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IN THE HIGH COURT OF DELHI AT NEW DELHI

\+ ITA No. 508 of 2009

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Reserved on : August 07, 2009
Pronounced on : September 4, 2009

Commissioner of Income-Tax – III, New Delhi . . . Petitioner

through : Mr. Sanjeev Sabharwal with
Mr. Mohan P. Gupta, Advocates

VERSUS

Selan Exploration Technology Ltd. . . . Respondent

through : NEMO

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE VALMIKI J. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. The respondent (hereinafter referred to as the 'assessee') is a limited company which carries on business activities in the field of crude oil production at each of the three oil fields, namely, Bakrol, Indora and Lohar. Its registered office is in New Delhi. The assessee filed its return for the assessment year 2002-03 declaring *'Nil'* income. The same was assessed under the provisions of Section 143(3) of the Income-Tax Act, 1961 (for short, the 'Act'). The assessment order was framed on 28.2.2005, as per which the Assessing Officer (AO)

a) The AO disallowed a sum of Rs.3,15,000/- on acc consultancy charges and added it back to the total income of the assessee.

b) The AO also disallowed the claim of Rs.20,40,000/- incurred for buyback of shares and treated the same as capital expenditure of the assessee and, thus, added the same to the income of the assessee.

The assessee preferred appeal against this order, which was dismissed by the Commissioner of Income-Tax (Appeal) vide orders dated 16.12.2005. The assessee successfully challenged this order before the Income Tax Appellate Tribunal (ITAT), as vide judgment dated 14.8.2008, the ITAT has set aside the order of CIT(A) and allowed the aforesaid deductions, thereby deleting those amounts from the income of the assessee. Revenue is in appeal against that order of the ITAT.

2. Consultancy charges of Rs.3,15,000/- paid by the assessee company to one Mr. B.M. Mirza were disallowed by the AO as he found that the payment to Mr. B.M. Mirza, Non-executive Director of the company, was not found satisfactory and in his opinion the payment was made just to avoid the tax liability and for non-business purpose. The explanation of the assessee was that it had paid consultancy fee of Rs.3,15,000/- to Mr. B.M. Mirza and Rs.60,000/- to Mr. V.B. Mahajan. After eliciting explanation from the assessee about the type

consultancy fee paid to Mr. Mirza. Submission of the asse that Mr. Mirza was a leading financial expert. He had been a Fellow of the Institute of Chartered Accountants of England & Wales as a senior partner at S.R. Batliboi & Co. He was head of finance of NOCIL, previously an associate company of Royal Dutch/ Shell Group and Chairman of Bank of Tokyo Advisory Committee. The AR of the assessee had even submitted before the Tribunal a brief note regarding payment made to Mr. B.M. Mirza. On the basis of material placed on record, the Tribunal came to the conclusion that payment of Rs.3,15,000/- was, in fact, made to Mr. Mirza for obtaining the consultancy services in the field of Review of Annual Accounts, Audit Review and Review of Internal Controls, etc. Even the applicable Tax at Source was deducted and paid by the company. The matter placed on record included invoice of Mr. Mirza and Board's Resolution of the assessee's company, in which the Board had noted the relationship of Mr. Mirza that the assessee company and the benefit of Rs.3,15,000/- derived by him.

3. The Tribunal also accepted the contention of the assessee that corporate governance and related disclosures were made mandatory by the SEBI Guidelines in the year 2001 and for this reason it was thought expedient by the company to avail the services of Mr. Mirza's expertise in this behalf. On this basis, the Tribunal returned the finding of fact that it became necessary for the assessee company

the CIT (A) in rejecting the claim has been brushed aside Tribunal in the following manner :-

> "Once it is not disputed that Corporate Governance requirement and specific guidelines are applicable to the assessee company, we feel that to ensure that full disclosures and proper compliance of SEBI guidelines, it is not necessary that the advisor should prepare a report. The said SEBI guidelines are stated to be issued in 2001 and the assessment year involved before us is assessment year 2002-03 and hence, the claim of the assessee cannot be rejected on this basis that no study/report was produced with regard to the special advise/contribution made Mr. Mirza. Considering the facts and circumstances of the case, we are of the considered opinion that the disallowance made by the Assessing Officer and confirmed by the Ld CIT (A) cannot be sustained because it is not disputed that SEBI guidelines regarding Corporate Governance was applicable to the assessee company in this year and it is also not in dispute that Mr. Mirza was a competent person having fellow Membership of Institute of Chartered Accountants of England & Wales and vast experience as a financial expert. We feel that for services rendered as an advisor regarding legal compliance, there may not be some documentary evidence as noted by Ld. CIT(A) but since the need of advisory services is shown by pointing out that new SEBI guidelines are made applicable in this year and it is also shown that Mr. Mirza was capable of rendering such services, the claim of the assessee deserves to be allowed in the facts and circumstances of this case."

4. We are of the opinion that the aforesaid finding of fact is based on cogent material and it cannot be termed as perverse nor such an attempt is made by the learned counsel for the Revenue. Since it is a pure finding of fact arrived at by the Tribunal that consultancy charges were paid by the assessee to Mr. Mirza against actual services rendered, we are of the opinion that no question of law in this regard arises.

5. Insofar as the amount of Rs.20,40,000/- is concerned, it was paid by

enable the assessee to prove exist opportunity to the sharehc the company by buyback the shares. According to the assessee, the payment was made as a normal business activity for the aforesaid purpose in order to maintain good and cordial relationship with the shareholders and, at the same time, safeguarding the interests of the existing shareholders. For this reason, the assessee company contended that it was an expenditure incurred wholly and exclusively for the purpose of assessee's business and should be allowed as business expenditure.

This was the explanation furnished to the query of the AO as to the nature and type of services which had been provided by the HSBC.

6. Another submission of the assessee company was that buyback enhances the earnings per share of the company in the future and creates long-term shareholder value and also prevents outflow of funds in the shape of dividends by reducing capital base of the company. The AO, however, was not satisfied with this explanation and, according to him, expenses were incurred for the buyback of the shares, which is directly related to the capital of the assessee. Therefore, he treated it as capital expenditure.

7. The Tribunal differed with the AO and CIT (A) holding that the expenditure in question was not in relation with the share capital of the assessee company. For coming to this conclusion, the Tribunal

issue involved was regarding expenses by way of stamp d registration for issue of bonus shares. These expenses were also in connection with the capital base of the assessee company therein. Under these facts, the Apex Court held that since there is no flow of funds or increase in the capital employed, it cannot be said that the company had acquired benefit or advantage of enduring nature.

8. We may also mention at this stage that to the same effect is the judgment of the Supreme Court in ***Empire Jute Co.*** v. ***CIT***, 124 ITR 1, wherein the following principle of law was enunciated :-

> "In short, what has been held in this case is that if the expenditure is made once and for all with a view to bringing into existence an asset or an advantage for the enduring of a trade then there is good reason for treating such an expenditure as properly attributable not to revenue but to capital. This is so, in the absence of special circumstances leading to an opposite conclusion."

9. It would be of interest to note that in ***Empire Jute Co.*** (supra), the Supreme Court considered its eqarlier two judgments in the case of ***Brooke Bond India Ltd.*** v. ***CIT***, 225 ITR 798 and ***Punjab State Industrial Development Corporation Ltd.***, 225 ITR 792. Distinguishing these two judgments, the Supreme Court pointed out that those cases related to the issue of fresh shares which led to an inflow of fresh funds into the company, which expands or adds to its capital employed in the company resulting in the expansion of its profit making apparatus. The expenditure incurred for the purpose of increasing the company's share capital by the issue of fresh shares

Further, when the expense incurred in connection with bonu there is no increase in the capital employed, which remains the same.

For this reason, and on this distinction, the Court held that such an expenditure would be treated as revenue expenditure/business expenditure as it cannot be such that in that case the company had acquired benefit or addition of enduring nature because the total funds available with the assessee company would remain the same.

10. It is clear from the aforesaid judgments that a fine distinction is made by the Supreme Court in classifying the expenditure under two categories:-

(a) When the expense incurred relates to the issue of fresh shares, which leads to an inflow of fresh funds into the company, such expenditure is to be treated as capital expenditure.

(b) On the other hand, where no such flow of funds or increase in the capital employed, the expenditure incurred would be revenue expenditure, as in such a case the company would not acquire benefit or addition of enduring nature.

11. In the present case, consultancy fee for advisory services was paid by the assessee company for buyback of shares. Instead of increase in the share capital, it was going to result in the decrease in funds with the buyback of the shares. In these circumstances, the Tribunal rightly held that the assessee had not acquired the benefit or addition of enduring nature because after the buyback, benefit or addition of

into existence any asset. Therefore, it was rightly held to expense of revenue nature.

12. The contention of learned counsel for the Revenue that with lesser capital dividend in future payable shall be less and, therefore, it shall be treated as a benefit of enduring nature cannot be accepted. We further find that in these circumstances the Tribunal rightly held that such an expenditure was allowed under Section 37 of the Act as expense incurred for business purpose in the following manner :-

> "15. Once we decide that the impugned expenditure is not capital in nature, we have to see its allowability under section 37. In this regard, we find that the expenses were incurred by the assessee company for compliance of SEBI guidelines with regard to buyback of shares. The buy back of shares is stated to be for the purpose of providing an exit opportunity to the existing shareholders who so desire. This Tribunal is taking a consistent view that expenditure incurred with regard to AGM is business expenditure. The AGM is held by a company for the benefit of existing shareholders. On the same reasoning, the impugned expenditure which were also incurred for the benefit of existing shareholders in the ordinary course of business is also an expenditure incurred for business purpose and hence the same is allowable under section 37. We, therefore, decide this issue in favour of the assessee."

13. We, thus, are of the opinion that no question of law arises, which needs determination by this Court, in the present appeal. This appeal is, accordingly, dismissed.

(A.K. SIKRI)
JUDGE

(VALMIKI J. MEHTA)