Issue : Depreciation & others

IN THE ITAT MUMBAI BENCH 'I'
Mukand Global Finance Ltd.
v.
Deputy Commissioner of Income-tax, Range 3(2), Mumbai
SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND J. SUDHAKAR REDDY, ACCOUNTANT MEMBER
IT APPEAL NO. 4078 (Mum.) of 2004
[ASSESSMENT YEAR 2000-01]
NOVEMBER 27, 2007

I. Section 50, read with section 32, of the Income-tax Act, 1961 - Capital gains - Computation in case of depreciable assets - Assessment year 2000-01 - Whether sections 50 and 32(1)(iii) deals with different types of situations on transfer of capital assets of assessee - Held, yes –

Whether section 50 deals with those cases where profit accrues to assessee on transfer of any block of assets, whereas section 32(1)(iii) deals with those cases where assessee suffers a loss on sale of any building, machinery, plant, furniture, etc. - Held, yes –

Whether, therefore, loss suffered on transfer of block of assets cannot be computed under section 50 and this type of situation would be dealt with by provisions of section 32(1)(iii) - Held, yes –

Whether, however, deduction of such loss would be allowed under section 32(1)(iii) if such deficiency is actually written off in books of assessee - Held, yes

II. Section 49, read with section 47, of the Income-tax Act, 1961 - Capital gains - Cost with reference to certain modes of acquisition - Assessment year 2000-01 - Whether when capital assets are sold and purchased between holding company and subsidiary company, transaction would not fall within ambit of sections 47 and 49 - Held, yes –

Whether when capital asset is sold by holding company to its subsidiary company, year of indexation in case of subsidiary company would be year of transfer of capital asset in favour of subsidiary company on its sale - Held, yes –

Assessee-company purchased certain shares from its holding company 'M' during year ending on 31-3-1994; while 'M' had acquired said shares in year ended on 31-3-1989 - During previous year, relevant to assessment year 2000-01, assessee sold said shares - Whether year of indexation for computing capital gain on sale of shares would be taken from assessment year 1994-95, i.e., when shares were transferred in favour of subsidiary company i.e., assessee, and not year in which it was acquired by holding company - Held, yes

III. Section 14A of the Income-tax Act, 1961 - Expenditure incurred in relation to exempt income - Assessment year 2000-01 - Whether for invoking proviso to section 14A there should be an assessment order passed which is sought to be reopened or rectified by subsequent act of Assessing Officer - Held, yes –

Whether disallowance under section 14A of interest paid on borrowed funds can only be made where borrowed funds are invested in shares which are held by assessee as an investment or as capital asset - Held, yes

Section 36(1)(iii) of the Income-tax Act, 1961 - Interest on borrowed capital - Assessment year 2000-01 - Whether where assessee had invested borrowed funds in shares which were kept as stock-in-trade, interest paid on borrowed funds was to be allowed under section 36(1)(iii) - Held, yes

IV. Section 115JA of the Income-tax Act, 1961 - Minimum alternate tax - Assessment year 2000-01 - Whether debt is amount receivable by assessee and not any liability payable by assessee and, therefore, any provision towards recovery of debt cannot be said to be provision for liability - Held, yes –

Assessee kept outstanding debts which could not be properly recovered under head non-performing assets and made provision for same - Assessing Officer treated provision for non-performing assets made by assessee as a provision for unascertained liability and, accordingly, increased net profit of assessee by this provision in order to compute book profit - Whether Assessing Officer was justified - Held, no

Facts-I
During the relevant assessment year, the assessee-company had sold a building forming part of block of assets and had incurred certain loss. The assessee claimed the said loss to be short-term capital loss under section 50. It also claimed set-off of the said loss against its business income on the ground that, although the said loss was deemed to be short-term capital loss, yet the said loss had been incurred in the course of its business and deduction in respect thereof be allowed from its business income. The Assessing Officer disallowed the assessee’s claim for set-off of loss in question.
On appeal, the Commissioner (Appeals) confirmed the action of the Assessing Officer. He held that the claim of loss could not be considered under section 50. It could only be considered under section 32(1)(iii), and since the assessee had not actually written off the deficiency in its books of account, it was not entitled for deduction under section 32 also.
On second appeal :
HELD-I
The title of section 50 is ‘Special provision for computation of capital gains in case of depreciable assets’. The assessee had raised a controversy that the words ‘capital gains’ included capital loss also. The intention of the Legislature, where the words ‘capital gain’ include capital loss, can be examined not by reading the title but by full reading of section 50. [Para 9]
A plain reading of section 50 shows that it is a non obstante clause and has overriding effect over section 2(42A) which defines short-term capital asset under different situations. Its sub-section (1) deals with the mode of calculation of the capital gain of depreciable asset. Through

the mode of computation, given in this section only profit earned on transfer of block of assets can be worked out. According to it where the full value of consideration received or accrued as a result of transfer of asset together with the value of such consideration received or accrued as a result of transfer of another capital asset falling within the block of assets during the previous year exceeds the aggregate of the expenditure wholly and exclusively incurred in connection with such transfer, written down value of the block of assets at the beginning of the previous year and the actual cost of any of assets falling within the block of assets acquired during the previous year, such excess shall be deemed to be the capital gain arising from the transfer of short-term capital asset. Meaning thereby, the provisions of sub-section (1) can only be invoked where the entire block of assets including the new assets which are acquired during the previous year and fall within the same block of assets, are transferred and the sale proceeds exceed the aggregate of expenditure on transfer, written down value of the asset and the actual cost of new asset acquired during the previous year. This provision would not apply to those cases where part of the block of assets are transferred. Sub-section (2) deals with those types of cases where any block of assets ceased to exist for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gain arising from the transfer of short-term capital assets. Provisions of this section do not apply to those cases where the block of assets are transferred and the full value of consideration is less than the written down value of the block of assets at the beginning of the previous year expenditure incurred wholly and exclusively in connection with such transfer and the actual cost of any asset falling within the block of assets acquired during the previous year. Meaning thereby, the loss suffered on transfer of block of assets cannot be computed under section 50. This type of situation is dealt with by the provisions of section 32(1)(iii), according to which deduction of the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, fall short of the written down value thereof in case the said building, machinery, plant or furniture is sold, discarded, demolished or destroyed in the previous year subject to actual write off of such deficiency in the books of the assessee. [Para 10]

If both the sections, i.e., section 32(1)(iii) and section 50, are read together one would find that these sections 50 and 32(1)(iii) deals with different types of situations on transfer of capital assets of the assessee. Section 50 deals with those cases where the profit accrues to the assessee on transfer of any block of assets, whereas section 32(1)(iii) deals with those cases where the assessee suffers a loss on sale of any building, machinery, plant and furniture. [Para 11]

Turning to the facts of the instant case it was found that the assessee had undisputedly sold its flat, which was the only block of assets under the head ‘building’ and its sale resulted into a loss inasmuch as sale consideration was less than the written down value of the asset in question. In such a situation where loss is incurred on sale of block of assets of the assessee, section 50 has no application in such a situation and the case would fall within the provision of section 32(1)(iii) and the loss is to be computed as per clause (iii) of section 32(1) and deduction of the same would be allowed to the assessee from the business profit provided such deficiency is actually written off in the books of the assessee. In the instant case, the Commissioner (Appeals) had disallowed the claim of the assessee under section 32(1)(iii) because the assessee had not written off the deficiencies in its books of account. During the course of hearing nothing was placed on record on behalf of the assessee in that regard. It had simply harped upon that its case was covered by section 50 and the capital gains included

capital loss; whereas section 50 deals only with those types of cases where the profit accrue to the assessee on transfer of block of assets. Therefore, the Commissioner (Appeals) had properly adjudicated the issue. Hence, the impugned order was to be confirmed. [Para 12]

FACTS-II

The assessee-company had purchased certain shares of a company 'I' from its holding company 'M' during the year ending on 31-3-1994; while 'M' had acquired the said shares in the year ending on 31-3-1989. During the previous year relevant to the assessment year 2000-01, the assessee sold the said shares. While computing the long-term capital gain it claimed indexation from the assessment year 1979-80. The Assessing Officer held that it was not a case of normal transfer of capital asset by a holding company 'M' to its subsidiary company, the assessee, as envisaged in section 47(iv) and, therefore, had taken the base year with reference to the date of acquisition by the assessee-company. The Assessing Officer, thus, applied indexation from the assessment year 1994-95 in order to compute capital gain.

On appeal, the Commissioner (Appeals) confirmed the action of the Assessing Officer.

On second appeal :

HELD-II

On reading the provisions of sections 47(iv) and 49(1)(iii)(e), it is clear that computation of capital gain on transfer of those assets which fall under section 47 would not be governed by the normal provisions of section 45. Cost of acquisition of the capital asset falling within the ambit of section 47(iv), (v), (vi), (via) and (viab) is to be computed as per provisions of section 49. With regard to transfer of capital asset by a holding company to its subsidiary company, it has been stated in sections 47(iv) and 49(1)(iii)(e) that the cost of acquisition of a capital asset, which has been transferred by a holding company to its subsidiary company, if the holding company or its nominee hold whole of the share capital of the subsidiary company and the subsidiary company is an Indian company, shall be deemed to be the cost for which the holding company acquired the said capital asset as increased by the cost of any improvement of the asset incurred or borne by the holding company or the subsidiary company in whose hands cost of acquisition is to be computed. Therefore, the cost of acquisition in the hands of the holding company shall be deemed to be the cost of acquisition in the hands of the subsidiary company in case of transfer of capital asset by the holding company. This proposition would not be applicable if the capital assets are sold by the holding company to the subsidiary company. Once the capital assets are sold to the subsidiary company, the sale value of the capital asset shall be the cost of acquisition in the hands of the subsidiary company. [Para 21]

Further, the provisions of sections 47 and 49 can only be invoked where the holding company transfers its capital asset without any consideration to its subsidiary company, but when the transfer of capital asset takes the character of sale and purchase, the sale consideration shall be the cost of acquisition in the hands of the buyer. This deeming provision can only be invoked where the cost of asset at the relevant point of time could not be determined and more so the consideration was not passed on from the buyer to the seller. Once the capital assets are sold and purchased between the holding company and the subsidiary company the transaction would not fall within the ambit of sections 47 and 49. [Para 22]

The next question which arose for consideration was as to what would be the period of indexation for computing the capital gain on transfer of assets by the subsidiary company. In those cases, where the cost of acquisition shall be deemed to be the cost for which the holding company acquired it the year of acquisition for the purpose of indexation shall be the year in which the capital was acquired by the holding company and the indexation might be computed accordingly. But in a case where the capital asset is sold by the holding company to its

subsidiary company the year of indexation in the case of the subsidiary company shall be the year of transfer of capital asset in favour of the subsidiary company on its sale. In the instant case, undisputedly, the shares were purchased by the assessee-company from its holding company. As such the year of purchase of the shares would be the year of acquisition of the shares and the indexation would be taken from the assessment year 1994-95 in which the capital asset was purchased and not the year in which it was acquired by the holding company. Therefore, the Assessing Officer had rightly computed the capital gain accrued on the sale of shares. [Para 23]

FACTS-III

The assessee, a non-banking finance company, was engaged in the business of investment and trading in shares and finance and leasing. It earned dividend income on both the types of shares, either kept as stock-in-trade or as an investment. The assessee paid interest on borrowed funds invested in shares and claimed deduction of the same. The Assessing Officer originally issued an intimation under section 143(1)(a) and granted refund to the assessee as claimed. Subsequently, the Assessing Officer issued a notice under section 143(2) on the assessee and in regular assessment framed under section 143(3) disallowed the interest expenditure under section 14A holding that the assessee had received dividend income, which was exempt from tax.

On appeal, the Commissioner (Appeals) rejected the preliminary objection raised by the assessee that the provisions of section 14A could not be invoked in the instant case in the light of the proviso inserted in section 14A by the Finance Act, 2002 with retrospective effect from 11-5-2001 and confirmed the disallowance made by the Assessing Officer.

On second appeal:

HELD-III

Section 14A was brought on the statute by the Finance Act, 2002 with retrospective effect from 1-4-2001. After the introduction of provision of section 14A a strong apprehension was raised on behalf of the corporate sector and the different assessees that this provision might be misused and assessment might be reopened. In order to avoid misuse of this provision proviso to this section was introduced by the Finance Act, 2002 with retrospective effect from 11-5-2001 and through this proviso a restriction was imposed upon the Assessing Officer that he would not be empowered either to reassess under section 147 or to pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before 1-4-2001. Therefore, the proviso to section 14A is applicable to a situation where the assessment order for an assessment year beginning on or before 1-4-2001 has already been passed and, subsequently, re-assessment is sought to be made under section 147 or the income assessed or refund issued, as the case may be, is sought to be enhanced or reduced by passing an order under section 154. Therefore, for invoking the proviso to section 14A there should be an assessment order passed which is sought to be reopened or rectified by the subsequent act of the Assessing Officer. In the instant case, undisputedly, there was no assessment order passed under section 143(3). Only an intimation was issued through which refund was granted. It is well-settled that intimation under section 143(1)(a) cannot be called to be an assessment order. It is merely an intimation. Further, in the instant case, regular assessment was framed after issuance of notice under section 143(2), which could not be called to be reassessment under section 147 or rectification under section 154. Therefore, proviso to section 14A could not be invoked in the instant case. Therefore, the Assessing Officer had rightly, invoked the

provisions of section 14A. Further, though the dividend income earned by the assessee on its shares which were kept as stock-in-trade was also exempted from tax but the interest paid on the borrowed funds invested in trading of shares could not be disallowed because it was borrowed for the purpose of business and was an allowable expenditure under section 36(1)(iii). Disallowance of interest on borrowed funds can only be made where the borrowed funds are invested in shares and the shares are held by the assessee as an investment or as capital asset. In the instant case, the lower authorities had disallowed the interest on borrowed funds, which were invested in shares without looking in to the nature of shares, whether they were kept as stock-in-trade or as an investment. Therefore, the Assessing Officer was directed to re-adjudicate the issue afresh and identify the borrowed funds, which were invested in shares, and held as an investment and only with regard to these borrowed funds disallowance under section 14A could be made. The interest paid on the borrowed funds which were invested in shares on kept as stock-in-trade was allowable as revenue expenditure under section 36(1)(iii). [Paras 32 and 34]

FACTS-IV

The assessee had maintained an account for non-performing assets. It kept the outstanding debts which could not be properly recovered under the head 'non-performing assets' and, accordingly, made a provision for non-performing assets while computing its total income. But the net profit computed as shown in the profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act was not increased by the said provisions for non-performing assets in order to compute book profit under Explanation to section 115JA. The Assessing Officer treated the provision for non-performing assets as a provision for unascertained liability and increased the aforesaid net profit by this provision for non-performing assets and then recomputed the book profit under section 115JA.

On appeal, the Commissioner (Appeals) confirmed the action of the Assessing Officer.

On second appeal:

HELD-IV

In the instant case assessee had maintained an account for non-performing assets and whatever recovery of the outstanding debts was not properly effected and certain defaults in instalments were committed, assessee put those outstanding dues under the head 'non-performing assets' and, accordingly, he made a provision for non-performing assets while computing the total income of the assessee. In the case of bad and doubtful debts similar type of practice is being adopted by the assessees whenever they failed to recover the debt. Therefore, the same analogy could also be applied to the instant case. In the case of bad and doubtful debts, the Special Bench of the Tribunal in the case of Jt. CIT v. Usha Martin Industries Ltd. [2007] 104 ITD 249 (Kol.) has categorically held that the provision for bad and doubtful debts is not a provision for any liability, it is rather a provision for diminution in the value of assets, i.e., debts, because even if a debt is not recovered no liability would be fastened upon the assessee. Debt is the amount receivable by the assessee and not any liability payable by the assessee and, therefore, any provision towards recovery of the debt cannot be the said to be the provision for the liability. Similar is the position with regard to provisions for non-performing assets. In that case also, if the debt is not recovered no liability would be fastened upon the assessee. It is the amount receivable by the assessee and not the liability payable by the assessee. Therefore, the provision for non-performing assets was not a provision for liability. As such, the question whether it is ascertained or unascertained is irrelevant. Therefore, the order of the

Commissioner (Appeals) was to be set aside and the Assessing Officer was directed not to increase the net profit shown in the profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act by this provision for non-performing assets in order to compute the book profit under section 115JA. [Para 41]

Editor's Note

1. The assessee was entitled to claim deduction in respect of lease equalization charge, and it could not be disallowed by treating same as capital expenditure.

2. Where the lease transaction of the assessee was treated as financial arrangement by the Assessing Officer, in such circumstances interest income accruing to the assessee would be charged to tax in place of rental income assessed by him.

Cases referred to

J.K. Chemicals Ltd. v. Asstt. CIT [IT Appeal Nos. 8206 and 8648 (Bom.) of 1989] (para 4), CIT v. J.H. Gotla [1985] 156 ITR 323/23 Taxman 14J (SC) (para 6), Telerad (P.) Ltd. v. P.N. Mittal, Asstt. CIT [1980] 126 ITR 1/3 Taxman 591 (Guj.) (para 22), CIT v. Stanes Motors (South India) Ltd. [1976] 105 ITR 289 (Mad.) (para 22), V. Uppalaiah v. Dy. CIT [2005] 94 ITD 178 (Hyd.) (para 33), MTNL v. Chairman, CBDT [2000] 246 ITR 173/112 Taxman 337 (Delhi) (para 33), CIT v. K.V. Mankaram & Co. [2000] 245 ITR 353/111 Taxman 439 (Ker.) (para 33), Bharat V. Patel v. Union of India [2004] 268 ITR 116/134 Taxman 178 (Guj.) (para 33), CIT v. ABAD Fisheries [2002] 258 ITR 641/125 Taxman 616 (Ker.) (para 33), CIT v. Echjay Forgings (P.) Ltd. [2001] 251 ITR 15/116 Taxman 322 (Bom.) (para 36), CIT v. Eicher Ltd. [2006] 287 ITR 170/[2007] 159 Taxman 293 (Delhi) (para 36) and Jt. CIT v. Usha Martin Industries Ltd. [2007] 104 ITD 249 (Kol.) (SB) (para 38).

Shivaram and Paras Salva for the Appellant.
Ms. Ashima Gupta for the Respondent.