$~64 to 67 and 70

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% *Date of Decision : 15.10.2025*

\+ ITA 525/2025
\+ ITA 526/2025
\+ ITA 527/2025
\+ ITA 528/2025
\+ ITA 531/2025

PR. COMMISSIONER OF INCOME TAX

.....Appellant

Through: Mr. Indruj Singh Rai SSC, Mr. Sanjeev Menon, Mr. Rahul Singh JSC and Mr. Gaurav Kumar, Adv.

versus

M/S. REMFRY AND SAGAR

.....Respondent

Through: Mr. Ajay Vohra, Sr. Adv. with Mr. Aditya Vohra and Tanmay Dhakras, Advs.

CORAM:
HON'BLE MR. JUSTICE V. KAMESWAR RAO
HON'BLE MR. JUSTICE VINOD KUMAR

V. KAMESWAR RAO , J. (ORAL)

CM APPL. 65031/2025 at ITA 525/2025
CM APPL. 65033/2025 at ITA 526/2025
CM APPL. 65037/2025 at ITA 527/2025
CM APPL. 65039/2025 at ITA 528/2025
CM APPL. 65043/2025 at ITA 531/2025

1. For the reasons stated in the applications, the delay of 914, 719, 1198, 858 and 1408 days in filing ITA no. 525/2025, ITA no. 526/2025, ITA no. 527/2025, ITA no. 528/2025 and ITA no. 531/2025 respectively, is

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condoned.

2. The applications are disposed of.

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3. All these appeals except the ITA no. 531/2025, whereas according to Mr. Indruj Rai, SSC, an additional substantial question of law has been proposed, are governed by judgment of this Court in ITA no. 199/2017 and connected appeal, with regard to the respondent/assessee herein. Mr. Rai states that the proposed substantial questions can be summed up as noted by this Court in paragraph 2 of the aforesaid judgment which we reproduce as under :

> *"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.""*

4. In view of the fact that Mr. Rai states that the issue which arises for consideration in all these appeals is covered against the Revenue/appellant in terms of the judgment in ITA no. 199/2017 ***Principal Commissions v. M/S Remfry & Sagar, NC: 2025:563-DB*** for the parity of reasons, more specifically as stated by this Court in paragraph 20 onwards, which we

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reproduce as under, the appeals are dismissed :

> *"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*

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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 CIT8 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: (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*

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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

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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 CIT9 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 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.

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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

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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

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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."

5. As no substantial question of law arises, the appeals are dismissed.

ITA 531/2025

6. In this appeal the additional substantial question of law proposed are in the following manner :

> *"Whether the Hon'ble ITAT has erred in ignoring the cautious note given by Auditors in Form 3CD report that infers that the auditors themselves have not examined the nature of the expenses. This clearly establishes that the assessee has no structured details of 'Travelling and Entertainment expenses' submitted to Auditors for examination and therefore, the personal element in such expenses is undisputedly a part of it?"*

7. In support of this proposed question, Mr. Rai submits this question is primarily relatable to the conclusion drawn by the Assessing Officer in his order whereby he has disallowed 5 per cent of the total travelling and entertainment expenses quantified as Rs.12,89,393/-. The CIT(A) has in

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paragraph 6 of its order, deleted the disallowance by stating as under :

> *"6. Ground No. 9, reads as follows:-*
> *"The Ld. AO has erred in disallowing Rs. 12,89,393/- being 5% of travelling expenses and entertainment expense on ad hoc basis. The disallowance is not tenable in law and on facts as it is made on conjectures and surmises without showing any evidence for personal use.*
> *6.1 Similar issue was presented before my predecessor in appeal for A.Y. 2011-12, vide order dated 30.03.2016 in appeal No. 167/2014-15 (as referred above), at 7.3, the issue was decided in favour of the appellant. Para 7.3 of the order dated 30.03.2016 of CIT(A)-20, New Delhi, reads as follows-*
> *"I have considered the submission of the appellant and the assessment order. Nowhere, the A.O has mentioned about any discrepancy he could found while checking the books of accounts. Any expenditure or part of it cannot be disallowed on mere presumptions/ assumptions. In view of the fact, I see no justification in disallowing 5% of expenditure of travel and entertainment expenses.* ***Accordingly, the addition of Rs. 10,39,081/- is deleted. Appellant's ground o f appeal on this issue is allowed."***
> *Following the order of my predecessor, I adjudicate ground No. 9 in favour of the appellant.""*

8. On an appeal by the Revenue/appellant, the ITAT has in paragraph 10 stated as under :

> *"AO without disputing the expenses claimed by the assessee on account of travelling expenses and entertainment expenses made ad hoc disallowance of 5% merely on the basis of assumptions and surmises by introducing some personal element in the claimed expenditure. We are of the considered view that none of the expenditure can be disallowed merely on the basis of surmises. Perusal of the impugned order passed by the Id. CIT (A) shows that he has followed the earlier year's order passed by the Id. CIT (A) allowing the identical expenditure."*

9. Noting the conclusion drawn by the CIT(A) with which the ITAT has agreed, we find that the justification given by the CIT(A) is correct and we do not find any substantial question of law which arises for consideration on

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this particular issue and as such this appeal is also dismissed.

V. KAMESWAR RAO, J

VINOD KUMAR, J

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