A.F.R.

IN THE HIGH COURT OF ORISSA AT CUTTACK

ITA No.1 of 2019
ITA No.3 of 2019
ITA No.4 of 2019
ITA No.42 of 2023

(From the orders of the Income Tax Appellate Tribunal, Cuttack Bench, Cuttack)

Principal Commissioner of Income Tax- I, Bhubaneswar **....** ***Appellant(s)***
(in all these ITAs)

-versus-

Paradeep Phosphates Limited, Bhubaneswar **....** ***Respondent (s)***
(In all these ITAs)

Advocates appeared in this case through Hybrid Arrangement Mode**:**

For Appellant(s) : *Mr. T.K. Satapathy, Sr. SC. for Income Tax*

For Respondent(s) : *Mr. P.R. Patro, Advocate along with Mr. S. Jolly, Adv.*

CORAM:
DR. JUSTICE S.K. PANIGRAHI
MR. JUSTICE G. SATAPATHY

DATE OF HEARING:-03.10.2023
DATE OF JUDGMENT: -24.11.2023

Dr. S.K. Panigrahi, J.

1. In this case, the appellant in ITA No.1 2019, ITA No.4 of 2019, ITA No.3 2019 and ITA No.42 of 2023 has challenged the orders passed by the Income Tax Appellate Tribunal, Cuttack Bench, Cuttack (for short "the

Tribunal") in favour of the respondent. Two common issues arise in the aforesaid four appeals. The first issue is whether the Income Tax Appellate Tribunal erred in holding that the provisions of diminution of Government of India Fertilizer Bonds [GoI Bonds] is an allowable deduction. This issue arises in ITA No.1, ITA No.4 and ITA No.42. The other issue that arises for considerations is whether "school expenses" can be treated as business expenditure. This issue arises in ITA No.3 of 2019 and ITA No.4 of 2019. As a result of the overlap in the issues in the aforementioned appeals, they are being dealt with together.

I. FACTUAL MATRIX OF THE CASE:

2. The assessee [the respondent] had filed two appeals against the orders passed by the CIT[A] Bhubaneswar for the assessment years 2010-11 & 2014-15 before the Income Tax Appellate Tribunal, Cuttack Bench. The respondent is an entity engaged in the business of manufacturing and trading of fertilizers. The original assessment under Section 143(3) was completed on 28.04.2014 on a total income of ₹ 2295,87,95,426. The said income was modified to ₹ 115,57,95,426. The AO reassessed the total income at ₹ 171,91,70,480 making an addition of ₹ 56,33,75,052. The latter amount was on account of disallowance of the diminution in value of the GOI Fertilizer Bond. Aggrieved by the order passed by the AO, the respondent preferred an appeal to the CIT[A]. The CIT[A] upheld the order of Assessing Officer. Aggrieved by the order of the CIT[A], the respondent approached the Income Tax Appellate Tribunal.

3. The GOI Fertilizer bonds were provided to the respondent in lieu of cash subsidy. Therefore, the reduction in the value of the bonds was claimed as a revenue loss by the respondent as it was incurred in the course of business. While the AO and CIT[A] had not concurred with this assertion of the assessee, the ITAT relying on the decisions of the Delhi High Court in DCM Shriram Consolidated Limited[1] [ITA Nos.939 & 940 of 2015] [hereinafter referred to as "**DCM Shriram**"] and the respondent's own case before the same tribunal for the assessment year 2009-10, held that since the fertilizer bonds were received in lieu of cash, they were incurred in the course of business and any reduction in the value of the bonds could be claimed as revenue loss. Thus, the tribunal allowed this to be claimed as business expenditure on account of the diminution of the value of the fertilizer bonds for the assessment year 2010-11 and 2014-15 and allowed for deductions. The diminution in value of the fertilizer bonds amounted to ₹ 23,98,00,000.

4. The second issue pertains to the assessment year of 2014-15. The issue arose due to the disallowance of ₹ 2,84,34,453 by the AO which was incurred by the respondent in running of a school for the benefit of its employees as an incidental and additional business expenditure under Section 40A(9) of the Income Tax Act, 1961 read with Section 37(1) of the IT Act,1961.As this deduction was not allowed by the AO, the respondent felt aggrieved and filed an appeal. The ITAT overturned the ruling of the AO and allowed the deduction.

[1]ITA Nos. 939 & 940 of 2015

5. In allowing the deduction under Section 40A(9) of the IT Act, the ITAT relied on its decision in a similar case involving the respondent for the assessment year 2010-2011. The tribunal held that the amount that was being incurred for education and being paid to DAV School was for the welfare of the staff which would ultimately result in the smooth functioning of the business. As it was incurred for the aforementioned purpose, it was an allowable business expenditure. Therefore, the tribunal held in favour of the respondent and allowed the deduction. Aggrieved by the order, the appellants have filed this appeal.

II. APPELLANT'S SUBMISSIONS:

6. Learned counsel for the appellant earnestly made the following submissions in support of his contentions:

(i) The running of the school by the DAV School Management is within the premises of the respondent and it has no direct nexus with the business. Further, the expenditure incurred was being debited to the profit and loss account. Thus, it is not an allowable deduction as per Section 40A(9) and Section 37(1) of the Income Tax Act, 1961.

(ii) The appellant contends that the reduction in value of the GOI Fertilizer Bonds cannot be claimed as the loss has not actually been incurred but it is merely on the anticipation of loss that a deduction is being claimed. In asserting so, reliance was placed on the decisions of the Supreme Court in Sajjan Mills Limited v. CIT[2][hereinafter referred to as "**Sajjan Mills**"] and of the Madras High Court in Commissioner of

[2]156 ITR 585 (SC)

Income Tax, Tamil Nadu-1 v. Indian Overseas Bank[hereinafter referred to as "**Indian Overseas Bank**"] [3].

III. SUBMISSIONS OF RESPONDENTS:

7. Per *contra*, learned counsel for the Respondent intently made the following submissions:

(i) The payment to DAV School Management is neither falling under "setting up" nor under "formation of" nor under "as contribution to" any fund/trust. As a result of this, it is outside the purview of Section 40A(9) of the IT Act. Further, the running of a school for the benefit and welfare of the staff is a business expenditure. Thus, it is an allowable deduction under Section 40A(10) and Section 37(1) of the IT Act.

(ii) The GOI Fertilizer bonds were received in lieu of cash subsidy. The bonds were not purchased and were received from the government in course of transaction of business. Thus, the reduction in the value of the bond is a business expense and the amount of reduction is value that can be claimed as allowable business expenditure. Further, the respondent relied on the decision of the Honorable Apex Court in Patnaik & Co. Ltd v. CIT[4][hereinafter referred to as "**Patnaik & Co.**"] where it was held that as the fertilizer bonds being allotted under compulsion, they were to be considered as business expenditure. Thus, they are to be considered as revenue expenses and can be claimed as allowable business expenditure.

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[3] 151 ITR 446
[4] 161 ITR 365(SC)

IV. COURT'S REASONING AND ANALYSIS:

8. At the outset, the much relied **Sajjan Mills and Indian Overseas Bank** has a different factual matrix which is different from the present set of facts. In **Sajjan Mills**, the issue was in relation to payment of gratuity. The court has held that gratuity was in the nature of a contingent liability and becomes payable to the employee only under certain circumstances. However, gratuity cannot be treated as a loss as it is in the nature of a statutory obligation which has little relevance in the present case. Further, in the ***Indian Overseas Bank*** case (supra) the assessment of loss was for foreign exchange transactions. The foreign exchange transactions were not accepted by the bank in lieu of any other payment. On account of this, the facts of the present case are entirely different.

9. In ***DCM Shriram*** case (supra), the Delhi High Court as well as the tribunal from which the appeal was preferred held that the fertilizer bonds were accepted in the course of business in lieu of fertilizer subsidy by the Government of India. The company had no intention to hold bonds as such and the same had been received by the company under compulsion in lieu of cash fertilizer subsidy amount. Thereby, the loss incurred due to the diminution in the value of the bonds may be regarded as a revenue loss and can be claimed as deduction while computing taxable income for the period under consideration. The Supreme Court in the case of Patnaik Company Limited vs. CIT[5], held that since the investment in the fertilizer bond was made by the

[5] [1986]161 ITR 365 (SC)

respondent under commercial expediency it did not bring an asset of a capital nature and the diminution in the value of the said bond are allowable as revenue loss. Having regard to the facts of the present case and after placing reliance on the above decisions by the Delhi High Court and the Supreme Court of India, this Court is of the view that the decision of the ITAT, Cuttack Bench is correct and the claim by the respondent as revenue loss on account of the diminution in the value of the GOI Bonds is held in favour of the Respondent. Thus, the appeal of the appellant on this ground is dismissed.

10. As far as the second issue of payment of a corpus to DAV School Management, the reasoning of this Court is as follows:

As per Section 40A (9) of the Income Tax Act, 1961, no deduction shall be allowed in respect of any sum paid by the assesse as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 (21 of 1860),or other institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or under clause (iv) [or clause (iva)] or clause (v) of sub-section (1) of section 36, or as required by or under any other law for the time being in force.

As per Section 40A (10) of the Income Tax Act, 1961, notwithstanding anything contained in sub-section (9), where the Assessing Officer is satisfied that the fund, trust, company, association of persons, body of individuals, society or other institution referred to in that sub-section has, before the 1st day of March, 1984, bona fide laid

out or expended any expenditure (not being in the nature of capital expenditure) wholly and exclusively for the welfare of the employees of the assessee referred to in sub-section (9) out of the sum referred to in that sub-section, the amount of such expenditure shall, in case no deduction has been allowed to the assesse in respect of such sum and subject to the other provisions of this Act, be deducted in computing the income referred to in section 28 of the assessee of the previous year in which such expenditure is so laid out or expended, as if such expenditure had been laid out or expended by the assessee.

The sole and whole object and reasons for the introduction of Section 40A (9) and (10) in the Act to make it clear that any expenditure met by an assessee wholly and exclusively for the welfare of the employees of the assessee is an allowable deduction in computing the income of the assessee.

As per Section 37(1) of the Income Tax Act, 1961, any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.

To be an allowance within section 37(1), barring the exceptions mentioned therein, "*the money paid out or away must be paid out wholly and exclusively for the purpose of the business*". The assessee can claim the whole of it for deduction in computing the income chargeable under

the head "*Profits and gains of business or profession*". The money by way of such expenditure must be "*laid out or expended wholly and exclusively for the purpose of business*". The word "*wholly*" refers to the quantum of expenditure and the word "*exclusive*" refers to the move, object or purpose of the expenditure.

While applying section 37(1), it must be kept in mind that the expenditure claimed therein need not be "*necessarily*" spent by the assessee. It might be incurred "voluntarily" and without any "*necessity*", but it must be for promoting the business. In other words, if the expenditure has been incurred by the assessee voluntarily, even without necessity, but if it is for promoting the business, the deduction would be permissible under section 37(1) of the Act.

11. In ***Season J. David and Co. P. Ltd. v. CIT***[6], the Supreme Court observed (at page 275 and 276) has succinctly echoed the similar sentiment which are as follows:

> *"It is relevant to refer at this stage to the legislative history of section 37 of the Income-tax Act, 1961, which corresponds to section 10(2)(xv) of the Act. An attempt was made in the Income-tax Bill of 1961 to lay down the 'necessity' of the expenditure as a condition for claiming deduction under section 37. Section 37(1) in the Bill read 'any expenditure... laid out or expended wholly, necessarily and exclusively for the purpose of the business or profession shall be allowed...." The introduction of the word 'necessarily' in the above section resulted in public protest. Consequently, when section 37 was finally enacted into law, the word 'necessarily' came to be dropped. The fact that somebody*

[6] [1979] 118 ITR 261

other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under section 10(2)(xv) of the Act if it satisfied otherwise the tests laid down by law".

12. Again, the words "*for the purpose of business*" used in section 37(1) should not be limited to the meaning of "earning profit alone". Business expediency or commercial expediency may require providing facilities like school, hospital, etc., for the employees of their children or for the children of the ex-employees. The employees of today may become the ex-employees tomorrow. Any expenditure laid out or expended for their benefit, if it satisfied the other requirements, must be allowed as deduction under section 37(1) of the Act. It may also be stated, as observed by the Supreme Court in the aforesaid case, that the fact that somebody other than the assessee is also benefited or incidentally takes advantage of the provision made, should not come in the way of the expenditure being allowed as a deduction under section 37(1) of the Act. But, nevertheless, it must be an "*expenditure*" allowable as deduction under the Act.

13. The question that, however, still remains is whether the donation claimed by the assessee for deduction can be said to be an "expenditure" as contemplated under section 37(1) of the Act. "*Expenditure*" primarily denoted the ideal of "*Spending*" or "*paying out or away*". It is something which is gone irretrievably, but should not be in respect of an unascertained liability of the future. It must be an

actual liability in present, as opposed to a contingent liability of the future. Some of these principles have been explained by the Supreme Court in ***Indian Molasses Co. (Private) Ltd. v. CIT***[7], wherein it has been reiterated that:

> *"The income-tax law does not allow as expense all the deductions a prudent trader would make in computing his profits. The money may be expended or grounds of commercial expediency but not of necessity. The test of necessity is whether the intention was to earn trading receipts or to avoid future recurring payment of a revenue character. But the income-tax law does not take every such allowance as legitimate for purposes of tax. A distinction is made between an actual liability in present and a liability de futuro which, for the time being, is only contingent. The Former is deductible but not the latter".*

14. Yet in some other cases like:- ***P. Balakrishnana, CIT v. Travancore Cochin Chemicals Ltd.***[8], the assessee is a Public Sector Unit engaged in the manufacture and sale of certain chemicals. During the Previous year, the assessee had made certain payments to the FACT school. The assessee claimed that the payment should be included under the welfare expenditure as the said expenditure was essential for the smooth running of the assessee's business. The assessing officer held that the above payment had no direct relation with the business activity of the assessee and was more or less in the nature of a donation and, therefore, disallowed the claim under Section 40A(9). On appeal by the assessee, the Commissioner (Appeals)

[7] [1959] 37 ITR 66
[8] [2000] 243 ITR 284

confirmed the disallowance of expenditure made by the assessing officer under section 40A(9) of the Income Tax Act, 1961 ('the Act'). However, the Tribunal held that the assessee's contribution to the FACT school was for the assessee's business purpose and allowed deduction thereof. The expenditure met towards the FACT school was not a donation but it was in the form of reimbursement of the proportionate expenditure met for the running of the school where the children of the employees of the assessee were having their education and such an expenditure was wholly and exclusively for the welfare of the employees of the assessee and also it was an expenditure for the business purpose of the assessee. the above expenditure shall not come within the purview of section 40A(9) and the expenditure made by the assessee for the welfare of the employees of the assessee is allowable under section 40A(10) and also section 37(l). Kerala High Court held that this payment was made towards contribution of the share of expenditure in running of the FACT School, wherein the children of the employees were studying. The expenditure met wholly and exclusively for the welfare of the employees of the assessee not covered under Sections 30 to 36 of the Act and not in the nature of capital expenditure or personal expenses is allowable under Section 37(1). Moreover, the expenditure of this nature leads to an increase in efficiency of the business. Thus, the court held this to be a business expense under 37(1) and also outside the purview of 40A(9).

15. Similarly, in ***Mysore Kirloskar v. Commissioner of Income Tax***[9], the assesse is a public limited company engaged in the manufacture and selling of tools, lathes, etc. The company constituted a trust, the object of which is to apply its income for the promotion and encouragement of education principally of the children of the employees and ex-employees of the company. The company was established in a place called Harihar which is not a developed city. In order to attract technocrats and men of managerial skill, the company had to establish facilities for the employees and education for their children. Hence, in furtherance of the object of the trust, the trust established a school at Harihar. To that school, the children of the employees and ex-employees as well as of general public are admitted. The assessee-company donates a certain sum every year to meet the expenditure of the school. In the accounting year relevant to the assessment year, the assessee has donated Rs.62,000/- and claimed out of it 61.1 per cent, by way of deduction under Section 37(1) of the Act. Such claim was made on the ground that 61 per cent of the school children are the children of the employees and the ex-employees of the assessee. The income tax officer did not allow the exemption as claimed. The Commissioner of Income Tax and the Appellate Tribunal also held similar view. Rather they allowed 50% deduction for the same expenditure under Section 80G as donation. There the Karnataka High Court held:

[9][1987] 166 ITR 836

> *"(i) that the words 'for the purpose of business' used in Section 37(1) should not be limited to the meaning of 'earning profit alone'. Business expediency or commercial expediency might require providing facilities like schools, hospitals, etc., for the employees or their children or for the children of the ex-employees. Any expenditure laid out or expended for their benefit, if it satisfied the other requirements, must be allowed as a deduction under Section 37(1) of the Act. Nevertheless, it is an expenditure allowable as deduction under the Act."*

16. In ***CIT v.Bombay Dyeing and Manufacturing Company Ltd.,***[10] the Supreme Court has held that the contribution of Rs.2,25,000 by the assessee company to the State Housing Board (Maharashtra Housing Board) for constructing tenements for the company's workers was incurred wholly and exclusively for the welfare of the employees which was necessary for carrying on the business of the assessee - company more effectively by having a contented labour force and constitute legitimate business expenditure. The Apex Court upheld the decision of the Tribunal which held that the expenditure was not in the nature of a capital asset to the assessee – company as the tenements, remained the property of the Housing Board and there was no obligation on the assessee – company to provide its workers tenements constructed by the Housing Board and that the benefit of better and cheaper housing obtained by the industrial workers of the assessee – company did not constitute a direct benefit of an enduring nature of the assessee. The Tribunal held that the expenditure was incurred merely with a view to carry

[10] [1996] 219 ITR 521

on the business of the assessee - company more efficiently by having a contented labour force. The High Court held that no question of law arose for reference from the order of the Tribunal. There, the Supreme Court held that, on the facts of the case the amount constituted revenue expenditure and, thus, it was an allowable expenditure.

17. After analysing the existing legal provisions of the Act and placing reliance on the above legal precedents, this Court is of the view that the Tribunal is fully justified in allowing the above expenditure towards contribution for the running of the school, as an expenditure for the smooth functioning of the business of the assessee and also an expenditure wholly and exclusively for the welfare of the employees of the assessee and, thus, allowable under Section 37(l) as well as Section 40A(10) as business expenditure. Thus, the tribunal decided correctly and there is no reason to set aside the orders of the Tribunal.

18. Accordingly, all the above stated ITAs are disposed of.

(Dr. S.K. Panigrahi)
Judge

G. Satapathy, J. *I agree.*

(G. Satapathy)
Judge

Orissa High Court, Cuttack,
Dated the 24th Nov., 2023/