

Is ransom an allowable expense?

**HT Chandigarh Live
Tax Matters/ S.P. Babuta
Sunday, May 14, 2006**

THIS WEEK I will answer a wide variety of questions from readers :

Query : Our company has entered into a contract with a multinational against a fixed amount of royalty payable each year. To promote the business and to minimize the burden of royalty, the company has paid commission to certain companies and persons, through account payee cheques and drafts the major commission was paid to a company who was involved in gas business but the company through its director brought us certain business. No formal agreements were entered with the agency. TDS were made, if applicable. The AO has disallowed the full claim of commission. Please advice.

Reply : It is well established that commission is not deductible when there is no evidence to establish that any specific service was rendered by the party to whom commission is paid although such payments is otherwise proved. The rationale behind this principle is that a party who has earned huge profits may have strong motive in showing distribution of the same amongst several parties by labeling it as payment of commission. Hence, such a party is expected to prove that the parties to whom payments have been made had rendered services which entitled them to receive commission from the assessee and there was commercial expediency in the payment of such commission.

Query : 'B' is a firm whose head office is in Patna and has got long-standing reputation. 'A' is one of the partners of the firm 'B' and is looking after the entire affairs of the head office of the firm exclusively. The kidnappers kidnapped 'A' in view of the reputation enjoyed by the firm. To save its reputation and good name, the firm paid ransom to the kidnappers. Whether the amount paid by the firm for the release of the partner from the kidnappers is in the nature of revenue or capital expenditure?

Reply : On the basis of the above facts no conclusion can be drawn to the effect that the ransom amount paid to persons who had kidnapped the partner of the firm to obtain his release was an expenditure laid out or expended wholly and exclusively for the purpose of the business of the firm. Facts do not show that kidnapping had taken place in the course of any business transaction. The kidnapping of the partner had no nexus with the carrying on of the business of the firm as understood in law. Hence, the amount does not seem to be deductible under sec. 37(1) in the computation of the profits and gains of the business of the firm.

Query : I am a partner in a firm and have introduced capital of Rs 5,00,000 in the firm. The capital invested was acquired by way of a loan. During the period ending March 31, 2006. I paid interest of Rs 1,00,000 at the rate of 20 per cent to the creditor. The firm does not pay any interest on the capital of the partners. During the years, I received remuneration of Rs 1,47,000 and share income of Rs

1,43,000. Can I claim the amount of Rs 1,00,000 representing interest paid as deduction from remuneration income?

Reply : The share in the income of the firm is not liable to be included in the total income of the partners in view of sec 10(2a). Hence no deduction in respect of interest paid by the partner is deductible against partners share.

However, the amount of remuneration of Rs 1,47,000 receivable from the firm is liable to be included in the total income under the head “Profits and gains of business or profession” in view of s. 28(v). The deduction of interest of Rs 1,00,000 can be certainly claimed against such income from business and profession, as the borrowed amount was utilized for capital contributing in the firm, i.e. for the purpose of earning the said income from business.