TRUST FOR BUSINESS PURPOSES

IT IS generally assumed that questions arising in the field of income tax depend for their answers exclusively on an interpretation of the taxing statutes. But anyone who either practises in this field or holds an office requiring knowledge of income tax law, comes to realise that this is not correct.

Take, for example, questions of taxation arising out of the creation of trusts. Whether a valid trust has been created or not, is really a question depending on the law of trusts and not on the Income-tax Act. No doubt, the Act may impose additional conditions for claiming concessions or exemptions from tax. But the discussion has to start first with an examination of the law of trusts.

The matter may acquire still greater complexity, if the trust is created by a company. In theory, a company, like any other person, can create a trust, subject to such limitations as may flow from company law. The reason is, that the power to dispose of property, which is usually given by statute to every body corporate created under it, includes within itself the power to create a trust. Essentially, a trust is a mode of disposition of property, coupled with compliance with such requirements as may be imposed by the law of trusts. These requirements may, for example, include writing and registration (in the case of immovable property) or effective transfer of ownership of the property to the trustee (in the case of movable property). It is also further necessary that, as provided by section 6 of the Indian Trusts Act 1882, the author of the trust must indicate with reasonable certainty his intention to create a trust and its purpose, as well as the beneficiaries and the trust property and (with certain exceptions) he must transfer the trust property to the trustee. In the case of a company, all this would have to be done in conformity with company law, as far as it is applicable.

All these aspects of the general law became crucial in *Dynavision Ltd.* v. *I.T.O.*, *Madras*,[1] decided by the Income Tax Appellate Tribunal, Madras, B Bench, on 17 September 1990. A company which manufactured television sets had created a trust whose amount was to be expended, (*i*) for providing concessional rates of finance to stockists of the company in case of financial difficulties; (*ii*) to promote the sales of the company by organising seminars, *etc.*; (*iii*) also for the welfare of dealers and stockists who were in difficulty. For a sum of Rs. 50 *lakhs* paid by the company as a contribution to the trust in the particular previous year, the company claimed a deduction under section 37(1) of the Income-tax Act 1961 and the question arose whether a valid trust had been created. It was argued by the department that no such trust had been created. The argument rested itself on an alleged non-com-

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1. (1991) 36 Income Tax Tribunal Decisions 1.

pliance with the Trusts Act, the Companies Act and other irregularities. This involved an examination of provisions of the relevant enactments.

The most important point related to the Trusts Act. In this case, there was no registered document. However, without it, a trust of movable property can be created by transferring ownership of the property to the trustee. This had been effectively done in this case and the fact that the alleged deed of trust had not been signed by the directors on behalf of the company became immaterial.

The next argument was advanced on the basis of section 46 of the Companies Act 1956. This section really relates to contracts on behalf of a company and provides (in substance) that such contracts, if they require writing by general law, may be made on behalf of the company by writing, signed by the authorised person. But, if the general law does not require a writing, they can be made by parol on behalf of the company by an authorised person. One fails to understand why the Income Tax Department advanced an argument on the basis of section 46, because there is a great difference between a contract and a trust. The former requires consideration and rests on promise, while the latter does not require consideration and rests on transfer. This is made amply clear by sections 5 and 6 of the Trusts Act. Money can always be transferred by actual delivery of cash or by payment through cheque. In this case, the cheque had been duly issued and credited to the account of the trust, thus satisfying the requirements of the Trusts Act. It is here, that the famous decision of the Privy Council in *All India Spinners' Association* v. *C.I.T.*,[2] came in handy for the company. There is also the important decision of the Bombay High Court in *Fazlhussein Sharafally* v. *Mohamedally Abdulally Sassoor*,[3] wherein it has been held:

> [I]f the original trust was void, the conduct of the trustees in subsequently admitting that they held the property on specified trust to which there is no valid objection, establishes a charity on those terms.[4]

There still remained the question of interpreting the Income-tax Act and the question was, whether payment of the amount to the trust was for the purpose of the business of the company. It was not difficult for the tribunal to hold that the payment was connected with the business. This was not a case of a colourable transaction, because it was not the case even of the department that the money came back to the company in any form. Even the controversial decision in *McDowell & Co. Ltd.* v. *C.T.O.*[5] could not come to the rescue of the department, as there was no attempt either to avoid or

2. (1944) 12 I.T.R. 482.
3. A.I.R. 1943 Bom. 366.
4. *Id.* at 370.
5. (1985) 154 I.T.R. 148 (S.C.).

evade the tax. It is also to be noted that the expression used in the Income-tax Act in allowing a deduction is "for the purpose of the business" and not "for the purpose of earning profits". So long as the purpose of the expenditure is the purpose of the business, it would appear that neither the large quantum of the expenditure nor the unorthodox manner of spending money, can disqualify the amount spent for deduction. The amplitude of the expression "for the purpose of the business" was elucidated by the Supreme Court in *C.I.T.* v. *Malyalam Plantations Ltd.*[6] Similarly, the distinction between capital and revenue expenditure in this context was dealt with by the Supreme Court in *M.K. Brothers Pvt. Ltd.* v. *C.I.T.*[7]

On the basis of these and other rulings, one can say that the following salient propositions emerge from the case law:

(*i*) There must be a link between the business and the expenditure.

(*ii*) It is not necessary that the expenditure should be limited in its quantum.

(*iii*) It is not necessary that the expenditure must be only for the day-to-day running of the business. It may cover measures for rationalising the administration, modernising the machinery, preserving the business and protecting its assets, paying statutory dues and taxes and many other acts incidental to the carrying on of the business.

(*iv*) What is required is that the expenditure must be intended to facilitate the carrying on of the business; and it is immaterial that a third party is also benefited.

(*v*) The payment may be in lump sum or in instalments. It is the real nature and quality of the payment, and not its quantum or manner of payment, that matters.

(*vi*) Finally, one cannot read into the Act the requirement that the expenditure must have been necessary for the business. This is evident from the fact that though the Income Tax Bill of 1961 proposed the addition of this word, it had to be dropped in response to loud protests from all concerned. Thus, the ingredient of compelling necessity is not there, as was pointed out in *Sassoon J. David and Co. Pvt. Ltd.* v. *C.I.T.*[8]

Of course, no proposition that one may deduce from the case law can be conclusive in a particular case, because there is no all embracing formula to provide a ready solution. It is the broad picture that has to be kept in mind. After all is said and done, there still remains the principle that a tax is not to be levied without express words. The reason for this rule (leaving aside fraudulent evasion of tax) was thus explained by Lord Reid in *W.M. Cory and Son Ltd.* v. *I.R.C.*:[9]

6. (1964) 53 I.T.R. 140.
7. (1972) 86 I.T.R. 38 (S.C.).
8. (1979) 118 I.T.R. 261 (S.C.).
9. (1965) A.C. 1088.

[C]ounsel for the respondents said, no doubt truly, that if this appeal were allowed the door would be open for wholesale evasion of stamp duty. But that consideration has never prevailed over the rule that the words of a taxing Act must never be stretched against a taxpayer. And there is a very good reason for that rule. So long as one adheres to the natural meaning of the charging words the law is certain, or at least as certain as it is possible to make it. But if courts are to give to charging words what is sometimes called a liberal construction, who can say just how far this will go? It is much better that evasion should be met by amending legislation.[10]

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10. *Id.* at 1107.

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