Commissioner of Income Tax, Madras

Vs

Amalgamation Pvt. Ltd.

(S.C. Agrawal, K. S. Paripoornan JJ)

25.04.1997

JUDGEMENT

S.C. AGARWAL, J.

1. These appeals, by certificate of fitness granted by the Madras High Court under Section 66(a)(2) of the Income Tax Act, 1922 (hereinafter referred to as 'the 1922 Act') and Section 261 of the Income Tax Act, 1961 (hereinafter referred to as 'the 1961 Act') read with Article 133 of the Constitution of India, are directed against the judgment of the said High Court dated March 1, 1976 in Tax Cases Nos. 160 of 1969 and 239 of 1971 (References Nos. 52 of 1969 and 1 of 1971) T.C. No. 160 of 1969 related to the assessment year 1958-59 wherein two question were referred by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') for the opinion of the High Court. T.C. No. 239 of 1971 related to the assessment years 1958-59 to 1962-63 wherein the Tribunal referred to six questions for the opinion of the High Court. By the impugned judgment both the questions in T.C. No. 160 of 1969 and all the questions, except question No.3 in T.C. No. 239 of 1971 were answered by the High Court against the Revenue and in favour of the assessee. Question No.3 in T.C. No. 239 of 1971 was answered in favour of the Revenue and against the assessee. Civil Appeals Nos. 139-142 of 1980 have been filed by the Revenue in respect of the questions that have been answered against the Revenue and Civil Appeals Nos. 7-11 of 1980 have been filed by the assessee in respect of question No.3 in T.C. No. 239 of 1971 which has been answered against the assessee.

2. We will first take up Civil Appeals No. 139-142 of 1980 filed by the Revenue. These appeals can be split up into two parts, one relating to the answers to the two questions in T.C. No. 160 of 1969 and questions Nos. 1 and 2 in T.C. No. 239 of 1971, and the other relating to answers to questions Nos. 4,5 and 6 in T.C. 239 of 1971. The two questions in T.C. no. 160 of 1969 and questions Nos. 1 and 2 in T.C. No. 239 of 1971 were as follows :-

T.C. No. 160 of 1969

> "(1) Whether, on the facts and in the circumstances of the case, the tribunal was right in upholding the basis of valuation adopted by the Income-Tax Officer for the shares in Messrs. Sri Rama Vilas Service (Private) Ltd. as on January 1, 1954?
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> (2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the proviso to section 12 B(2) has no application 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 12 B(2) has no application in regard to the sale of various shares by the assessee-company to M/s Simpson & Company Ltd. through M/s Simpson & General Finance Co. (Private) Ltd. and that the assessee was entitled to a capital loss of Rs. 9,47,541/- in the assessment year 1958-59?

(2) Whether, on the fact and in the circumstances of the case, the Tribunal was right in law 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?"

3. These questions arise in the following facts and circumstances.

4. 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- company held 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.7,50,000 shares of Rs. 10 in Simpson and Company Ltd. The assessee-company held, at the material time, 7,06,933 ordinary shares. Simpson and Company Ltd, had a subsidiary by name Simpson and General Finance Company (Private) Ltd. carrying on the business of financing by way of hire purchase transactions to outsiders and by way of loans and advances to the companies of this group. As on July 1, 1956 a sum of Rs. 1,85,16,000/- was due to Simpson and General Finance/ company (Private) Ltd. from the assessee-company. Under Section 295 of the Companies Act, 1956, which came into force on April 1, 1956, no company could, without obtaining the previous approval of the Central Government in that behalf, directly or indirectly, make any loan to a company, which is its holding company. In sub-section (3) of Section 295 it was provided that there where any loan made by a lending company and outstanding at the commencement of the Companies Act, 1956, could not have been made without the previous approval of the Central Government if that section had then been in force, then the lending company had to, within six months from the commencement of the Act or such further time not exceeding six months as the Central Government might grant for that purpose, either obtain the approval of the Central Government to the transaction or enforce the repayment of the loan made. The liability of Rs. 1,85,16,000/- to Simpson and General Finance Company (Private) Ltd. by the assessee-company was affected by the aforesaid provision and, therefore, it became necessary for the assessee-company to liquidate this liability. Simpson and General Finance Company (Private) Ltd. owed a sum of Rs. 1,05,21,750/- to Simpson and Company Ltd. the assessee-company approached the Government of India for necessary approval to put through certain transactions of sale of shares held by to Simpson and General Finance Company (Private) Ltd. in liquidation of the liability. Simpson and General Finance Company (Private) Ltd., in its turn, would discharge its liability to Simpson and Company Ltd. by selling its holdings to Simpson and General Finance Company (Private) Ltd. The assessee-compnay as well as Simpson and General Finance Company (Private) Ltd. proposed to sell the shares at certain specified price per share and sought the approval of the Central Government for such sale. The Central Government, in approving the salem fixed its own price and stated that the said fixation was without prejudice to any valuation of shares for the purposes of capital gains. Thereafter the shares held by the assessee-company in various companies in respect of which approval had been granted by the Central Government were transferred by the assessee-company to Simpson and General Finance Company (Private) Ltd. with effect from June 13, 1957 at the prices fixed by the Company Law Administration and Simpson and General Finance Company (Private) Ltd. sold part thereof to Simpson and Company Ltd. the transaction between

Simpson and General Finance Company (Private) Ltd., and Simpson and Company Ltd. was also at the same prices.

5. In submitting its income tax return for the assessment year 1958-59, the relevant previous year ending June 30, 1957, the assessee-compnay claimed a capital loss of Rs.4,37,703/- in respect of the above transactions. In arriving at this loss the assessee-compnay opted for the substitution of the market value as on June 1, 1954 in respect of 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 the basis that the price structure approved by the department of Company Law Administration for the transfer of the aforesaid shares was pure and simple on an ad hoc basis and meant to serve the limited purpose of approval to be given under Section 372 of the Companies Act, 1956 and that the price at which the sales took place could not, therefore, be taken to represent the fair market value of the shares. He took the break-up as on January 1, 1954 for the purpose of computation of capital gains and revised the sale prices and arrived at Rs. 6,95,082/- as the net capital gains. Even according to his computation there were certain capital losses which were adjusted as against the capital gains determined by him. In the case of S.R.V.S. (Private) Ltd. the Income Tax officer took the break-up value as on January 1, 1954 at Rs. 36,35,350/- and their sale value at Rs. 21,88,395/- resulting in the capital loss of Rs. 14,46,955/-.

6. The assessee-company appealed against the assessment of the capital gains to the Appellate Assistant Commissioner. While the said appeal is pending, the Commissioner of Income Tax proceeded under Section 33B of the 1922 Act as he was of the view that the order of the Income Tax Officer was erroneous and prejudicial to the interest of revenue in so far as he had wrongly allowed the capital loss amounting to Rs. 14,46,955/- on the sale of the shares in 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 the S.R.V.S. (Private) Ltd. should not have been taken into account and if the value of the shares held by S.R.V.S., (Private) Ltd. in Simpson and Company Ltd., as on January 1, 1954 , had been Rs. 24,38,578/- S.R.V.S. (Private) Ltd. would not have parted with these shares at cost on July 31, 1955. The Commissioner revised the capital loss of Rs. 14,46,955/- allowed by the Income Tax Officer and considered that there was capital gain liable for assessment of Rs. 3,91,579/-. This figure was directed to be substituted and the assessment of capital gains was revised accordingly.

7. The assessee-company appeal against the said order of the Commissioner to the Tribunal contending that the sale value fixed by the Company Law Administration represented the correct value of the shares and the transactions were without any motive to avoid capital gains and they had been necessitated by the various provisions of the Companies Act which prohibited inter-company loans and that the method adopted by the Income Tax Officer, viz., the secondary valuation, was proper. 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 valuation was held to be proper. The Appellant Assistant Commissioner took up the appeals of the assessee-company for this and other years subsequent to the order of the tribunal and following the Tribunal's order he worked out the capital loss in respect of the other shares 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-compnay 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 the Appellate Assistant Commissioner instead of Rs. 4,90,244/- which could be the correct figure. 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 the returns.

8. On the first occasion when the matter came before the Tribunal, it remanded the case to the Appellate Assistant Commissioner and called for a specific finding whether the sales under consideration were effected with the object of avoidance of tax or reduction of liability to tax and also wanted to full value of consideration to be worked out, in case the first proviso to Section 12B(2) of the 1922 Act was held to be applicable. The Appellate Assistant Commissioner observed that there was ample evidence to show that the sale of shares was a forced one and that the assessee-company had no option but to comply with the statutory provisions and that the evidence produced clearly established the assessee- company's contention that the sale was not motivated by any desire to avoid capital gains and 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 the prices fixed by the Company Law Administration were not very much different from the figures worked out by him. After receiving the report of the Appellate Assistant Commissioner, the Tribunal 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 evidence to support the view that the sales were effected with a view to avoid the provisions of Section 12B. The Tribunal accepted the contention of the assessee-company and held that the Revenue was not justified in computing the capital gains and disturbing the figures fixed by the Government of India. The two questions referred in T.C . No. 160 of 1969 arise out of proceedings under Section 33B of the 1922 Act, while questions Nos. 1 and 2 referred in T.C. No. 239 of 1971 arise out of the order of the Tribunal in the appeal against the order of the Appellate Assistant Commissioner in respect of the assessment year 1958-59.

9. Since the second question in T.C. No. 160 of 1969 and question Nos. 1 and 2 in T.C. No. 239 of 1971 raised more or less the same issue, they were taken up together by the High Court. After referring to the provisions of Section 12B(2) and more particularly the first proviso, namely, that the person to whom the sale is made should be a person with whom the assessee is directly or indirectly connected, was satisfied in the present case because the sale of shares to a subsidiary of a subsidiary is one to a person with whom the assessee-company is directly or indirectly connected. As regards the second requirement of the proviso, as to whether the sale was effected with the object of avoidance or reduction of the liability of the assessee-company under that section, the High Court has pointed out that the Income Tax Officer had not given a finding that the object with which the transaction was put through was the avoidance or reduction of the liability to capital gains tax and the only observation that he had made in his order was that there was a reduction of liability to capital gains. According to the High Court, such a finding of taking the result as if it was the object would not satisfy the requirement of the first proviso to Section 12B(2) of the 1922 Act. The High Court was of the view that the Tribunal had rightly called for a finding on this point specifically from the Appellate Assistant Commissioner. After referring to the finding recorded by the Appellate Assistant Commissioner, which was accepted by the Tribunal, that the object of the transaction was not to avoid or reduce such liability to capital gains tax, that the sale was a forced sale since the assessee-company had no option and that the prices had been fixed by the Company Law Administration, the High Court held that the first proviso to Section 12B(2) cannot be attracted to the present case. The High Court did not accept the contention urged on behalf of the Revenue that the sale price had been fixed by the Company Law Administration worked out the figures in consultation with the Central Board of Revenue and when the assessee-company sold the shares at those prices, it could not be validly contended that the assessee-company transferred the shares at certain prices with object of avoidance or reduction of liability to capital gains. On that view of the High Court answered the second question in T.C. No. 160 of 1969 and the second question in T.C.

no. 239 of 1971 in the affirmative and against the Revenue.

10. As regards the first question in T.C. No. 160 of 1969 which raises the question of valuation. The High Court felt that on the view it had taken as regards the second question it would not survive for consideration because the question of valuation would be material only if the proviso applied. The High Court has, however, considered the said question and has indicated the answer to that question also. The High Court has expressed the view that this is a case of substantial holding and that there is textual backing to the method adopted by the Income Tax Officer and that the Commissioner had found fault with it without any valid reason. The High Court, therefore, answered the first question in T.C. No. 160 of 1969 in affirmative and in favour of the assessee-company.

11. As regards the first question in T.C. No. 239 of 1971, the High Court felt 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 answer that question also. Therefore, that question also was answered in the affirmative and in favour of the assessee-company.

12. We have heard Shri K.N. Shukla, the learned senior counsel appearing 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 has rightly construed the provisions contained in the proviso to Section 12B(2) of the 1922 Act and, in view of the finding recorded by the Appellate Assistant Commissioner, which finding was accepted by the Tribunal, 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, the said finding of the High Court does not suffer from any legal infirmity and there is no ground to interfere with the judgment of the High Court on this aspect of the case.

13. We may now take up the appeals of the Revenue in respect of 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 circumstances of the case, the Appellate Tribunal was right in law in holding that the loss sustained by the assessee on account of standing guarantee to Sembiam Saw Mills (Private) Ltd. (in voluntary liquidation) should be allowed in 1962-63 assessment after taking into account the amounts received from the liquidators during the years 1959-60 to 1962-63?
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> (5) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the receipts of Rs. 1,41,000/-, Rs. 2,29,627/-, Rs. 1,10,500/- and Es. 4,381 from the liquidators for Sembiam Saw Mills (Private) Ltd. (in voluntary liquidation), from the assessments for 1959-60, 1960-61, 1961-62 and 1962-63 respectively?
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> (6) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that an amount of Rs. 4,23,256/- representation the real loss sustained by the assessee on account of standing guarantee of Sembiam Saw Mills (Private) Ltd. (in voluntary liquidation) should be allowed in the assessment year 1962-63?"

14. 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 SSM thus became the direct subsidiary of the assessee-company. SSM had borrowed monies from the National Bank of India Ltd. and the assessee-compnay had guaranteed the loan to the said company by the said Bank. SSM went into liquidation some time in 1955. 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 Bank along with a separate guarantee letter in favour of the Bank. When the SSM went into liquidation, the assessee-company, as guarantor, was required to clear those overdrafts in accordance with the terms of the guarantee. After adjusting the amount recovered from the liquidators, the sum due to the assessee-company from the liquidated company on account of the said overdraft was Rs. 9,08,764/-. The assessee-company claimed this amount as a loss which arose in the course of and incidental to its business in the assessment for the year 1958-59. There was receipts by the assessee-company in the course of the liquidation of SSM in the later years. The total amount received came to Rs. 4,85,508.28 spread over the relevant accounting years for the assessment years 1959-60 to 1962-63. The assessee-compnay relied on the clause in the memorandum of association authorising it to be the guarantor for the loans and contended that the transactions in question sprant out of normal business transactions and hence the loss was 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 12B of the 1922 Act. In making the assessments for the years 1959-60 to 1962-63 the Income Tax Officer treated the receipts from the liquidator as income as a protective measure. In appeal the Appellate Assistant Commissioner did not accept the claim of the assessee-company for allowance of the loss in 1958-59 as he was of the view that it was not a loss which arose during the course of or was incidential to its business. But the appeals for the years 1959-60 to 1962-63 were allowed in so far as they related to the question of the receipts in the respective years from the liquidator. As the guarantee loss had not been allowed as a deduction in 1958-59, the Appellate Assistant Commissioner held that the subsequent recoveries could not be included in the total income in the later years. The assessee-company as well as the Revenue preferred appeal against the said order of the Appellate Assistant Commissioner before the Tribunal. The Tribunal held that the assessee-company had guaranteed the loan in the course of carrying on its own business and that the loss was clearly admissible as a deduction. But since the assessee-company had received the last of the payments from the liquidator in the previous year relevant to the assessment year 1962-63 it was held that the balance of Rs. 4,23,256/- remaining unrecoverable represented the real business loss allowable for the assessment year 1962-63. At the instance of the Revenue the Tribunal referred the aforementioned questions Nos. 4, 5 and 6 for the opinion of the High Court.

15. The High Court, while dealing with said questions, has observed that the real point in issue was whether the guarantee that was executed in favour of the Bank in respect of the loan to SSM, the subsidiary of the assessee-company, was done in the course of its own business. The High Court has referred to its earlier judgment in Amalgamations P. Ltd. v. Commissioner of Income Tax, (1969) 73 ITR 380, wherein the nature of the business of the assessee-company has been considered and it has been held that the provisions of Section 23A of the 1922 Act were applicable to the assessee-company since the assessee-company's business includes furnishing guarantee to debts borrowed by subsidiary companies. The High Court has held that the said finding given in that case 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 the High Court, the loss was allowable as a deduction in the year which it came to be ascertained and in the instant case the High Court held that the assessee-

company could have ascertained whether there was loss in the transaction of guarantee only at the stage of final payment by the liquidators which was received in the relevant previous year for the assessment year 1962-63 and that the Tribunal was right in allowing it in that year. The High Court, therefore, answered questions Nos. 4, 5 and 6 in the affirmative and against the Revenue.

16. After hearing Shri Shukla on the appeals filed by the Revenue in respect of these questions, we are unable to hold that the judgment of the High Court in respect of these questions suffers from any legal infirmity. We, therefore, affirm the answer given by the High Court to question Nos. 4,5 and 6 referred to it. In the circumstances, it must be held that Civil Appeals Nos. 139-142 of 1980 filed by the Revenue are liable to be dismissed.

17. We would now come to Civil Appeal Nos. 7-11 of 1980 filed by the assessee-company in relation to question No.3 in T.C. No. 239 of 1971, which was as under :-

> "(3) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the sums of Rs. 437,066/-, Rs. 90,896/-, Rs. 1,08,978/-, Rs. 1,18,102 and Rs. 1,11,740/- are admissible as a deduction in the assessments of the assessee for the assessment years 1958-59 to 1962-63 respectively?"

18. The assessee-company was a bulk shareholder in several companies and in the relevant years there were sixteen companies. The asseessee-company was 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 and the Departments of export promotion and internal audit was borne by the assessee-company and was recovered from the subsidiaries. The finance committee was working in an advisory capacity to the various subsidiary companies to help them to carry on their business more efficiently. All purchase requisitions for the purchase of capital equipment beyond Rs. 500/- each purchase and Rs. 2,500/- with reference to purchase of raw materials were submitted to the finance committee for their approval. The purpose of such control was to judiciously use the funds of the company to the best advantage of each company. Various data were gathered before such sanction was accorded or refused. Technical matters or other matters of management were also referred to the members of the finance committee who were experienced in their respective fields. The finance committee went through the financial position of each company daily. The Directors of the assessee- company were also Directors/Managers in the subsidiary companies. As per the service agreements between them and the concerned subsidiary company they were entitled to payment of renumeration and also a certain percentage of the profits as commission. Similar service agreements had been entered by other directors of the assessee-company. In view of the provisions of Section 198 of the Companies Act, 1956, fixing a ceiling on the overall managerial renumeration at 11% of the net profits of the company, it was not possible for the subsidiary companies to pay the contracted renumeration to the persons concerned. On April 4, 1959 the Board of Directors of the assessee-company passed a resolution whereby it was resolved that the renumeration payable to them in full in accordance with the terms of the contract respectively entered into by them and the amount in excess of the maximum amount permissible under the Companies Act, 1956 would be met by the assessee-company. Out of these nine Directors three were directors of the assessee-company and out of these three Directors two were members of the finance committee. None of the other six Directors of the subsidiary companies was a member of the finance committee. In accordance with the said resolution the assessee-company paid diverse amounts to the said Directors. The total amounts so paid to the several persons for the different

years are mentioned in question No.3. The assessee-company claimed the said amounts as deduction under Section 10(2)(xv) of the 1922 Act for the assessment years 1958-59 to 1961-62 and under Section 37 of the 1961 Act for the assessment years 1962-63. Before the Income Tax Officer it was not disputed that these payments were in respect of services rendered by respective persons to the various subsidiary companies of which they were Directors/Managers and that no part of the payment could be related to any service directly rendered by time to the assessee-company. IT was submitted that though the services were rendered by them to other companies, they should be deemed to have 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 and held that the excess renumeration over and above what was admissible under Section 198 of the Companies Act, which was not borne by the respective companies, could not be allowed as deduction under Section 10(2)(xv) of the 1922 Act and Section 37 of the 1961 Act as expenditure wholly and exclusively incurred for the purpose of the business of the assessee-company. It was also stressed that the resolution of the Board of Directors 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 took the same view. The matter was remained by the Tribunal to the Appellate Assistant Commissioner for consideration and submission of report on the points mentioned in the order of remand. The Appellate Assistant Commissioner after taking further evidence submitted his report wherein he reported that deduction may be allowed in respect of renumeration paid to persons who were directors of the assessee-comapny and were members of the finance committee, but such deduction could not be allowed in respect of renumeration paid by the assessee-company in respect of person who were only directors and employees of the subsidiaries but neither directors of the assessee-company nor members of the finance committee. The Tribunal was of the view that looking to the nature of the business of the assessee- company of holding shares of a number of subsidiary companies and that it was looking after the interest and welfare of those companies with a view it earn dividends, the whole of the expenditure referable to the renumeration paid by the assessee-company was admissible as a deduction.

19. Rejecting the contention urged on behalf of the Revenue that the assessee-company was not carrying on any business because merely holding of investments would not constitute business, the High Court has held that in view of Section 23A of the 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 systematic or organised course of activity or conduct with set purpose of earning profit which is the test for a business. The High Court has observed that the assessee-company is not a mere investor in a single company but has investments in sixteen companies and had taken active interest in the business of these companies as is clear from the services that had been rendered in the shape of export promotion, liaison office at Delhi and internal audit and it also rendered consultation in respect of finance by its directors meeting every day with reference to the needs and requirements of each company and that it is not a case where the assessee-company contended itself with merely making an investment and looking for the dividend. The High Court has, 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 been incurred was wholly and exclusively laid out for the purpose of the assessee-company's business, the High Court has negatived the contention that the said question is purely factual because in order to be deductible the expenditure must satisfy two tests; (i) the expenditure must be incurred by the assessee in his capacity as a trader; and (ii) it must be incidential to the carrying on of his business. The High Court was of the view that there must be a nexus between the expenditure and the business of the assessee. Applying these tests the High Court has held that the purpose of the payments in the present 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 renumeration payable to its direction and that the expenditure had not been incurred wholly and exclusively for the business of the assessee-company and it could not be allowed as deduction. The alternative claim put forward on behalf of the assessee-company that at any rate the expenditure incurred by the assessee-company in renumerating its own directors who were also members of the finance committee should be allowed as deduction as there is a nexus between the expenditure and the business of the assessee- company in rendering services to its subsidiaries, was not accepted by the High Court for the reason that the resolution passed by the assessee-company does not say that the expenditure was incurred for the purpose of renumerating its own directors in so far as they 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 not as a class and with reference to all of them the assessee-company incurred the expenditure only because they could not be renumerated to that extent by the subsidiary companies and the fact that they were Directors of the assessee-company and they they were members of the finance committee had not been taken into account in taking over the renumeration payable to them. Question No.3 was, therefore, answered in the negative and against the assessee-company.

20. The amounts paid by the assessee-company to the Directors of its subsidiary companies can be admissible as a deduction under Section 10(2)(xv) of the 1922 Act or Section 37(1) of the 1961 Act only if they can be regarded as expenditure "laid out or expended wholly and exclusively for the purpose of the business" of the assessee-company. This expression was also used in the Income Tax 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 the said expression :-

> "...... 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 the trade." [p.191]

21. These observations have been referred to with approval by this Court while construing Section 10(2)(xv) of the 1922 Act. [See : Eastern Investments Ltd. v. Commissioner of Income Tax, (1951) 20 ITR 1; Commissioner of Income Tax v. Chandulal Keshavlal & Co., (1960) 38 ITR 601].

22. In Travancore Titanium Products Ltd. v. Commissioner of Income Tax, Kerala, (1966) 60 ITR 227, this Court, while construing the expression "for the purpose of business" in Section 10(2)(xv) of the 1922 Act, has said :-

> "The expenditure must be incidential to the business and must be necessitated or justified by commercial expediency. It must be directly and intimately connected with the business and be laid out by the taxpayer in his character as a trader. To be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business i.e. between the expenditure and the character of the assessee as a trader, and not as owner of assests, even if they are assests of the business."

23. In The Indian Aluminium Co. Ltd. v. Commissioner of Income Tax, (1972) 84 ITR 735,decided by a Constitution Bench of this Court, the aforementioned test laid down in Travancore Titanium Products Ltd. vs. Commissioner of Income Tax, Kerela (supra), was qualified in these terms :-

> "In our view, the test adopted by this Court in Travancore Titanium case that `to be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business, i.e., between the expenditure and the character of the assessee as a trader, and not as owner of assests, even if they are assests of the business' needs to be qualified by stating that if the expenditure is laid out by the assessee as owner-cum-trader, and the expenditure is really incidental to the carrying on of his business, it must be treated to have been laid out by him as a trader and as incidental to his business."
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> [p. 747]

24. The High Court, in our opinion, has rightly proceeded on the basis that there must be a nexus between expenditure and business of the assessee.

25. 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 the payment of renumeration to the directors of the subsidiary companied was to enable these companies to earn higher profits which would be passed on to the assessee- company as and by way of dividends. The learned counsel has placed strong reliance on the decision of Bombay High Court in Tata Sons Ltd. v. Commissioner of Income Tax, Bombay City, 18 ITR 460, and the decision of the Gujarat 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 the ground that they related to managing agents whereas the present case relates to a holding company and its subsidiaries. Shri Ramachandran has contended that the principle laid down in the said decision is equally applicable to a case of a holding company.

26. We are unable to accept this contention. The High Court, in our opinion, has rightly pointed out that the business of the assessee-company is the holding of investments and if with reference to the business of holding investments any expenditure had been incurred that could have been allowed as deduction. The expenditure incurred in payment of managerial renumeration to the directors of the subsidiary companies cannot be said to be expenditure incurred in carrying on the business of the assessee-company of holding its investments. The assessee-company could hold its investments and earn its dividends without incurring this expenditure. Since the subsidiary company was not obliged to distribute by way of dividends the entire profits earned on account of their managerial renumeration paid by the assessee-company and the assessee-company was only entitled to dividend from the subsidiary company as and when 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 decision in Tata Sons Ltd. v. Commissioner of Income Tax, Bombay City, (supra) and J.R. Patel and sons (P) Ltd. v. Commissioner of Income Tax, Gujarat (supra) are not applicable in the facts of this case.

27.In Tata Sons Ltd. vs. Commissioner of Income Tax, Bombay City (supra) the assessee was the managing agent of another company and under the managing agency agreement the assessee was to be paid a commission at a certain rate which was to be computed upon the net profits of the managed company. During the relevant years the assessee paid voluntarily certain sums as half share of the bonus which the managed company paid to some of its officers and it claimed deduction of the said amounts under Section 10(2)(xv) of the 1922 Act. The Bombay High Court upheld the claim of the assessee for such a deduction on the view that from the point of view of commercial principles what the assessee had done was something which had as its object increasing the profits

of the managed company and thereby increasing its own shares on commission and, therefore, the deduction claimed by the assessee was wholly and exclusively for the purposes of its business and was an allowable deduction under Section 10(2)(xv) of the 1922 Act. While dealing with the contention urged on behalf of the Revenue that the payment had been made not to the employees of the assessee but to the employees of a managed company - a different entity altogether - the High Court has observed :-

> " Here again if it can be shown that here was a very important nexus between the assessee company and the managed company which necessitated the assessee company making the payment to the employees of the managed company, then again it would be possible for the assessee-company to satisfy us that the expenditure was one which fell within the ambit of Section 10(2)(xv). Now it cannot be seriously disputed that the bonus was paid by the managed company to their employees in order to increase the efficiency of the working of the company. An increased efficiency of that company would incidentally result in higher and better profits , and the assessee- company would be as much interested in the working of the managed company being more efficient as the managed company itself. Whatever tended to increase the profits of the managed company would also tend to increase the income and profits of the assessee company. Therefore it cannot be suggested that the assessee company has an indirect or ulterior motive in making this payment. The purely commercial and pecuniary one and that managed company so that its own commission should thereby be increased."
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> [p. 468]

28. In that case there was a direct nexus between 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 the managed company. As indicated earlier, there was no such nexus between the increased profit of the subsidiary company and the profit earned by the assessee-company by way of dividend on the shares held by it in the subsidiary company.

29. In J.R. Patel and sons (P) Ltd. v. Commissioner of Income Tax, Gujarat (supra) the assessee was the managing agent and its Managing Director was also the Director of the managed company. Prior to coming into force of the Companies Act, 1956 on April 1, 1956, he was getting monthly salary from the assessee and in addition he was getting monthly renumeration as technical adviser of the managed company as well as commission at a prescribed rate on the sale price of healds and reeds manufactured and sold by the managed company. After the passing of the Companies Act, 1956 , the renumeration that could be received by him was reduced and he could not be also be paid the commission. The assessee, therefore, increased the emoluments. The said excess payment made by the assessee was disallowed and the expenditure incurred was restricted to the amount that was being paid prior to coming into force of the Companies Act, 1956. The Gujarat High Court held that the assessee had paid extra payment to its Managing Director so that the affairs of the managed company could be properly looked after and that as a result of the renumeration the profits of the managed company and the share of the commission of the assessee increased and, therefore, the excess amount paid by the assessee to its Managing Director was expended wholly and exclusively for the purpose of its business and was an allowable deduction under Section 10(2)(xv) of the 1922 Act. Reliance was placed on the decision in Tata Sons Ltd. (supra). This was also a case where the profits of the assessee in the form of managing agency commission were directly linked to the profit of the managed company which is not the position in the present case.

30. The alternative claim by the assessee-company for deduction in respect of the expenditure incurred by the assessee-company in respect of amounts paid to its own directors who were also the members of the finance committee has been rightly rejected by the High Court in view of the resolution passed by the assessee-company wherein the directors, whether they be the members of the finance committee or not, have been treated as a class and with reference to all of them the assessee-company incurred the expenditure only because they could not be renumerated to that extent by the subsidiary companies. The fact that they were Directors of the assessee-company and members of the finance committee was not taken into account in taking over the renumeration payable to them. In the circumstances, Civil Appeals Nos. 7-11 of 1980 filed by the assessee-company are also liable to be dismissed.

31. In the result, Civil Appeals Nos. 139-142 of 1980 filed by the Revenue and Civil Appeals Nos. 7-11 of 1980 filed by the assessee-company are dismissed. No order as to costs.