



* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
% **Judgment reserved on: 16 October 2024**
Judgment pronounced on 31 January, 2025

+ ITA 199/2017

PR. COMMISSIONER OF INCOME TAX -21Appellant
Through: Mr. Indruj Singh Rai, SSC with
Mr. Sanjeev Menon, Mr. Rahul
Singh, Mr. Anmol Jagga, JSCs

versus

M/S.REMFRY & SAGARRespondent
Through: Mr. Ajay Vohra, Sr. Adv. with
Mr. Aditya Vohra and Mr.
Shashwat Dhamija, Adv.

+ ITA 449/2022

PRINCIPAL COMMISSIONER OF INCOME TAX,
DELHI-12Appellant
Through: Mr. Abhishek Maratha, Adv
Senior Standing Counsel Ms.
Nupur Sharma, Mr. Parth
Semwal, Jr. St. Counsel, Mr.
Apoorv Agarwal, Jr. St. Counsel,
Mr. Gaurav Singh, Mr.
Bhanukaran Singh, Ms. Muskan
Goel, Ms. Parithi Kohli, Mr.
Himanshu Gaur, Adv

versus

M/S REMFRY AND SAGARRespondent
Through: Mr. Ajay Vohra, Sr. Adv. with
Mr. Aditya Vohra and Mr.
Shashwat Dhamija, Adv.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE RAVINDER DUDEJA
J U D G M E N T

YASHWANT VARMA, J.

1. These two appeals have been instituted by the Principal



Commissioner of Income Tax and call in question the correctness of the judgment rendered by the **Income Tax Appellate Tribunal**¹ on 06 September 2016 pertaining to **Assessment Year**² 2009-10 [ITA 199/2017] and order dated 26 July 2019 pertaining to AY 2011-12 [ITA 449/2022].

2. The appeals had come to be admitted on the following three primary questions as is evident from the order dated 07 March 2017 passed in ITA 199/2017 and which is reproduced hereinbelow:-

“(i) Did the ITAT fall into error in allowing the license fee paid to M/s. Remfry & Sagar for use of goodwill by the assessee, having regard to the provisions in the Bar Council Rules and the Advocate's Act, 1961?

(ii) Did the ITAT overlook the effect of first Explanation to Section 37 of the Income Tax Act, 1961, in the circumstances of the case?

(iii) Whether the ITAT fell into error in holding that the existence or otherwise of a devise, i.e. use of goodwill, was irrelevant in the circumstances of the case.”

3. On hearing learned counsels for parties, we find that the following would appear to be the undisputed facts relevant for the purposes of deciding whether the expenditure claimed by the respondent/assessee was liable to be disallowed in view of Explanation 1 to Section 37 of the **Income Tax Act, 1961**³.

4. Those facts are the following. From the material placed before us, we gather that a sole proprietorship came to be established in 1827 under the name of ‘Grant & Remfry’ by a British immigrant, Mr. Henry Oliver Remfry. That sole proprietorship was subsequently converted into a partnership firm and was operated by five generations of the

¹ Tribunal

² AY

³ Act



Remfry family upto the year 1957. In that year, four partners, Mr. Holloway, Mrs. Silverstone, Mr. Bernier and Mr. Burrington came to join 'Remfry & Sons'. Mr. Bernier and Mr. Burrington are stated to have retired in 1970 as a consequence of which the surviving partners entered into a fresh deed of partnership. In 1973, Mr. Holloway and Mrs. Silverstone transferred the entire business of that partnership along with all the assets including the name and goodwill to Dr. V. Sagar. 'Remfry & Sons' thus came to be acquired by Dr. V Sagar with effect from 01 April 1973 along with the goodwill that had been earned and acquired by that firm over the years.

5. In 1990, Dr. V. Sagar is stated to have merged his sole proprietorship practice being run under the name of 'Sagar & Co.' with 'Remfry & Sons' and changed the name of the proprietorship to 'Remfry and Sagar'. On 01 June 2001, Dr. V. Sagar gifted the goodwill vesting in 'Remfry & Sagar' to a private limited company, **Remfry & Sagar Consultants Private Limited**⁴ by way of a registered instrument. It is pertinent to note that the shareholding of RSCPL was substantially held by Dr. Sagar's children who were not legal practitioners.

6. Soon thereafter, Dr. V. Sagar entered into a partnership with Mr. R. Sampath Kumar, Mrs. Ashwin Julka, Mr. Ramit Nagpal and Mr. Prem Nath Sewak. The partnership deed which came to be executed and constituted the genesis of the firm "Remfry & Sagar" coming into existence, embodied the following significant clauses:-

"III. By a Deed of Gift executed by him on the first day of June, 2001, Dr V Sagar has granted, conveyed, transferred, given and

⁴ RSCPL



assured by way of gift unto and to the use of Remfry & Sagar Consultants Private Limited (hereinafter referred to as "R&S Consultants") a company incorporated under the Companies Act, 1956 freely, voluntarily and without consideration the said Goodwill and R&S Consultants has executed the said Deed of Gift in token of acceptance thereof:

IV. Dr V Sagar has sold and transferred to R&S Consultants the infrastructure associated with the said Practice in the form of office equipment and facilities including the library (hereinafter referred to collectively as "the said Infrastructure"):

V. The Partners are desirous of forming themselves into a partnership ("the Partnership") to carry on the practice and profession of attorneys-at-law with specialisation in the areas of intellectual property law and corporate law with the object of carrying on with effect from June 1,2001 in the National Capital Region and Mumbai the said Practice (hitherto carried on by Dr V Sagar) without a break in its continuity; the practice and profession to be carried on by the Partners being hereinafter referred to as "the Continued Practice";

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VIII. Pursuant to a request by the Partners, R&S Consultants has agreed to:

(a) permit the Partners and the Partnership to use the name "Remfry & Sagar" in the carrying on of the Continued Practice and in connection therewith on terms and conditions incorporated in an Agreement being entered into between the Partners and R&S Consultants contemporaneously with the execution of this Deed of Partnership

(b) make available to the Partners and the Partnership the use of secretarial, accounting and other supporting services for the purpose of carrying on of the Continued Practice on terms and conditions contained in an Agreement being entered into between the Partners and R&S Consultants contemporaneously with the execution of this Deed of Partnership; and

(c) make available to the Partners and the Partnership use of the said Infrastructure for the purpose of carrying on of the Continued Practice on terms and conditions contained in an Agreement being entered into between the Partners and R&S Consultants contemporaneously with the execution of this Deed of Partnership.

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4. The Partnership shall always have a "Senior Partner". He shall be nominated unanimously by the Partners and approved by R&S Consultants. If the Partners fail to achieve unanimity R&S



Consultants shall nominate in writing one of the Partners as Senior Partner. The Partners hereby nominate Dr V Sagar as the first Senior Partner and hereby acknowledge that R&S Consultants has given its approval to said nomination. In the event of Dr V Sagar's disassociation from the said Practice on account of retirement or death, the remaining Partners will forthwith unanimously nominate a Senior Partner from amongst themselves and review the powers to be exercised by him. Should such remaining Partners fail to achieve unanimity either with respect to the nomination of a Senior Partner and/or with respect to the powers to be exercised by him, the decision of R&S Consultants shall prevail and the remaining Partners shall respect such decision."

7. This was followed by the execution of an instrument titled "License of the Use of Goodwill" between RSCPL and the individual partners who had come together to constitute the firm referred to above. We deem it apposite to extract the following covenants which formed part of this License Agreement:-

"I. Dr V Sagar was carrying on the practice and the profession of attorneys-at-law with specialisation in the areas of intellectual property law and corporate law under the name and style of Remfry & Sagar (hereinafter referred to as "the said Practice") at New Delhi in the National Capital Region and Mumbai;

II. The goodwill in the name "Remfry & Sagar" and all rights associated therewith (including intellectual property rights) belonged exclusively to Dr Sagar;

III. By a Deed of Gift executed by him on the first day of June,2001 by Dr V Sagar has granted, conveyed, transferred, given and assured by way of gift unto and to the use of R&S Consultants, freely, voluntarily and without consideration the goodwill in the name "Remfry & Sagar" and all rights associated therewith (including intellectual property rights) and R&S Consultants has executed the said Deed of Gift in token of acceptance thereof;

IV. Contemporaneously with the execution of this Agreement, the said Legal Practitioners have entered into an agreement to form a partnership to carry on the practice and profession of attorneys-at-law with specialisation in the areas of intellectual property law and corporate law with the object of carrying on with effect from June 1,2001 in the National Capital Region and Mumbai the said Practice (hitherto carried on by Dr Sagar) without a break in its continuity, the partnership agreed to be formed by the said Legal Practitioners being hereinafter referred to as "the said Partnership" and the



practice and profession to be carried on by the said Legal Practitioners being hereinafter referred to as the "Continued Practice";

V. The said Legal Practitioners and the said Partnership have requested R&S Consultants to permit them to use the name "Remfry & Sagar" in the carrying on of the Continued Practice and in connection therewith."

8. The aforementioned prefatory clauses were followed by the following substantive provisions which constituted the grant of license:-

"1. R&S Consultants shall permit the said Legal Practitioners and the said Partnership to use the name "Remfry & Sagar" in the carrying on of the Continued Practice and in connection therewith on terms and conditions contained herein.

2. The said Legal Practitioners and the said Partnership shall use the name "Remfry & Sagar" exclusively for the purpose of the Continued Practice and for no other purpose whatsoever.

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5.1 The said Legal Practitioners and the said Partnership agree that all rights in the name "Remfry & Sagar" and all rights associated therewith (including intellectual property rights) belong exclusively to R&S Consultants who alone are entitled to make use thereof or any of them in any manner whatsoever except as is envisaged by this Agreement.

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14.1 In consideration of R&S Consultants permitting the said Legal Practitioners and the said Partnership to use the name "Remfry & Sagar" in the carrying on of the Continued Practice and in connection therewith, the said Legal Practitioners and the said Partnership shall pay to R&S Consultants a sum calculated at the rate of 25% of the amount of bills raised by the said Partnership during the currency of this Agreement. The payment shall be made on monthly basis within fifteen days of the end of each month in respect of bills raised during the previous month.

14.2 Rates of fees to be charged by the said Partnership both for scheduled work and non-scheduled work - shall be decided upon by the Senior Partner of the Continued Practice in consultation with the other partners thereof and no deviation therefrom shall be made without his approval."



9. The **Assessing Officer**⁵ was called upon to scrutinize a return which came to be filed by the respondent/assessee and which had claimed deductions in terms contemplated under Section 37 of the Act in respect of the license fee paid for use of goodwill as well as for the utilization of infrastructure and support services which were governed by separate yet similar license agreements which were executed in favour of the firm. The said return is stated to have been selected for scrutiny and on culmination of assessment, the AO denied the deductions in respect of license fee holding the same to be a colourable transaction aimed at diversion of funds for the personal benefit of the children of Dr. V. Sagar. The AO further held that since RSCPL was not engaged in the practice of law, it could not claim any goodwill.

10. The aforesaid view was assailed by the respondent/assessee before the **Commissioner of Income-Tax (Appeals)**⁶. The CIT(A) came to hold that since the goodwill as acquired by Dr. V. Sagar was amenable to purchase and sale, it could have been validly gifted. It thus came to the conclusion that consequent to Dr. V. Sagar gifting the said goodwill to RSCPL with an intent to institutionalize it in perpetuity, the partnership was liable to pay license fee to RSCPL.

11. The CIT(A) also observed that since the receipts representing license fee had already been taxed in the hands of RSCPL and if that assessee were to be allowed a deduction, it would result in tax being levied twice over. For all the aforesaid reasons, the CIT(A) proceeded to overrule the view that had been expressed by the AO.

12. In the appeal which came to be preferred by the Revenue before

⁵ AO

⁶ CIT(A)



the Tribunal, the appellants appear to have asserted that the expenditure was merely a ruse wholly disconnected with the furtherance of business interest and merely aimed at diversion of funds to the children of Dr. V. Sagar. It was thus urged that the said expenditure could not possibly be characterized as sums expended wholly and exclusively for the purposes of business. The appellants appear to have also urged that for the purposes of examining the legitimacy of the expenditure incurred, it would be the 'purpose test' which would apply and tested on that anvil, the view as taken by the CIT(A) was clearly unsustainable.

13. Before the Tribunal, although the appellants appear to have conceded that the legal heirs of Dr. V. Sagar would be entitled to consideration for goodwill on behalf of their deceased father. However, it was urged that they could not possibly be regarded as lawful owners of the goodwill or claim a right to license the same. This becomes evident from a reading of para 8.11 of the judgment of the Tribunal which is reproduced hereinbelow: -

“8.11. At the same time, the revenue concedes that the legal heirs of the advocates would be entitled to the benefit of the goodwill earned and created by the legal practitioner. It was submitted that the legal heirs may be entitled to consideration for the goodwill on behalf of the deceased father but they cannot be regarded as the lawful owners of the goodwill or having the rights of owning the goodwill or to license the same. In our view, we find a contradiction in these submissions. When it contended that the legal heirs of a practitioner are entitled to receive consideration for goodwill on behalf of the deceased parent, it would be difficult to hold that, the goodwill cannot be separated from the legal practice and the fruits of such goodwill cannot be enjoyed by the legal heirs of the legal practitioner or that it can be enjoyed by the legal heirs only in a particular manner.”

14. The Tribunal, however, proceeded to negate the challenge as



mounted by the Revenue including those in terms of which it was sought to be asserted that the gift was essentially an arrangement for avoidance of tax and diversion of profits. This becomes apparent from a perusal of paras 8.16 to 8.18 and which are extracted hereunder: -

“8.16. Applying the propositions laid down in this case law to the facts of the case, we have to necessarily hold, that the argument of Revenue that the arrangement was for avoidance of tax and diversion of profits and hence the deduction was rightly denied by the Assessing Officer, has to be rejected. Even otherwise, it has been demonstrated by the assessee that the Revenue has accepted that both the entities i.e. the assessee as well as RSCPL, pay taxes, at the maximum rate and that there is no loss of Revenue on account of this arrangement. The taxes due to the Government have not been avoided or evaded by this arrangement. Thus the disallowance made on the ground of diversion of profits is devoid of merit.

8.17. Though the Ld. Special Counsel for the Revenue argued that good will of a profession cannot be sold to a company which does not have a right to carry on practice, no specific law or section was brought to the notice of the Bench in support of the argument. Only several submissions have been made. Certain judgements of Foreign Courts were cited, which were based on "ethical considerations" and not legal prohibition. In any event, the ITAT has no power or authority to adjudicate the issue as to whether, the gift of goodwill by Dr. V. Sagar of his profession of law, to a company is violating the Advocates Act, 1961 or the Bar Council Rules. No authority has held that this arrangement violates any Act or law of the land, though the assessee firm has been carrying on its profession of Attorneys at law under this arrangement for the last many years.

8.18. Another important fact that has to be considered is that, Dr. V. Sagar had the sole and exclusive rights to the said goodwill. The goodwill was held by him. Without legal authorization from him, the assessee firm could not use the name and style of “Remfry & Sagar” along with its goodwill and other assets and rights. The assessee firm had to seek permissions and licences to continue and carry on its profession under as the goodwill is not owned by it the payment made in pursuance of an agreement which enable the assessee firm to carry on its professions, in the manner in which it is now doing definitely an expenditure laid down wholly and exclusively for the purpose of business or profession. The argument of the Ld. Special Council that the purpose test contemplated u/s 37 of the Act is not satisfied is devoid of merit. Irrespective of whether the gift of Dr. V.Sagar to RSCPL being ethical or not and irrespective of the fact whether the gift is legally valid or not, from



the view point of the assessee firm, as it could not have continued and carried on the profession of Attorneys-at-Law in the name of "Remfry & Sagar" and use its goodwill and all its associated rights without the impugned agreement with RSCPL. Hence the payment has to be held as that which is incurred wholly .and exclusively for the purpose of business or profession.”

15. Appearing in support of the appeal, it was the aforementioned contentions which were reiterated by Mr. Rai. However, the principal argument which was addressed by Mr. Rai before us revolved upon Explanation 1 to Section 37 and proceeded along the following lines. Mr. Rai firstly drew our attention to Chapter 3 comprised in the Bar Council of India Rules and which while setting out conditions for a right to practice provides for what he termed to be a prohibition in law. The provision on which Mr. Rai’s submissions principally rested reads as follows: -

“Chapter III (Conditions for right to practice)
(Rules under Section 49(1) (ah) of the Act)

2. An advocate shall not enter into a partnership or any other arrangement for sharing remuneration with any person or legal practitioner who is not an advocate.”

16. According to Mr. Rai, the aforesaid condition contained in Chapter 3 is liable to be viewed as a prohibition introduced by law and the expenditure thus falling foul of Explanation 1. The aforesaid contention was premised on the relevant clauses comprised in the license agreements entered into between RSCPL and the partners of the firm and which had linked the consideration payable for the permissive use of the name “Remfry & Sagar” to 25% of the amount billed and earned by the partnership firm. According to Mr. Rai, the aforesaid clause would clearly fall within the ambit of the prohibition of sharing of remuneration with a person who was neither a legal practitioner nor



an advocate.

17. Mr. Rai also relied upon the following principles as enunciated by the Supreme Court in **Apex Laboratories Private Limited Vs Deputy Commissioner of Income Tax**⁷ and which had an occasion to explain the scope of Explanation 1 of Section 37. It becomes pertinent to note that *Apex Laboratories* was concerned with the providing of extravagant amenities and “freebies” to medical practitioners in exchange for prescribing expensive branded medication. While dealing with the issue of whether such benefits could be legitimately claimed as business expenses, the Supreme Court held as follows:-

“24. This Court is of the opinion that such a narrow interpretation of Explanation 1 to Section 37(1) defeats the purpose for which it was inserted i.e. to disallow an assessee from claiming a tax benefit for its participation in an illegal activity. Though the memorandum to the Finance Bill, 1998 elucidated the ambit of Explanation 1 to include “protection money, extortion, hafta, bribes, etc.”, yet, ipso facto, by no means is the embargo envisaged restricted to those examples. It is but logical that when acceptance of freebies is punishable by the MCI (the range of penalties and sanction extending to ban imposed on the medical practitioner), pharmaceutical companies cannot be granted the tax benefit for providing such freebies, and thereby (actively and with full knowledge) enabling the commission of the act which attracts such opprobrium.

25. The illogicality and completely misconceived nature of such an interpretation was dealt with in a similar interpretation of the provisions of the PC Act, by a Constitution Bench of this Court in *P.V. Narasimha Rao v. State (CBI/SPE)* [*P.V. Narasimha Rao v. State (CBI/SPE)*, (1998) 4 SCC 626 : 1998 SCC (Cri) 1108] . Prior to the 2018 Amendment [Subs. Section 8, Act 16 of 2018, w.e.f. 26-7-2018.] , the PC Act only punished the bribe-taker who was a public servant, and not the bribe-giver. Reliance was placed on this to acquit the appellant bribe-giver. Rejecting such an interpretation, this Court held:

⁷ (2022) 7 SCC 98



“145. Mr Rao submitted that since, by reason of the provisions of Article 105(2), the alleged bribe-takers had committed no offence, the alleged bribe-givers had also committed no offence. Article 105(2) does not provide that what is otherwise an offence is not an offence when it is committed by a Member of Parliament and has a connection with his speech or vote therein. What is provided thereby is that a Member of Parliament shall not be answerable in a court of law for something that has a nexus to his speech or vote in Parliament. If a Member of Parliament has, by his speech or vote in Parliament, committed an offence, he enjoys, by reason of Article 105(2), immunity from prosecution therefor. Those who have conspired with the Member of Parliament in the commission of that offence have no such immunity. They can, therefore, be prosecuted for it.

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147. Mr Rao submitted that the alleged bribe-givers had breached Parliament's privilege and been guilty of its contempt and it should be left to Parliament to deal with them. By the same sets of acts the alleged bribe-takers and the alleged bribe-givers committed offences under the criminal law and breaches of Parliament's privileges and its contempt. From prosecution for the former, the alleged bribe-takers, Ajit Singh excluded, enjoy immunity. The alleged bribe-givers do not. The criminal prosecution against the alleged bribe-givers must, therefore, go ahead. For breach of Parliament's privileges and its contempt, Parliament may proceed against the alleged bribe-takers and the alleged bribe-givers.

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150. To repeat what we have said earlier, Mr Rao is right, subject to two caveats, in saying that Parliament has the power not only to punish its Members for an offence committed by them but also to punish others who had conspired with them to have the offence committed : first, the actions that constitute the offence must also constitute a breach of Parliament's privilege or its contempt; secondly, the action that Parliament will take and the punishment it will impose is for the breach of privilege or contempt. There is no reason to doubt that the Lok Sabha can take action for breach of privilege or contempt against the alleged bribe-givers and against the alleged bribe-takers, whether or not they were Members of Parliament, but that is not to say that the courts



cannot take cognizance of the offence of the alleged bribe-givers under the criminal law.”

26. Even if Apex's contention were to be accepted—that it did not indulge in any illegal activity by committing an offence, as there was no corresponding penal provision in the 2002 Regulations applicable to it—there is no doubt that its actions fell within the purview of “prohibited by law” in Explanation 1 to Section 37(1).

27. Furthermore, if the statutory limitations imposed by the 2002 Regulations are kept in mind, Explanation 1 to Section 37(1) of the IT Act and the insertion of Section 20-A of the Medical Council Act, 1956 [Inserted vide Medical Council (Amendment) Act, 1964.] (which serves as parent provision for the Regulations), what is discernible is that the statutory regime requiring that a thing be done in a certain manner, also implies (even in the absence of any express terms), that the other forms of doing it are impermissible.

28. In this regard the decision of this Court in Jamal Uddin Ahmad v. Abu Saleh Najmuddin [Jamal Uddin Ahmad v. Abu Saleh Najmuddin, (2003) 4 SCC 257] is of some relevance. There, the scope of Section 81 of the Representation of the People Act, 1951 was examined in the light of powers of the High Court to administer election petitions by invoking the rule of implied prohibition. The Court observed that:

“11. Dealing with “Statutes conferring power; implied conditions, judicial review”, Justice G.P. Singh states in the Principles of Statutory Interpretation (8th Edn., 2001, at pp. 333, 334) that a power conferred by a statute often contains express conditions for its exercise and in the absence of or in addition to the express conditions there are also implied conditions for exercise of the power. An affirmative statute introductive of a new law directing a thing to be done in a certain way mandates, even if there be no negative words, that the thing shall not be done in any other way. This rule of implied prohibition is subservient to the basic principle that the Court must, as far as possible, attach a construction which effectuates the legislative intent and purpose. Further, the rule of implied prohibition does not negative the principle that an express grant of statutory power carries with it by necessary implication the authority to use all reasonable means to make such grant effective. To illustrate, an Act of Parliament conferring jurisdiction over an offence implies a power in that jurisdiction to make out a warrant and secure production of the person charged with the offence; power conferred on the Magistrate to grant maintenance under Section 125 of the Code of Criminal



Procedure, 1973 to prevent vagrancy implies a power to allow interim maintenance; power conferred on a local authority to issue licences for holding “hats” or fairs implies incidental power to fix days therefor; power conferred to compel cane growers to supply cane to sugar factories implies an incidental power to ensure payment of price. In short, conferment of a power implies authority to do everything which could be fairly and reasonably regarded as incidental or consequential to the power conferred.

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21. Herbert Broom states in the preface to his celebrated work on Legal Maxims —‘In the legal science, perhaps more frequently than in any other, reference must be made to first principles.’ The fundamentals or the first principles of law often articulated as the maxims are manifestly founded in reason, public convenience and necessity. Modern trend of introducing subtleties and distinctions, both in legal reasoning and in the application of legal principles, formerly unknown, have rendered an accurate acquaintance with the first principles more necessary rather than diminishing the values of simple fundamental rules. The fundamental rules are the basis of the law; maybe either directly applied, or qualified or limited, according to the exigencies of the particular case and the novelty of the circumstances which present themselves.

In *Dhannalal v. Kalawatibai* [*Dhannalal v. Kalawatibai*,2002) 6 SCC 16] this Court has held that :

‘20. ... When the statute does not provide the path and the precedents abstain to lead, then sound logic, rational reasoning, common sense and urge for public good play as guides of those who decide’.”

29. It is also a settled principle of law that no court will lend its aid to a party that roots its cause of action in an immoral or illegal act (ex dolo malo non oritur actio) meaning that none should be allowed to profit from any wrongdoing coupled with the fact that statutory regimes should be coherent and not self-defeating. Doctors and pharmacists being complementary and supplementary to each other in the medical profession, a comprehensive view must be adopted to regulate their conduct in view of the contemporary statutory regimes and Regulations. Therefore, denial of the tax benefit cannot be construed as penalising the assessee pharmaceutical company. Only its participation in what is plainly an action prohibited by law, precludes the assessee from claiming it as a deductible expenditure.



30. This Court also notices that medical practitioners have a quasi-fiduciary relationship with their patients. A doctor's prescription is considered the final word on the medication to be availed by the patient, even if the cost of such medication is unaffordable or barely within the economic reach of the patient —such is the level of trust reposed in doctors. Therefore, it is a matter of great public importance and concern, when it is demonstrated that a doctor's prescription can be manipulated, and driven by the motive to avail the freebies offered to them by pharmaceutical companies, ranging from gifts such as gold coins, fridges and LCD TVs to funding international trips for vacations or to attend medical conferences. These freebies are technically not “free”—the cost of supplying such freebies is usually factored into the drug, driving prices up, thus creating a perpetual publicly injurious cycle. The threat of prescribing medication that is significantly marked up, over effective generic counterparts in lieu of such a quid pro quo exchange was taken cognizance of by the Parliamentary Standing Committee on Health and Family Welfare [45th Report on Issues Relating to Availability of Generic, Generic-Branded and Branded Medicines, their Formulation and Therapeutic Efficacy and Effectiveness, dated 4-8-2010.] which made the following observations:

“The Committee also notes that despite there being a code of ethics in the Medical Council Rules introduced in December 2009 forbidding doctors from accepting any gift, hospitality, trips to foreign and domestic destinations, etc. from healthcare industry, there is no let-up in this evil practice and the pharma companies continue to sponsor foreign trips of many doctors and shower with high value gifts like air conditioners, cars, music systems, gold chains, etc. to obliging prescribers who then prescribe costlier drugs as quid pro quo. Ultimately all these expenses get added up to the cost of drugs. The Committee's attention was drawn to a news item in Times of India dated 1-7-2010 by Reema Nagarajan giving specific instances of violations of MCI Code. The Committee calls upon the Government to take strict and speedy action on such violations. Since MCI has no jurisdiction over drug companies, the Government should take parallel action through DCGI and the Income Tax Department to penalise those companies that violate the MCI Rules by cancelling drug manufacturing licences and/or disallowing expenses on unethical activities.”

18. Proceeding further to hold that the agreement between pharmaceutical companies and medical practitioners would violate Section 23 of the Indian Contract Act, 1872 the Supreme Court



pertinently observed: -

“34. The impugned judgment, along with the judgments of the Punjab & Haryana High Court (Kap Scan [CIT v. Kap Scan & Diagnostic Centre (P) Ltd., 2010 SCC OnLine P&H 12926 : (2012) 344 ITR 476]) and the Himachal Pradesh High Court (Confederation [Confederation of Indian Pharmaceutical Industry (SSI) v. Central Board of Direct Taxes, 2012 SCC OnLine HP 8007 : (2013) 353 ITR 388]) have correctly addressed the important public policy issue on the subject of allowance of benefit for supply of freebies. The impugned judgment's [Apex Laboratories (P) Ltd. v. CIT, 2019 SCC OnLine Mad 38980] reasoning is quoted as follows: (Apex Laboratories case [Apex Laboratories (P) Ltd. v. CIT, 2019 SCC OnLine Mad 38980] , SCC OnLine Mad para 3)

“3. ... 8. A perusal of the decision [Apex Laboratories (P) Ltd. v. CIT, 2017 SCC OnLine ITAT 20260] of Co-ordinate Bench of this Tribunal in the assessee's own case as also the decision [Confederation of Indian Pharmaceutical Industry (SSI) v. Central Board of Direct Taxes, 2012 SCC OnLine HP 8007 : (2013) 353 ITR 388] of the Hon'ble Himachal Pradesh High Court clearly shows that the basic intention of the decision was that the receiving of the gifts/freebies by Professionals is against public policy as also against the law insofar as the amendment by the Medical Council Act, 1956 to the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, once receiving of such gifts have been held to be unethical obviously the corollary to this would also be unethical, being giving of such gifts or doing such acts to induce such Doctors and Medical Professionals to violate the Medical Council Act, 1956.”

35. Thus, one arm of the law cannot be utilised to defeat the other arm of law—doing so would be opposed to public policy and bring the law into ridicule. [Biharilal Jaiswal v. CIT, (1996) 1 SCC 443 : 1995 Supp (5) SCR 285] In Maddi Venkataraman & Co. (P) Ltd. v. CIT [Maddi Venkataraman & Co. (P) Ltd. v. CIT, (1998) 2 SCC 95] , a fine imposed on the assessee under the Foreign Exchange Regulation Act, 1947 was sought to be deducted as a business expenditure. This Court held : (Maddi Venkataraman case [Maddi Venkataraman & Co. (P) Ltd. v. CIT, (1998) 2 SCC 95] , SCC p. 105, para 24)

“24. Moreover, it will be against public policy to allow the benefit of deduction under one statute, of any expenditure incurred in violation of the provisions of another statute or any penalty imposed under another statute. In the instant



case, if the deductions claimed are allowed, the penal provisions of FERA will become meaningless.”

36. It is crucial to note that the agreement between the pharmaceutical companies and the medical practitioners in gifting freebies for boosting sales of prescription drugs is also violative of Section 23 of the Contract Act, 1872 (as also noted by the Punjab and Haryana High Court in Kap Scan [CIT v. Kap Scan & Diagnostic Centre (P) Ltd., 2010 SCC OnLine P&H 12926 : (2012) 344 ITR 476]). The provision is as follows:

“23. What considerations and objects are lawful, and what not.—The consideration or object of an agreement is lawful, unless—
it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or the Court regards it as immoral, or opposed to public policy. In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful, is void.”

37. Before us, Apex has continually stressed on the need to divorce interpretation of tax provisions from a perceived immorality/violation of public policy. Apex repeatedly relied on T.A. Quereshi [T.A. Quereshi v. CIT, (2007) 2 SCC 759] , Khemchand Motilal Jain [CIT v. Khemchand Motilal Jain, 2011 SCC OnLine MP 681 : (2011) 4 MP LJ 691] and CIT v. Vishwanath Sharma [CIT v. Vishwanath Sharma, 2008 SCC OnLine All 200] . We find that none of these judgments find much favour with the case of the appellant. T.A. Quereshi [T.A. Quereshi v. CIT, (2007) 2 SCC 759] addressed a business “loss”, not a business “expenditure” as envisioned under Section 37(1). In Khemchand Motilal Jain [CIT v. Khemchand Motilal Jain, 2011 SCC OnLine MP 681 : (2011) 4 MP LJ 691] , the ransom money paid to kidnappers of the employee of the assessee company was allowed deduction primarily based on the fact that the assessee was helpless and coerced to pay the amount in order to save its employee's life. Thus, the assessee was not a wilful participant in commission of an offence or activity prohibited by law. The same is not applicable to the present facts. Pharmaceutical companies have misused a legislative gap to actively perpetuate the commission of an offence. In Vishwanath Sharma [CIT v. Vishwanath Sharma, 2008 SCC OnLine All 200] , a Division Bench of the Allahabad High Court was faced with the question of whether payment of commission to government doctors could be exempted under Section 37(1). At the time, there was no statutory provision prohibiting doctors engaged in private practice



from accepting such commission. Hence, the High Court held that while the assessing officer had correctly allowed such deduction for private doctors, the same could not be allowed for government doctors : (Vishwanath Sharma case [CIT v. Vishwanath Sharma, 2008 SCC OnLine All 200] , SCC Online All paras 11 & 16)

“11. In the present case, payment of commission to government doctors cannot be placed on the same pedestal. A distinction has already been made by the authorities while allowing deduction to the assessee in respect to commission which the assessee has paid to private doctors since in their case, payment of commission cannot be said to be an offence under any statute but in respect to government doctors such payment could not have been allowed as it is an offence under the statutes as stated above.

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16. We are, therefore, clearly of the opinion that payment as commission to government doctors for obtaining a favour therefrom by prescribing medicines in which the assessee was dealing cannot be said to be a “business expenditure” and no deduction can be allowed thereof under the Act.”

(emphasis supplied)

The 2002 Regulations, applicable to all medical practitioners (including doctors in private practice), was introduced w.e.f. 14-12-2009.”

19. It ultimately came to record the following conclusions: -.

“44. In the present case too, the incentives (or “freebies”) given by Apex, to the doctors, had a direct result of exposing the recipients to the odium of sanctions, leading to a ban on their practice of medicine. Those sanctions are mandated by law, as they are embodied in the code of conduct and ethics, which are normative, and have legally binding effect. The conceded participation of the assessee—i.e. the provider or donor—was plainly prohibited, as far as their receipt by the medical practitioners was concerned. That medical practitioners were forbidden from accepting such gifts, or “freebies” was no less a prohibition on the part of their giver, or donor i.e. Apex.”

20. It was in the aforesaid backdrop, that Mr. Rai urged that the proscription comprised in the Bar Council of India Rules with respect to sharing of remuneration had clearly been violated and consequently the expenditure was liable to be disallowed in terms contemplated by



Explanation 1 forming part of Section 37.

21. Appearing for the respondent assessee, Mr. Vohra, learned senior counsel submitted that it would be wholly incorrect to view the Bar Council of India Rules as amounting to a prohibition imposed by law and thus fall within the ken of Explanation 1. Mr. Vohra submitted that the Explanation to Section 37 prohibits an expenditure which may have been incurred for the purposes of commission of an offense or an action prohibited by law. Learned senior counsel essentially laid emphasis on the provision embodying the word “*purpose*” and which according to Mr. Vohra would have to necessarily be read as envisaging expenditure incurred for a purpose which is prohibited by law

22. It was contended that undisputedly and in terms of the license agreements, the remuneration which was paid to RSCPL was in lieu of the grant of license to utilize the goodwill represented by the name “Remfry & Sagar”. Mr. Vohra submitted that the name “Remfry & Sagar” had earned substantial goodwill which had been acquired over several decades as a result of delivering exceptional legal services. It was thus submitted that the payment of licence fee was solely for the purposes of enabling the newly constituted firm to derive benefits of the goodwill attached to the name “Remfry & Sagar”. Bearing in mind the same constituting the primary purpose for payment of license fee, Mr. Vohra submitted the same could not be possibly construed as being an expenditure prohibited by law.

23. It was his submission that the appellants were wholly unjustified in seeking to interpret the provisions of the license agreement as embodying an intent of sharing of remuneration with RSCPL or the



heirs of Dr V. Sagar. This, according to Mr. Vohra, clearly overlooks the principal purpose for which license fee was agreed to be paid and which was to use and exploit the goodwill attached to the name “Remfry & Sagar”. It was thus his contention that if the purpose of payment of license fee were borne in consideration, the Court would come to the inevitable conclusion that the same was for utilizing goodwill and which could by no stretch of imagination be said to be an offence or an act prohibited by law.

24. Mr. Vohra also commended for our consideration the well settled precept of courts being obliged to look at and discern the real nature of a transaction, the aim and object underlying the expenditure incurred in order to answer the issue of whether the expenditure was for the purpose of business. Our attention in this respect was firstly drawn to the decision of the Supreme Court in **Assam Bengal Cement Co Ltd Vs CIT**⁸ and where the aforesaid principle was explained in the following terms:-

“ 22. In *Benarsidas Jagannath, In re* [*Benarsidas Jagannath, In re*, 1946 SCC OnLine Lah 71 : (1947) 15 ITR 185 (Lah)] , a Full Bench of the Lahore High Court attempted to reconcile all these decisions and deduced the following broad tests for distinguishing capital expenditure from revenue expenditure. The opinion of the Full Bench was delivered by Mahajan, J. as he then was, in the terms following : (ITR pp. 198-99)

“... It is not easy to define the term “capital expenditure” in the abstract or to lay down any general and satisfactory test to discriminate between a capital and a revenue expenditure. Nor is it easy to reconcile all the decisions that were cited before us for each case has been decided on its peculiar facts. Some broad principles can, however, be deduced from what the learned Judges have laid down from time to time. They are as follows:

⁸ (1954) 2 SCC 672



(1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment : vide Lord Sands in *IRC v. Granite City Steamship Co. Ltd.* [*IRC v. Granite City Steamship Co.*, 1927 SC 705 : 13 TC 1 at p. 14] at TC p. 14. In *City of London Contract Corpn. v. Styles* [*City of London Contract Corpn. v. Styles, (Surveyor of Taxes)*, (1887) 2 TC 239 at p. 243 (CA)] at TC p. 243, Bowen L.J. observed as to the capital expenditure as follows:

‘You do not use it “for the purpose of” your concern, which means, for the purpose of carrying on your concern, but you use it to acquire the concern.’

(2) Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade : vide Viscount Cave, L.C., in *Atherton v. British Insulated & Helsby Cables Ltd.* [*Atherton (Inspector of Taxes) v. British Insulated & Helsby Cables Ltd.*, 1926 AC 205 : 10 TC 155 (HL)] If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be deducted out of the profits by claiming that it relieves the annual labour bill, the business has acquired a new asset, that is, machinery.

The expressions “enduring benefit” or “of a permanent character” were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset.

(3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it.”



23. This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the principles which emerge from the authorities. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlay whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital expenditure. The question however arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. If it was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in the manner above indicated.”

25. Mr. Vohra also cited for our consideration the decision rendered by this Court in **Shriram Refrigeration Industries Ltd Vs CIT**⁹ and where the test was formulated as warranting a determination of the purpose for which the amount had been paid. It was thus contended that

⁹ (1981) 127 ITR 746 (Del)



Courts have consistently applied the “*purpose test*” in order to ascertain the legitimacy of an expenditure stated to have been incurred in the course of and in furtherance of business. It is these rival submissions which fall for our consideration.

26. We at the outset note that the disallowance which is contemplated under Section 37 is expenditure incurred for any purpose which is an offense or a purpose prohibited by law. It is thus manifest that it is principally the purpose for which the expenditure is incurred which would be decisive of whether it is liable to be disallowed. Regard must also be had to the fact that the expression “prohibited by law” is coupled to the commission of an offense. It is, therefore, apparent that the expenditure which the provision intends to be ignored and disallowed is that which may be expended for commission of an offense or like motive. We would, therefore, have to consider whether consideration parted for use of goodwill would fall within the scope of that expression as well as whether the asserted violation of the Bar Council of India Rules would have justified the disallowance.

27. We at the outset note that it is not the case of the appellants that an offense, as generally understood, was committed. According to them, a violation of the Bar Council of India rules amounted to the respondent acting in violation of a statutory prohibition and thus the expenditure liable to be disallowed.

28. We find ourselves unable to sustain that contention since, in our considered opinion, it is the principal purpose test which would be determinative of whether the expenditure was one which could have been disallowed. As noticed in the previous parts of this judgment,



while examining the reach of the Explanation to Section 37, it would have to be found as a matter of fact that the expenditure was incurred for the commission of an offense as known in law or for a purpose prohibited. A breach of the Bar Council of India Rules is admittedly not classified as an offense. That then leaves us to examine whether the purpose underlying the expenditure was for a purpose prohibited by law.

29. As was rightly contended by Mr. Vohra, the primary, nay, sole purpose for incurring expenditure towards license fee was to use the words “Remfry & Sagar” and derive benefit of the goodwill attached to it. The appellant do not dispute that Dr. Sagar had validly acquired the goodwill and that the same constituted a valuable asset which was transferable. The execution of the gift deed is also not questioned. What the appellant seeks to contend is that the gift to RSCPL was a ruse.

30. We at the outset note that the validity of the gift deed was clearly an unwarranted digression since the primary question which arose for consideration was the validity of the expenditure incurred. The solitary transaction which arose for scrutiny was the payment of license fee. We fail to appreciate how the appellants could have meandered down the path of questioning the validity of the gift or doubting the motive, purpose and intent underlying the same. Whether the same was a measure adopted for the purpose of monetising the goodwill or a part of legacy planning were clearly not issues germane to the question whether the expenditure was liable to be disallowed. We, in this regard, also bear in consideration the undisputed fact that four unrelated parties joined the partnership and unanimously decided to make use of the goodwill and the name of the firm which had earned a considerable



reputation. The appellants thus, and in our considered opinion, clearly committed an error in seeking to question the motive underlying the gift made by Dr. Sagar.

31. We then revert to the fundamental issue of whether the payment of license fee could be regarded as an expenditure incurred for a purpose prohibited by law. A payment made for use of goodwill cannot possibly be viewed as being an illegal purpose or one prohibited by law. A person would be obliged to part with consideration for the use of goodwill if it seeks to derive benefit and advantage therefrom. Undisputedly, Remfry & Sagar had acquired a reputation and goodwill in the field of legal services. What the respondent assessee thus sought to do was to derive advantage and benefit of association as also the use of a name which carried a reputation in the legal arena. The agreement to utilise and derive benefits of goodwill cannot therefore be viewed as a ruse or one aimed at tax avoidance.

32. We have already found that it was permissible for Dr. Sagar to monetise the goodwill acquired and earned. The goodwill thus represented an asset held by Dr. Sagar and which could have been validly gifted to his children. It was the resultant firm which sought to derive benefit from the goodwill attached to that name. The consideration paid for the use of the same, thus, can neither be said to be for an unlawful purpose or one motivated by the intent to overcome a prohibition raised by law.

33. Insofar as the Bar Council of India Rules are concerned, they are concerned with a sharing of revenue and fee. What those rules proscribe is the sharing of remuneration earned by a firm of lawyers



with one who is not a member of the legal profession. The use of the word “sharing” in that Rule is clearly intended to deal with a situation where a lawyer intends to part with or enter into an arrangement with another to claim a part or portion of the fee that may be earned. What the said Rule envisages is an arrangement where a lawyer agrees to share the fee earned from a practise with someone who is not a lawyer. It prohibits a split, divide, dividend or equity in the revenue that may be generated by a law practise.

34. However in the facts of the present case, we find that the reference to a percentage of the revenue earned by the law practise was intended to principally provide for a basis to compute the consideration liable to be paid for use of goodwill and the utilisation of the name. The primary purpose of referring to the total billing of the law firm was to provide a firm, definite and fixed basis to compute the consideration liable to be paid for use of goodwill. The consideration so paid is thus clearly not liable to be characterised as a sharing of revenue derived from the practise but fundamentally for the exercise of the right to exploit and derive advantage from goodwill.

35. The linking of the consideration for the aforesaid purpose to the revenue earned by the firm only constituted a basis and a measure to determine the consideration that was to be paid. The arrangement was clearly not driven by a motive to share revenues earned by the legal firm. It was purely consideration paid for use of the goodwill attached to the name “Remfry & Sagar”. We thus find ourselves unable to accept the argument of the appellant that the Bar Council of India Rules were violated.



36. The sheet anchor of the submissions advanced by Mr. Rai was the judgment of the Supreme Court in *Apex Laboratories* and where the “freebies” provided to legal practitioners was found to be an expenditure incurred for a purpose prohibited by law. In our considered opinion, the reliance placed on *Apex Laboratories* is clearly misplaced since the said judgment turned upon Regulation 6.8 of the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 and which clearly prohibited a medical practitioner from receiving gifts, travel expenses, hospitality as well as cash or other monetary grants. It was that prohibition in law which was found to have been violated. In view of all of the above, we find ourselves unconvinced of the challenge that stands raised in these appeals.

37. We would consequently answer the questions posed for our consideration in the negative and against the appellants. The appeals shall stand dismissed.

YASHWANT VARMA, J.

RAVINDER DUDEJA, J.

JANUARY 31, 2025 *Ineha*