

## Legal fee paid to protect and maintain right in a registered software was an allowable expenditure

**Summary – The High Court of Madras in a recent case of Managed Information Services (P.) Ltd., (the Assessee) held that where Legal fee paid by assessee to protect and maintain its right in a registered software was eligible for deduction under section 37(1)**

### Facts

- During relevant year, the assessee paid legal fee to Hammonds, UK, to protect and maintain its right in a registered software.
- The Assessing Officer rejected assessee's claim for deduction of said fee on ground that legal fee was exorbitant and far in excess to the compensation received in the matter from the entity, which had infringed its rights in the registered software.
- The Commissioner (Appeals) as well as the Tribunal allowed assessee's claim.
- The revenue filed instant appeal again raising contention that since the legal fee paid was far in excess to the compensation received, the same could not be allowed as a deduction under section 37(1).

### Held

- What has been lost sight of by the revenue by advancing aforesaid argument is, that the assessee-company was protecting its rights in a registered software. The registered software was a property of the assessee-company, which, one would assume, could earn the assessee, the revenue from time to time, as and when, its licence is used by third parties. Therefore, to compare the value of compensation paid by the infringer of the right, with the expenses incurred on legal fees, would be fallacious, to say the least.
- Furthermore, as rightly held by the Commissioner (Appeals), the revenue, if, at all, ought to have compared the fees paid to Hammonds, with the fees demanded by a professional working out of UK, *qua* a similar kind of work.
- It is important to note that the Commissioner (Appeals) has categorically held that the transaction between the assessee and its legal adviser, *i.e.*, Hammonds UK, which, included the amount paid towards fee was genuine. If, that be the case, surely, this argument cannot be sustained.
- Therefore, on both counts, there is no flaw in the judgment of the Tribunal, as also that of the Commissioner (Appeals).
- Before concluding, it may be indicated that the test to be employed for examining as to whether or not a particular expenditure incurred by an assessee, be allowed, is that, which is, provided in section 37 itself. Therefore, what is required to be ascertained is, whether or not, the expenditure in issue is laid out or incurred wholly and exclusively for the purpose of business, and that, it is not an

expenditure, which is described under sections 30 to 36, or an expenditure in the nature of capital expenditure or, if, an assessee is an individual, it involves defrayment of personal expenses.

- In ascertaining as to whether the expenditure has been laid out or expended wholly and exclusively for the purpose of business, what is to be borne in mind, is that, it is incurred on account of commercial expediency of the assessee. The fact that the expenditure incurred by an assessee is not propelled on account of any legal obligation, or that, it benefits a third party, would not come in the way of it being allowed, as long as it is incurred due to commercial expediency.
- As to what is commercial expediency is to be looked at by revenue authorities by placing themselves in the shoes of a prudent business person.
- Further, the fact that a particular expense does result in a profit for the assessee in the immediate proximity cannot form the basis of its disallowance. In incurring an expense, a business person could have a short and a long term perspective. The fact that in the short term the expense incurred does lead to a profit, cannot rule out the possibility of accretions of profits to the assessee in the long run. These are business decisions best left to the wisdom of those who run and manage the business. Therefore, as long as expense is incurred, wholly and exclusively for the purpose of the business carried on by the assessee, it ought to be, ordinarily, allowed under section 37 of the Act.
- Thus, if, the aforesaid principles are applied, it is clear that notwithstanding the fact that the legal fee paid was more than the compensation received by the assessee, the same, was amenable for deduction under section 37 of the Act.
- The appeal is, accordingly, dismissed.