

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 256 of 2006

FOR APPROVAL AND SIGNATURE:

HONOURABLE MR.JUSTICE AKIL KURESHI

and

HONOURABLE MR.JUSTICE Z.K.SAIYED

1	Whether Reporters of Local Papers may be allowed to see the judgment ?	
2	To be referred to the Reporter or not ?	
3	Whether their Lordships wish to see the fair copy of the judgment ?	
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?	

BANIHAL HOLDINGS PVT. LTD.....Appellant(s)

Versus

ASSTT.COMMISSIONER OF INCOME TAX....Opponent(s)

Appearance:

MRS SWATI SOPARKAR, ADVOCATE for the Appellant(s) No. 1

MRS MAUNA M BHATT, ADVOCATE for the Opponent(s) No. 1

CORAM: HONOURABLE MR.JUSTICE AKIL KURESHI
and
HONOURABLE MR.JUSTICE Z.K.SAIYED

Date : 22/02/2016

ORAL JUDGMENT**(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)**

1. This appeal is filed by the assessee in which the following substantial question of law has been raised :

“Whether, in the facts and circumstances of the case the Income Tax Appellate Tribunal was right in law in holding that expenses incurred by the assessee on salary paid to the Company Secretary and other expenses for maintaining its very corporate existence cannot be allowed completely and the same has to be apportioned between the taxable and exempted income of the assessee ?”

2. This question arises in the following background. The assessee is a company registered under the Companies Act. For the assessment year 2001-2002, the company filed its return of income on 5.10.2001 declaring loss of Rs.2.67 lacs (rounded off). The return was taken in scrutiny. The Assessing Officer wanted to inquire into the assessee's claim of loss. From the materials produced before the Assessing Officer, it was noticed that the company during the previous year relevant to the assessment year 2001-2002, had shown a total income of Rs.73.75 lacs(rounded off). Only sum of Rs. 39,900/- (rounded off) was liable to income tax. Remaining income was exempt under section 10 of the Income Tax Act, (“the Act” for short) being either dividend income or agricultural income. Against the taxable income of Rs. 39,900/-,the assessee had claimed expenditure of Rs. 3.07 lacs(rounded off) which comprised of salary paid to the Company Secretary of Rs.2.91 lacs

(rounded off) and other miscellaneous expenses of Rs.16,000(rounded off) and that is how the company claimed loss of Rs.2.67 lacs.

3. The Assessing Officer asked the assessee to justify the loss to which the assessee contended that the loss pertains primarily to the salary paid to the Company Secretary and the same should therefore, be allowed. The Company Secretary was engaged not for earning exempt income but to maintain the status of the company since it was under the statute compulsory to engage a Company Secretary.
4. The Assessing Officer however, did not accept such a contention. He was of the opinion that the expenses incurred by the company had primarily resulted in income which was exempt under section 10 of the Act and, therefore, would not be allowable in terms of section 14A of the Act. The Assessing Officer therefore, totally disallowed the expenditure and the corresponding loss.
5. Against such order of the Assessing Officer, the assessee filed appeal before the appellate Commissioner and raised the same contentions. Commissioner(Appeals) allowed the appeal to a limited extent of apportionment of the expenditure between taxable and exempt income, making following observations :

“I have considered the order of the AO and the submission of the appellant. It is seen that the only salary paid by the appellant company was to the Company Secretary as he was only employee on the role and other expenses included audit fee, consultancy fee, etc as pointed out by the

appellant. So far as the audit fee is concerned, I agree with the contention of the appellant that the same are required to be spent for the very existence of the company and hence audit fee can be considered as incurred for the purpose of business. However, salary paid to the employee i.e. Company Secretary, Consultancy fees, rates and taxes and other expenses had to be attributed in part for earning the exempted income. The exempted income i.e. Dividend income is not accruing to the appellant on its own and it requires the decision to be taken by the employee of the company making investments, to earn dividend income which may be exempted as well as to make advances to earn interest income. In any case, the appellant employee is required to arrange the financial matters in a proper manner which may result in earning of exempted income or taxable income, hence the expenses incurred by the appellant on salary and other expenses have to be apportioned proportionately for earning taxable income and exempted income. I therefore, hold that the AO was not justified in disallowing the entire expenses incurred on salary and other expenses. Instead he should apportioned the expenses pertaining to the earning of taxable income and exempted income. The AO is therefore, directed to apportion these expenses proportionate to the exempted income earned and taxable income earned and accordingly amend his order on this point.”

6. The assessee thereupon preferred further appeal before the Income Tax Appellate Tribunal (“the Tribunal” for short). The Tribunal relied on the earlier decision in case of **Dy. CIT v. S.G. Investments & Industries Ltd.** reported in 89 ITD 44 and held as under :

“From the facts of the case it appears that the salary paid to company secretary was not only for retaining the status and existence of the assessee company. There were two

business activities of the assessee company one of pertaining to exempt income and other is pertaining to taxable income. The expenditure incurred is indivisible between exempted income and taxable income. In the case of Water Fall Estates Ltd. vs..CIT 219 ITR 563 the Supreme Court has laid down the principle of apportionment of expenditure. The judgement of Hon'ble Calcutta High Court in the case of CIT Vs. Ganga Properties Ltd. cites supra by the Id. AR is distinguishable on facts as the Hon'ble Court had no occasion to examine sec. 14A which has been inserted subsequently to that judgment. Further in that case the expenditure was incurred to comply with the statutory obligation of the company whereas in the case under consideration the assessee is having both type of income taxable as well as exempted income. In the light of the above discussion, we find that the theory of apportionment of expenditure between taxable and non-taxable income has, in principle, been accepted by the various High Courts and the Apex Court. Keeping in View the object of the insertion of Sec. 14A we are of the considered view that the CIT(A) has correctly directed the Assessing Officer to portion the expenses proportionate to the exempted income earned and taxable income earned. Therefore we accordingly confirm the order of the CIT”

7. The assessee thereupon preferred this appeal in which the above-noted question of law has been framed.
8. Learned counsel for the assessee contended that the Company Secretary was engaged by the assessee not for earning exempt income but since it was compulsory to do so under the Companies Act. Thus the salary paid to the Company Secretary was merely for the purpose of maintaining status of the company. He relied on the following decisions :

1) **Commissioner of Income-tax v. New Savan Sugar and Gur Refining company limited** reported in 1990(185) ITR 564.

2) **Commissioner of Income-tax v. Ganga Properties Limited** reported in 1993(199) ITR 94.

2) **CIT, Mumbai v. Walfort Share & Stock Brokers P Ltd** reported in 2010 (326) ITR 1.

9. On the other hand, learned counsel Shri Bhatt for the Revenue opposed the appeal contending that admittedly virtually the entire income of the assessee was exempt under section 10 of the Act. The assessee had incurred expenditure by way of salary paid to the Company Secretary. Merely because it was compulsory to engage such a Company Secretary would not mean that such expenditure was not relatable to earning exempt income.

10. Having heard learned counsel for the parties and having perused the materials on record, short question that calls for consideration is, whether the expenditure in question would be hit by Section 14A of the Act. As is well known, as per section 14A of the Act for the purpose of computing the total income under Chapter-IV, no deduction would be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income. In short, therefore, if any expenditure has been incurred in relation to income which is exempt from payment of tax, such expenditure would

not be an allowable deduction. Out of total income of Rs. 73.75 lacs of the assessee, virtually entire sum ,barring a small portion of Rs. 39,900/-, came from two sources namely, dividend income and agricultural income, which was exempt under section 10 of the Act. The assessee company had engaged a Company Secretary and paid salary of Rs. 2.91 lacs during the year. This expenditure the assessee claims against the taxable income of Rs.39,900/-. The authorities have however, held that such expenditure is liable to be apportioned in proportion to the taxable and non taxable income of the assessee.

11. In our opinion, the CIT(Appeals) and the Tribunal committed no error. The fact that virtually entire income of the assessee was exempt is not in dispute. The fact that the assessee paid salary of Rs. 2.91 lacs to the Company Secretary so engaged by the company is also not in dispute. Merely because under the relevant provision of the Companies Act, it was compulsory for the company to engage a Company Secretary, would not in any manner change the fundamental facts. The salary paid to the Company Secretary was for running the business of the company which principally comprised of investment in shares and agricultural operations. It is not necessary that the Company Secretary should himself have directly contributed to any of the tasks relatable to the earning of income. Expression used in sub-section(1) of section 14A of the Act is “in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income”. Therefore, merely because it was compulsory in law to engage the Company Secretary would

not in any manner change this position. The fact of the matter is that the company did engage a Company Secretary and incurred expenditure of Rs. 2.91 lacs by way of salary.

12. The act of engagement of Company Secretary was clearly for the purpose of carrying on activities of the company, in absence of which, the company would be breaching the legal requirement. That being the position, the expenditure had to be apportioned between the taxable income and the exempt income.
13. The issue can be looked from a slightly different angle. The claim of the expenditure of Rs.2.91 lacs towards the taxable income of Rs.39,900/- would be incongruent with the assessee's stand that such expenditure was not for earning income but was by way of salary to engage an officer which was statutorily compulsory for the company to do. For whatever reason, once the company engaged a Company Secretary and the salary payable to the Company Secretary if it is claimed by way of expenditure for earning taxable income, we do not see how the company can argue that the same had no relation to operations of the company insofar as the activity of earning exempt income is concerned. The issue can also be looked from yet another angle. In a given case, if the assessee had only taxable income of considerable amount, would the assessee not claim the salary paid to the Company Secretary by way of expenditure on the premise that services of the Company Secretary were not engaged for the purpose of carrying out the income generating activities of the company but was

compulsory on account of the statutory provision? This is not even the stand of assessee company. If therefore, such expenditure even if compulsorily expended by the company is part of the company's expenditure for earning taxable income, we fail to see how when it comes to question of reckoning the exempt income, the character of the expenditure would change.

14. In case of **New Savan Sugar and Gur Refining company limited** (supra) before the Division Bench of Calcutta High Court, the question was entirely different and related to claim of deduction of expenditure under section 37 of the Act.

15. In case of **Ganga Properties Limited**(supra), the Division Bench of Calcutta High Court in relation to claim of the assessee company for deduction of the expenditure, observed that such expenditure was incurred by the company for retaining the status. It was observed that even if the company does not carry on business but derives income from other sources, the company has to maintain its establishment for complying with statutory obligations. Expenditure incurred in the process would be deductible. We do not see that this ratio in any manner conflicts with our conclusion.

16. In case of **Walfort Share & Stock Brokers P Ltd**(supra), the Supreme Court was considering the provisions of section 14A of the Act in the context of dividend stripping transactions. The assessee had purchased mutual fund units from the market shortly before the company was

likely to declare the dividends. Soon after, in a few days, when the dividend was declared and received by the assessee, units were sold ex-dividend. The assessee would claim exemption on dividend income and the difference between cum-dividend purchase price and ex-dividend sale price as loss. The Revenue allowed the claim on dividend but regarding the loss, contended that such loss would be an expenditure covered under section 14A of the Act. The Supreme Court in the said case while interpreting provisions of section 14A as they stood prior to 1.4.2002 amendment, held that the pay back does not constitute expenditure in terms of section 14A of the Act. It was held that profits have to be computed after deducting losses and expenses incurred for business. A deduction for expenditure or loss which is not within the prohibition must be allowed if it is on the facts of the case a proper debit item to be charged against the Incomings of the business in ascertaining the true profits. A return of investment or a pay-back is not such a debit item and therefore, is not expenditure incurred in terms of section 14A. The said decision therefore, was rendered in a completely different facts and the observations made by the Supreme Court on the import of section 14A of the Act cannot be applied.

17. In the result, question is answered against the assessee. Tax Appeal is dismissed.

(AKIL KURESHI, J.)

(Z.K.SAIYED, J.)

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