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Tax alert: SC holds that exclusive expenditure incurred by HO for branch, subject to threshold

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The Supreme Court (SC) has held that head office expenditure incurred by non-resident towards its Indian branch comes under the ambit of section 44C of the Income-tax Act 1961 (ITA), irrespective of whether it is a 'common expenditure' or expenditure incurred 'exclusively' for Indian branches. The SC further held that 'executive and general administrative expenditure' would only cover expenses specifically mentioned in respective clauses under explanation to section 44C of the ITA.

In a nutshell

Even if HO expenditure can be allowed a deduction under section 37(1), it would not be permitted if it exceeds the ceiling limit set under section 44C.

For an expense to be governed by the tenets of section 44C of the ITA, two conditions must be fulfilled:

- the taxpayer should be a non-resident, and
- the expenditure should be 'head office expenditure'.

For an expense to be categorised as 'HO expenditure', the AO must be satisfied

- on three distinct fronts: the expenditure must have been incurred outside India;
- it must be in the nature of 'executive and general administration' expenditure; and
- the said executive and general administration expenditure must fall within the specific categories enumerated in clauses (a), (b), or (c) respectively of the Explanation, or prescribed under clause (d).

Irrespective of whether the expenditure was 'common' or 'exclusive', the moment it is incurred by a non-resident taxpayer outside India and falls within the specific nature described in the explanation, section 44C would come into play and become applicable.

Background:

- The taxpayer[1], a non-resident banking company, was engaged in the business of providing banking-related services. It filed its income-tax return for the Assessment Year (AY) 1997-1998 claiming deductions for the following expenses under section 37(1) of the Income-tax Act, 1961 (ITA):
  - expenses incurred for solicitation of deposits from non-resident Indians; and
  - expenses incurred at the head office (HO) directly in relation to the Indian branches.
- The Assessing Officer (AO) in audit proceedings enquired as to why these expenses should not be subjected to the ceiling of 5% of the gross total income (as specified under section 44C of the ITA). The taxpayer, amongst others, contended that if the entire expenditure is incurred solely for the business in India, then the ceiling specified under section 44C of the ITA did not apply.
- The AO, however limited the deduction to 5% of the gross total income by applying section 44C of the ITA based on the following:
  - Section 44C of the ITA is a non-obstante provision that begins with the words "*notwithstanding anything to the contrary contained in Section 28 to 43A,"*
  - The purpose of inserting section 44C was to address the difficulties encountered in scrutinising the books of account maintained outside India;
  - The definition of HO expenditure is clear and the same includes all kinds of expenses of any office outside India.
- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings the matter reached before the Supreme Court (SC).

Relevant provisions in brief:

Section 37 of the ITA

"(1) 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..."

Section 44C of the ITA

"Notwithstanding anything to the contrary contained in Sections 28 to 43-A, in the case of an assessee,

being a non-resident, no allowance shall be made, in computing the income chargeable under the head "Profits and gains of business or profession", in respect of so much of the expenditure in the nature of head office expenditure as is in excess of the amount computed as hereunder, namely:

(a) an amount equal to five per cent of the adjusted total income; or

(b) [* *]*

(c) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as

is attributable to the business or profession of the assessee in India:

whichever is the least: .....

Explanation – For the purposes of this section, —

...

[1] Director of Income-tax (IT)-I, Mumbai vs. American Express Bank Ltd. [2025] 181 taxmann.com 433 (SC)

(iv) "head office expenditure" means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of—

(a)rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;

(b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

(c) travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and

(d) such other matters connected with execution and general administration as may be prescribed."

Decision of the SC

The SC acknowledged that the issue for consideration was whether expenditure incurred by the head office of a non-resident taxpayer exclusively for its Indian branches falls within the ambit of section 44C of the ITA, thereby limiting the permissible deduction to the statutory ceiling specified therein.

The SC observed as follows:

Whether HO expenditure under section 44C has to be common or exclusive?

- The scope of section 44C was illustrated by way of an example. If a general counsel is appointed by the HO solely to handle Indian matters, it constitutes exclusive expenditure. However, if a general counsel is appointed by the head office to handle matters in branches across the globe (including India), it constitutes common expenditure. The Revenue contended that section 44C applies in both cases, whereas the taxpayer argued that it is only applicable in the latter scenario.
- Under ordinary circumstances, it is impermissible for the Court to add or read words into the statute, especially when the language is plain and unambiguous, on the notion that such words would appear to better serve the legislative object or purpose.
- For an expense to be governed by the tenets of section 44C of the ITA, two conditions must be fulfilled:
  - the taxpayer should be a non-resident, and
  - the expenditure should be a 'head office expenditure'.

  If both conditions are met, then section 44C, being a non-obstante provision, will apply regardless of whether its principles contravene sections 28 to 43A respectively.
- Even if HO expenditure can be allowed as a deduction under section 37(1), it would not be permitted if it exceeds the ceiling limit set under section 44C. To decide otherwise would be to overlook the non-obstante nature of Section 44C.
- From the words 'head office expenditure' under section 44C of the ITA it does not appear that the legislature has limited the scope to cover only common expenditure incurred by the HO for the benefit of various branches, including those in India.
- The explanation is unambiguous in stating that for an expenditure to be considered as head office expenditure, it must meet two conditions only: (i) it has to be incurred outside India by the taxpayer, (ii) it must be expenditure of a nature related to executive and general administrative expenses, including those specified in clauses (a) to (d), respectively, of the explanation.
- It does not matter whether the expense was a common expense or an expense exclusively for the Indian branch, so long as the expense incurred is for the business or profession. Therefore, the meaning of the 7explanation is clear, straightforward, and unambiguous. Adding words is generally not permissible,

especially when the plain meaning of the statute is unambiguous.

- Irrespective of whether the expenditure was 'common' or 'exclusive', the moment it is incurred by a non-resident taxpayer outside India and falls within the specific nature described in the explanation, then section 44C would come into play and become applicable.
- Section 44C(c) of the ITA allows for the computation of HO expenditure on an actual basis, wherein all the HO expenditure attributable to the business in India, is taken into account. A plain reading of the clause does not indicate that the legislature envisaged taking into account only 'common' HO expenditure while excluding 'exclusive' HO expenditure under the clause.
  The text of the provision is broad and unqualified. It employs the phrase "*HO expenditure incurred by the taxpayer as is attributable to the business or profession of the taxpayer in India,*" without carving out any exception for expenses incurred exclusively for Indian branches.
- 'Attributability' is a genus of which 'exclusivity' is merely a species. Expenditure that is incurred *exclusively* for the business in India is, by its very nature, *attributable* to the business in India. Therefore, exclusive expenditure, without contrary legislative intent, which is absent in section 44C(c), must necessarily be treated as part of attributable expenditure. When the statute uses the term 'attributable', it brings into its fold all things concerned with the Indian business, whether they are common expenses allocated to India or expenses incurred exclusively for India.
- The words 'attributable to' in the context of section 44C(c) would include both common and exclusive expenditure.
- Section 44C of the ITA does not create a distinction between common and exclusive HO expenditure. Consequently, the view expressed by the Bombay High Court in an earlier ruling[2] regarding the applicability of section 44C was incorrect and does not declare the position of law correctly.

Whether the term 'executive and general administration expenditure' is inclusive or exhaustive?

- The Revenue had contended that:
  - The definition of 'head office expenditure' in Explanation to section 44C of he ITA is inclusive and has wide scope.
  - One needs to only satisfy that the expenditure falls under the genus of 'executive and general administration' expenditure, and not necessarily satisfy that within the broad genus they fall under the distinct species, specified or prescribed under clauses (a) to (d) of the explanation.
- Such an interpretation is impermissible as clause (d) stands as a clear statutory indicator that the explanation would cover 'executive and general administration' expenditure only of the kind mentioned in clause (a), (b) and (c) or of the kind prescribed under (d). If the Explanation were to be interpreted as broadly inclusive, covering all kinds of executive and general administration expenses without restriction, it would render the words "as may be prescribed" in clause (d) otiose and redundant.
- For an expense to be categoried as 'HO expenditure', the AO must be satisfied on three distinct fronts as below:
  - the expenditure must have been incurred outside India;
  - it must be in the nature of 'executive and general administration' expenditure; and
  - the said executive and general administration expenditure must fall within the specific categories enumerated in clauses (a), (b), or (c) respectively of the Explanation, or prescribed under clause (d).

[2] Commissioner of Income-tax vs. Emirates Commercial Bank Ltd. [2004] 134 Taxman 682 (Bombay)

The SC remanded the matter back to ITAT so as to examine the expenses afresh in light of the legal principles, more particularly to verify whether the disputed expenditures satisfy the aforesaid tripartite test necessary to qualify as 'HO expenditure' under the explanation to section 44C.

Comments:

Multinational companies operating through a branch office in India may incur certain expenses outside India which may be for the Indian operations. Such expenses may be incurred for various other operations (including India) or exclusively for India). The deductibility of such HO expenses being governed by the statutory limit of 5% under section 44C of the ITA, has been a subject of debate.

The SC in this ruling has discussed about the interplay between these considerations and the specific framework governing non-resident taxation and has *inter alia* held as follows:

- Even if HO expenditure can be allowed as a deduction under section 37(1), it would not be permitted if it exceeds the ceiling limit set under section 44C.
- For an expense to be governed by the tenets of section 44C of the ITA, two conditions must be fulfilled:
  - the taxpayer should be a non-resident, and
  - the expenditure should be a 'head office expenditure'.

For an expense to be categorised as 'HO expenditure', the AO must be satisfied on three distinct fronts as below:

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- Irrespective of whether the expenditure was 'common' or 'exclusive', the moment it is incurred by a non-resident taxpayer outside India and falls within the specific nature described in the explanation, then section 44C would come into play and become applicable.

The SC has also distinguished its earlier rulings[3] in this context.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

[3] CIT vs. Emirates Commercial Bank Ltd. (Civil Appeal No. 1527 of 2006) (SC) and CIT vs. Deutsche Bank A. G. (Civil Appeal No. 1544 of 2006) (SC)

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