its object increasing the profitsof themanaged company and thereby increasing its own shares oncommission and, therefore, the deduction claimedby theassessee was wholly and exclusively for the purposes of its business and was anallowable deduction under section 10(2)(XV) of the1922 Act. Whiledealingwith the contentionurged on behalf of the Revenue that the paymenthad been madenot to the employees ofthe assessee but tothe employees of a managed company -a different entity altogether - theHigh Court has observed:-

> "Here again if it can be shown that there wasa veryimportant nexus between the assessee company and the managedcompany which necessitated the assessee company making thepaymentto the employees ofthe managed company, taken again it would be possiblefor the assessee company to satisfy us that the expenditure was one which fell within the ambit of Section 10(2)(XV). Nowit cannot be seriously disputed that the bonus was paid by the managed company to their employees in order to increase the efficiency of the order to increase the efficiency of

the working of the company. An increased efficiency of that company would incidentally result inhigherand better profits, and the assessee company would be as much interested in the working of the managed company being more efficient as themanaged company itself. Whatever tended toincrease the profits of the managed company would also tend to increase the income and profits of theassessee company, Therefore, it cannot be suggested that theassessee company had an indirect or ulterior motive inmakingthis payment. The only motive by which itwas actuated was a purely commercial and pecuniary one and that wasto see that more profits were madeby the managed company so that its own commission should thereby be increased."

[p.468]

Inthat case there was a direct nexusbetween the increased profits of the managed company and the managerial commission payable to the assessee since the managing agency commission was a prescribed percentage of the net profits of themanagedcompany. As indicated earlier,there was no such nexus between the increased profit of the subsidiary companyand theprofit earned by the assessee-company by way of dividend onthe shares held by it in the subsidiary company.

InJ.R. Patel and Sons (P) Ltd,V. Commissioner of Income Tax, Gujarat (supra) the assessee wasthe managing agent and its managing directorwas also the director of the managed company. Prior tocominginto force of the Companies Act, 1956 on April 1,1956, he was getting monthly salary from the assessee and in addition hewas getting monthlyremuneration as technical adviser of the managed companyas well as commissionat a prescribed rate on the sale price of healds and reedsmanufactured and sold by the managedcompany. Afterthe passing of the CompaniesAct, 1956, the remunerationthat could bereceived by him was reducedand hecould not also be paid the commission. The assessee, therefore, increased the emoluments. Thesaid excess paymentmade by the assessee was disallowed and the expenditure incurred was restricted to the amount that was being paid prior to coming intoforce of the companiesAct, 1956. The Gujarat High Court held that the assessee had paid extra payment toits managing director so that the affairsof themanaged company couldbe properly looked after and thatas a result ofthe remuneration the profits of themanagedcompany and the shareof the commission of the assessee increasedand, therefore, the excess amount paid by the assessee to its managing directingwas expended wholly and exclusivelyfor the purpose of itsbusiness and was anallowable deduction under Section 10(2)(XV) of the 1922 Act, Reliance was placedon the decisionin TataSons Ltd. (supra). This wasalso a case where the profits of the assessee in the form of managing agency commissionwere directly linked to the profitof the managed company which is not the position in the present case.

The alternative claim by the assessee-company for deduction in respect of the expenditure incurred by the assessee-company in respect of amount paidto its own

directors who were alsothe members of the finance committee has been rightly rejected by the HighCourt in view of the resolution passed by the assessee-companywherein the directors, whether they be the members ofthe finance committee or not, have been treated as a class andwith reference to all of them the assessee-companyincurred the expenditure only because theycould not be remunerated to that extent by the subsidiary companies. The fact thatthey were directorsof theassessee-company and members of the financecommittee was not taken into account in takingover the remuneration payable to them. In the circumstances, Civil Appeals Nos. 7-11 of 1980 filed by the assessee-companyare also liableto be dismissed.

Inthe result, Civil Appeals Nos. 139-142 of 1980 filed by theRevenueand Civil Appeals Nos. 7-11 of 1980 filed by the assessee-company are dismissed. No order asto costs.