आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'D', CHENNAI

श्री संजय अरोड़ा, लेखा सदस्य एवं श्री जी. जॉर्ज माथन, न्यायिक सदस्य के समक्ष
BEFORE SHRI SANJAY ARORA, ACCOUNTANT MEMBER
AND SHRI GEORGE MATHAN, JUDICIAL MEMBER

आयकर अपील सं./ITA No.476 /Mds/2017
निर्धारण वर्ष / Assessment Year : 2013-14

BGR Investment Holding Company Ltd., New No.60, Old No.100, IV Street, Abhiramapuram, Chennai – 600 018. [PAN: AACS 7054B]	Vs.	Dy. Commissioner of Income Tax, Corporate Circle-1(2), Chennai – 600 034.
(**अपीलार्थी /Appellant**)		(**प्रत्यर्थी/Respondent**)

आयकर अपील सं./ITA No.507/Mds/2017 &
CO.No.41/Mds/2017
निर्धारण वर्ष / Assessment Year : 2013-14

Asst. Commissioner of Income Tax, Corporate Circle-1(2), Chennai – 600034.	Vs.	BGR Investment Holding Company Ltd., New No.60, Old No.100, IV Street, Abhiramapuram, Chennai – 600 018. [PAN: AACS 7054B]
(**अपीलार्थी /Appellant**)		(**प्रत्यर्थी/Respondent/Cross Objector**)

अपीलार्थी की ओर से / Appellant by	:	Ms. CA Jharna B Harilal, FCA
प्रत्यर्थी की ओर से/Respondent by	:	Ms. Vijayaprabha, Jt. CIT
सुनवाई की तारीख/ Date of hearing	:	31.08.2017
घोषणा की तारीख /Date of Pronouncement	:	08.09.2017

आदेश /O R D E R

Per Sanjay Arora, AM:

These are cross appeals by the Assessee and the Revenue directed against the Order by the Commissioner of Income Tax (Appeals)-1, Chennai ('CIT(A)'

for short) dated 02/12/2016, partly allowing the assessee's appeal contesting its assessment u/s. 143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) for assessment year (AY) 2013-14 vide the order dated 14.01.2016. The assessee has in addition also preferred a Cross Objection.

2. The only issue arising in the instant appeals is the maintainability or otherwise in law of the assessee's claim for deduction in respect of a sum of ₹. 1,06,67,930/-, paid as professional charges to one, M/s. Proskauer Rose LLP, USA, stated to be a law firm, by the assessee, an investment holding company. The basis of the disallowance is the non-deduction of tax at source u/s. 195, attracting disallowance u/s. 40(a)(i) and, in any case, being capital in nature, so that it is inadmissible u/s. 37(1). The assessee's case *qua* the latter objection having not been accepted by the ld. CIT(A), is in appeal in its respect, while the Revenue appeals the deletion of the disallowance on the ground of non-application of sec. 40(a)(i). The assessee's CO is supportive.

3. We have heard the parties, and perused the material on record.

We shall consider the aspect of deduction u/s. 37(1) first. This is as only where the amount is deductible that the *non obstante* provision of s. 40(a)(i) could operate to render it non-deductible on the satisfaction of the condition/s specified therein. The payment admittedly is for representing the assessee (and one or more of its US affiliates, referred to collectively as the 'Clients') for the purpose of bidding on and potentially acquiring the business and assets of Qual Teq, Inc. and its affiliates in their Chapter 11 bankruptcy proceedings currently on in the US Bankruptcy Court for the new district of Illinois, referred to as the 'Project' in the engagement letter dated October 12, 2012 (PB pages 17 – 20). It is stated before us that the acquisition did not materialize, and the expense was thus abortive. Relying on *CIT v. United Breweries Ltd.* [2010] 321 ITR 546 (Kar), it is pleaded that the expenditure incurred in connection with acquiring a

capital asset, being in the nature of a fee paid toward consultation for the business expansion, is to be regarded as revenue expenditure inasmuch as the expenditure incurred may or may not result in the acquisition of a capital asset, the very purpose of the expenditure being to find out the prudence or the feasibility of acquiring the asset by seeking an expert opinion thereon. The Revenue, on the other hand, is of the view that if the project had been acquired, the relevant expenditure would be capitalized. Even if therefore the venture did not materialize, the expenditure would remain capital in nature (para 23 of the impugned order – IO). Reliance for the purpose is placed on a number of decisions, viz. *Swadeshi Cotton Mills Co Ltd v. CIT* [1967] 63 ITR 65 (SC); *Kwality Fun Foods and Restaurants (P.) Ltd.* [2013] 356 ITR 170 (Mad) (refer paras 24 and 25 of IO). Without doubt, the character of the expenditure would not alter merely because the object or the purpose for which it is incurred does not fructify. The success of the expenditure does not determine its admissibility, or result in a change in its character, as explained by the Apex Court in *CIT v. Rajendra Prasad Moody* [1978] 115 ITR 519 (SC). In S*wadeshi Cotton Mills Co. Ltd.* (supra), a decision by a larger bench of the Apex Court, the amount paid on cancellation of a contract for purchase of machinery, claimed as a business loss, was held as only capital expenditure. The decision stands followed and applied in a number of decisions by the Hon'ble High Courts, including the Hon'ble jurisdictional High Court. In *Kwality Fun Foods and Restaurants (P.) Ltd.* (supra), again, following another decision by the Apex Court, the Hon'ble Court held that the loss of advance paid by the assessee, a manufacturer of ice cream, for constructing a cold storage plant, claimed as a business loss, was only capital expenditure. The basis of the decision in *United Breweries Ltd.* (supra) is that a feasibility report is being prepared with a view to decide if the project is to be taken up or not. In the present case, on the other hand, the decision to acquire, or undertake the project, by following the legal process, has already been arrived at, and it is on following the same that the

expenditure has been incurred. The said decision would thus be of no assistance to the assessee. Why, the expenditure on feasibility studies, etc., decidedly capital, is covered by sec. 35D of the Act. Again, the issue involved in *CIT v. Relaxo Footwears Ltd.* [2007] 293 ITR 231 (Del), another decision relied upon by the assessee, is in respect of capital issue and preoperative expenses. The same are clearly capital in nature, and for which reference may be made to the decisions in the case of *Brooke Bond India Ltd. v. CIT* [1997] 225 ITR 798 (SC) and *Challapalli Sugar Ltd. v. CIT* [1975] 98 ITR 167 (SC), being in relation to capital issue and preoperative expenses respectively. Whether the new unit is being set up as a part of the existing business or new business, is wholly irrelevant. Why, new additions to assets, viz. by way of plant and machinery, etc. for the existing busines keep taking place all the time, and does not cease to be the acquisition of a capital asset for that reason. The advance for machinery in *Swadeshi Cotton Mills Co. Ltd* (supra); *Kwality Fun Foods and Restaurants* (supra); and *Hasimara Industries Ltd. v. CIT* [1998] 231 ITR 842 (SC), relied upon by the Hon'ble jurisdictional High Court, was only for the existing business. The principle involved is well settled, and the assessee's case in this regard is wholly without merit.

The moot question, however, to be answered is if what was being acquired is indeed a capital asset, an acquisition of and, thus, an enhancement in the profit-making apparatus of the assessee company. The ld. AR would toward this draw our attention to object clause 1 of the assessee's Memorandum of Association (PB pgs. 21-25), which reads as under, stating, on that basis, that the company would earn dividend income from the shares bought:

> '1. To carry on the business of investment company in all its branches to buy, underwrite, invest in and acquire and hold, sell and deal in shares, stocks, debentures, debentures stocks, bonds, obligations and securities issued or guaranteed by any company constituted or carrying on business in India or abroad and debentures stocks, bonds, obligations and securities issued or guaranteed by any Government, State or authority, body corporate or any person whether in India or

> elsewhere and to deal with and turn to account the same, provided always that no part of investment imposing unlimited liability on the company shall be made.'

The same is followed by object clauses 2 & 3, which read as under:

> '2. To carry on the business of assisting, promoting and participating in the creation, expansion, modernisation of industrial enterprise by means of providing finance in the form of long and *I* or medium term loans and/or by sponsoring and underwriting new issues of shares and securities and/or providing guarantee and undertaking obligations.
>
> 3. To carry on generally and undertake any business commonly carried on hire purchase, leasing investment and non-banking financial companies.'

We do not find the purpose of acquisition of a business or asset/s of another company *per se*, as an object of the company. This aspect was considered by the ld. CIT(A), who holds that the assessee's business is of holding investment, and it is not its business to hunt for possible ventures. Does it mean that the proposed acquisition, which though did not materialize, would have been *ultra vires* the company? If so, so would be the expenditure. What are its implications? Would it, for that reason, be hit by *Explanation* to s. 37(1), or be allowable, nevertheless? Continuing further, true, the acquisition could be by way of shares, but then this cannot be presumed in view of the clear language of the engagement letter, stating 'for the purpose of bidding on and potentially acquiring the business and assets of Qual Teq, Inc. and its affiliates'. How could, one may ask, the shares be acquired if the individual (or combination of) assets of the company are being put to sale? It is only where the company itself is available on block, that its shares could be bid for and acquired. *It needs to be borne in mind that the engagement letter does not speak of purchase of shares or even of the controlling interest in the said company or its affiliates*. Further, even assuming that the shares are acquired, the assessee-company could sell the shares, earning profit. However, neither earning dividend, as the ld. AR would canvass, nor selling the shares soon after, seems to be a likely course in view of

the bankruptcy proceedings. The shares may have, for all we know, and for that reason, been delisted, and being purchased by participating in the bidding process by observing a separate legal procedure in its regard. Pray, how, again, one wonders, the shares of a bankrupt company increase merely by holding them? Rather, why would the seller sell them in that case and, in any case, anybody could purchase them, earning profit. Yes, the assessee could turn around the target company or facilitate the same, so that it could sell the shares at a profit. Again, however, the moot question would be as to how the assessee company, an investment holding company, would turn it into account? Does it have the wherewithal to turn around the business of the target company? Could it possibly evaluate the worth of the individual assets, which would again be, for most part, technical in nature, viz. specialized plant and machinery, used by that company, and which would also include an assessment of its operating capacity and capability; the balance operating life, etc., as well as the options available in the market, and then scout for their sale inasmuch as there seems to be no ready market for the same. In fact, unless backed up by adequate experience and clarity on the various processes involved, it would not be possible to bid – again, a highly technical matter. This would also throw light on the different business processes involved, and the concomitant business plan to turn the investment into account, of course, consistent with the local laws. We ask these questions as only upon a clarity on the investment objectives and purpose, as well as the *modus operandi*, could the nature of the acquisition be determined and, further, whether the same would constitute an investment or a current asset (stock-in-trade) in the hands of the assessee-company. Notably, the engagement letter clearly speaks of 'representing you', i.e., the assessee company and one or more of its US affiliates *to be formed* (for the purpose). Also relevant is the financial capacity inasmuch as lines of credit for acquiring such assets may not be forthcoming. We are afraid to say, we have no clue as to the business model of the assessee. Surely, where a stock-in-trade, the expenditure on its acquisition

is only revenue expenditure, in the nature of a business loss. On the other hand, where a capital asset, the impugned expenditure would be a capital loss, inadmissible u/s. 37(1). There is, after all, no bar in law for an investment company to also make an investment, that is, invest in a source of income. In our view, the matter needs further examination. The ld. CIT(A) ought not to have rested the issue by merely stating that it does not form part of its business, but required the assessee to justify its case in this regard. Where not a part of the assessee's business, the expenditure gets ousted at the threshold, and there is no necessity of proceeding further, which could only be in the alternative, i.e., assuming otherwise, as where this finding is reversed in further appeal. The matter, accordingly, both for determining the business purpose as well as the nature of the acquisition – be it of the business or the individual assets of Qual Teq Inc. and its affiliates, is restored to the file of the ld. CIT(A), who shall adjudicate by issuing definite findings of fact and after allowing the assessee a fair opportunity of presenting its case before him. He may, at his option, seek the comments/report from or even cause verification by the AO in the matter on any aspect thereof.

The next question that arises for consideration is if the payment attracts tax deduction at source u/s. 195, would it be hit by s. 40(a)(i) for the current year inasmuch as no tax has admittedly been deducted or deposited. The Revenue claims the impugned payment to be a fee for technical services, defined in *Explanation 2* to section 9(1)(vii), which reads as under:

> **'Income deemed to accrue or arise in India.**
> (1) The following incomes shall be deemed to accrue or arise in India :—
> (*i*) to (*vi*)….
> (*vii*) income by way of fees for technical services payable76 by—
> (*a*) the Government ; or
> (*b*) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or
> (*c*) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried

> on by such person in India or for the purposes of making or earning any income from any source in India:'

Surely, the payment being by a resident person is sought to be covered by clause (b) of the provision. Now, clearly, if the business is being acquired for running it, the payment would be excepted by the first limb of the saving. If, on the other hand, the acquisition is of an asset/s, again, it is this asset, located outside India, which becomes the source of income, unless of course the asset is, under the business plan, to be brought to India. This issue, therefore, to this extent, gets linked with the first issue, for determining which the matter has been set aside to the file of the ld. CIT(A). Further, where the acquisition is by way of shares, their *situs* shall continue to be outside India and, thus, excepted by the second limb of the provision. No tax u/s. 195 is accordingly liable to be deducted at source. As such, except where the asset is proposed to be brought to India, the amount paid shall not accrue or arise in India.

It is therefore only where the asset/s (to be) acquired is to be, under the business plan, brought into India that the payment, a fee for technical services, shall accrue or arise in India. It is only in such a case that the applicability of Article 15 of the Indo US DTAA shall have to be seen, which reads as under:

> *'Independent Personal Services*
> *1. Income derived by a person who* is *an individual* **or** ***firm*** *of individuals (other than a company) who* is *a resident of a Contracting State from the performance in the other Contracting State of professional services or other independent activities of a similar character shall be* ***taxable only in the first-mentioned State*** *except in the following circumstances when such income may also be taxed in the other Contracting State:*
> *(a) if such person* ***has a fixed base regularly available to him*** *in the other Contracting State for the purpose of performing his activities; in that case, only* so *much of the income as* is *attributable to that fixed base may be taxed in that other State; (or)*
> *(b)if the* ***person's stay in the other Contracting State*** **is** ***for a period*** **or** ***periods amounting to*** **or** ***exceeding in the aggregate 90 days in the relevant taxable year.***
> *2. The term* ***"professional services"*** *includes independent scientific literary, artistic, educational or teaching activities as well as the*

independent activities of physicians, surgeons, ***lawyers,*** *engineers, architects, dentists and accountants.'*

Without doubt, the services rendered by the payee firm are in the nature of professional services covered under Article 15. The income arising shall therefore be liable to be subject to tax only in the contracting state, i.e., of which the payee, rendering services, is a resident, USA, in the instant case. The exceptions, being with regard to the 90 day stay in the other contracting state (India) as well as a fixed base thereat, are clearly not applicable in the present case. As such, Art. 15 shall operate to exclude withholding tax, even where, on account of the asset/s (to be) acquired being brought to India, makes the relevant income as accruing or arising in India.

As such, either way, no tax is deductible u/s. 195 on the impugned payment, so that the same could not be disallowed for non-deduction thereof u/s. 40(a)(i) of the Act. We decide accordingly.

4. In the result, the assessee's appeal is allowed for statistical purposes; the Revenue's appeal is dismissed; and the assessee's CO is dismissed as infructuous.

Order pronounced on September08, 2017 at Chennai.

Sd/-	Sd/-
(जॉर्ज माथन)	(संजय अरोड़ा)
(George Mathan)	(Sanjay Arora)
न्यायिक सदस्य/Judicial Member	लेखा सदस्य/Accountant Member

चेन्नई/Chennai,
दिनांक/Dated, September 8, 2017.
EDN

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant 2. प्रत्यर्थी/Respondent 3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त/CIT 5. विभागीय प्रतिनिधि/DR 6. गार्ड फाईल/GF