IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE

BEFORE SHRI ABRAHAM P GEORGE, ACCOUNTANT MEMBER
and
SHRI VIJAY PAL RAO, JUDICIAL MEMBER

ITA No.1105/Bang/2013
(Assessment year:2008-09)

M/s.Jeans Knit Pvt. Ltd.
No.21, E1, 2nd Phase,
Industrial Area, Peenya,
Bangalore-560058. … Appellant
PAN: AABCJ4513B

Vs.

Asst. Commissioner of Income-tax,
Circle 11(5),
Bangalore. … Respondent

AND

ITA No.1244/Bang/2013
(Assessment year: 2008-09)
(By the Revenue)

Assessee by: Shri Nageswar Rao, Advocate.
Revenue by: Shri Sanjay Kumar, CIT(DR).

Date of hearing : 03/11/2015
Date of pronouncement: 27/11/2015

O R D E R

Per VIJAY PAL RAO, JM:

These cross appeals are directed against the order dated 13/05/2013 of the CIT(A) for the assessment year 2008-09.

2. First we take up the revenue's appeal ITA No.1244/Bang/2014 wherein the following grounds are raised:

1. "The order of the Learned CIT(Appeals), in so far as it is prejudicial to the interest of revenue, is opposed to law and the facts and circumstances of the case.

2. The CIT(A) erred in allowing the deduction u/s 10B by placing reliance on the decision in ITA No.193/AC-11(5)/A-I/10-11 dated 24.08.2012 for assessment year 2007-08 in assessee's own case without appreciating that the decision has not reached finality and an appeal to ITAT has been preferred.

3. The learned CIT(A) erred in not appreciating that the assessee company has been formed by reconstruction of the business already in existence and the assessee has made use of used plant and machinery which is not in conformity with the provisions of section 10B, the company is not eligible for deduction u/s 10B.

4. The learned CIT(A) erred in not appreciating that it was the totality of the reconstruction that has to be looked for allowing the deduction and not the extent of usage of the used plant and machinery during the relevant assessment year in question or the initial assessment year.

5. The CIT(A) erred in deleting the addition of Rs. 23,08,94,447/- u/s 2(22)(e) holding that there was no accumulated profits and the advances/loans made to sister concern were out of Securities Premium Account of Rs.63.75 crore which is a capital reserve and placing reliance on ITAT,

Chandigarh decision in the case of Radhe Sham Jain reported in 140 ITD 244 (CHD) without appreciating that the relied on decision has not become final and appeal has been preferred before Punjab & Haryana High Court.

6. The learned CIT(A) erred in directing the AO to allow deduction u/s 10B on enhanced profit on account of disallowances u/s 37, 40(a)(i) and 40A without appreciating that deduction u/s 10B itself is not allowable due to the splitting and reconstruction of the business.

7. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.

8. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that may be urged at the time of hearing of the appeal. ”

3. Ground Nos.1 to 4 and 6 are regarding eligibility for deduction u/s 10B of the Income-tax Act,1961 [‘the Act’ for short].

4. We have heard the learned departmental representative as well as the learned AR of the assessee and considered the relevant material on record. At the outset, we note that an identical issue has been considered and decided by this Tribunal

in the assessee's own case for the assessment year 2007-08 in ITA No.1382 & 1516/2012 vide order dated 17/4/2015 in para.6 as under:

> "6. Having heard the rival contentions and having considered the material on record, we find that the CIT(A) has considered the issue at length and has come to the conclusion that there was no transfer of old plant and machinery during the financial year 2004-05, 2005-06 and 2006-07 and further that the plant and machinery purchased by the assessee from FFIPL in the financial year 2007-08 also did not exceed 20% of the total plant and machinery of the assessee during the said financial year. He further observed that since there was no purchase of old plant and machinery from FFIPL in the earlier assessment year even as per contemporaneous records of the EOU/Customs authorities. The relevant date of the plant and machinery purchased by the assessee over the years is reproduced at para 1.2.3, page 30 of the order of the CIT(A). Thus, CIT(A) held that the manufacturing activity carried on by the assessee in the assessment years earlier to assessment year 2008-09 was by use of new plant and machinery. As regards the transfer of business premises, employees and the customers of FFIPL to the assessee, the CIT(A) observed that there was no prohibition in the use of the business premises of FFIPL by the assessee and also of the employees and customers of FFIPL and further that the transfer of employees and customers of the assessee was only a small percentage of the total employees and customers of the assessee respectively. Thus holding, the CIT(A) set aside the finding of the AO and allowed the

deduction u/s 10B of the Act. We find that the CIT(A) has given elaborate reasons for coming to the conclusion and that the learned Departmental Representative has not been able to rebut any of the findings of the CIT(A) with any evidence to the contrary. Since the findings of the CIT(A) are based upon the evidence produced by the assessee which has not been rebutted by the revenue, we do not see any reason to interfere with the order of the CIT(A). Thus, the revenue's appeal is dismissed."

Following the earlier order of this Tribunal in assessee's own case, we do not find any error or illegality in the order of the CIT(A) qua this issue. These grounds of the revenue are dismissed.

Ground No.5 regarding addition u/s 2(22)(e) on account of deemed dividend:

5. We have heard the learned departmental representative as well as the learned AR of the assessee and considered the relevant material on record. The learned departmental representative has submitted that the AO has recorded the fact that the assessee has advanced an amount of Rs.23,08,94,447/- to concern in which the directors are interested and the same amount is shown as due. The AO proposed to consider the advance given to the concern in which the directors are interested as deemed dividend u/s 2(22)(e) of the Act. He further submitted that the AO found that the assessee was having sufficient amount in its reserve and surplus account and therefore, the conditions provided u/s 2(22)(e) are satisfied for

treating the said amount as deemed dividend. He has relied upon the orders of the AO.

6. On the other hand, Shri Nageswar Rao, learned Senior Counsel has submitted that there was no accumulated profit with the assessee and the amount shown in the reserve and surplus fund pertains to premium on securities. Therefore, in the absence of accumulated profit, provisions of sec.2(22)(e) cannot be invoked. He has referred to the finding of the CIT(A) and submitted that the CIT(A) has recorded this fact at page 55 of the impugned order that the assessee is not having any accumulated profit and the amount shown in the reserve and surplus pertains to premium on securities. Thus, the Senior Counsel has submitted that the provisions of sec.2(22)(e) cannot be invoked when the conditions provided under the said provision, particularly, the existence of the accumulated profit is not satisfied. He has relied upon the decision of the Hon'ble Punjab & Haryana High Court dated 29/10/2013 in ITA No.225/2013 in case of CIT vs. Radhe Sham Jain and submitted that while considering an identical issue, the Hon'ble High Court has held that in the absence of accumulated profit, share premium amount lying as reserve and surplus of the company is not income of the company and therefore, the provisions of sec.2(22)(e) cannot be invoked.

7. Having considered the rival submissions as well as the relevant material on record, we note that the CIT(A) has recorded the fact and details of the reserve and surplus at page 55 of the impugned order as under:

Reserves and Surplus	**March 31, 2008**	**March 31,2007**
Securities Premium Account	63,75,62,600	63,75,62,600
Opening balance of Profit and loss account	(2,92,94,761)	33,36,68,037
Appropriations	-	(32,76,62,239)
Profit and loss account closing balance	(7,30,08,345)	(3,53,00,559)
Total	**53,52,59,493**	**60,82,67,838**

From the details given above, it is clear that the balance in the reserve and surplus is only on account of security premium amount after reducing the loss incurred by the assessee for the earlier year as well as during the year under consideration. Therefore, there is no dispute about the fact that the reserve and surplus amount does not show any accumulated profit but the amount shown is only loss as well as premium on securities. The term 'accumulated profit' has been defined and explained in Explanation 1 and 2 to sec.2(22)(e) as under:

> "Explanation 1 – The expression 'accumulated profits', wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.
>
> Explanation 2 – The expression 'accumulated profits' in sub-clauses (a), (b), (d) and (e) shall include all profits

> of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place. ”

Thus, Explanation 1 and 2 to sec.2(22)(e) do not propose to include the premium on securities/shares in the expression ‘accumulated profit’. The Hon’ble Punjab & Haryana High Court in the case of Radhe Sham Jain (supra) had the occasion to consider the identical question which is framed as under:

> “Whether the Hon’ble ITAT was right in giving a finding that the share premium amount lying as reserve and surplus of the company is not an income of the company and thus are not accumulated profit of the company.”

While deciding the above question, the Hon’ble High Court has held as under:

> “A perusal of the order passed by the Income Tax Appellate Tribunal reveals that after considering that a cheque was issued in favour of the assessee, from the account of the proprietorship concern, the assessee

deposited the cheque in the account of the newly formed company, which returned this amount to the assessee, held that the amount belonged to the assessee on account of his capital in the proprietorship concern. The Income Tax Appellate Tribunal also held that the Commissioner of Income Tax (Appeals) rightly restricted addition of Rs.34,858/- i.e. to the extent of accumulated profits.

We have considered the arguments advanced by counsel for the revenue and are not inclined to take a view different from the opinion recorded by the Tribunal. The arguments raise disputed questions of fact, which have been answered in favour of the assessee. In the absence of any error, while considering the facts or in applying any provision of the Act, we find no reason to hold that findings of facts recorded by the Income Tax Appellate Tribunal and the Commissioner of Income Tax (Appeals) give rise to a question of law, much less, the questions of law framed by the revenue."

8. In view of the above facts and circumstances of the case, when there is no accumulated profits in the books of the assessee, then merely because the reserve and surplus having the balance on account of premium on security would not lead to the conclusion that the assessee was having sufficient accumulated profits to invoke the provisions of sec.2(22)(e). Accordingly, we do not find any error or illegality in the order of the CIT(A) qua this issue.

9. The assessee, in its appeal has raised the following grounds:

"Ground I

1.1 The order of the learned CIT(A) is erroneous and bad in law to the extent it does not allow the grounds on deductibility of the expenses relating to rent, legal and professional charges, wash trial expenditure and Payment of sales commission, on the ground that the disallowance would only increase the claim of deduction under Section 10B of the Act.

Ground 2: Payment of rent to overseas entity

2.1 The learned CIT(A) has erred in not upholding the Appellants claim of deductibility of rental expenditure of Rs. 20,865,900 on merits.

2.2 The learned CIT(A) has erred in not upholding the deductibility of expenses in light of the submissions filed by the Appellant during the appellate proceedings.

Ground 3: Payment of legal fees to Dutch law firms

3.1 The learned CIT(A) has erred in not upholding the Appellants claim for deduction of legal fees of Rs.5,600,000 on merits.

3.2 The learned CIT(A) erred in not deciding that, these payments were not disallowable under Section 40(a)(i) of the Act as the payments made are not taxable in India and therefore the withholding tax provisions would not apply.

3.3 The learned CIT(A) has erred in not upholding the deductibility of expenses in light of the submissions filed by the Appellant during the appellate proceedings.

Ground 4: Payment for wash trial charges

4.1 The learned CIT(A) has erred in not upholding the Appellant's claim for deduction of Rs.3,231 000 towards wash trial charges on merits.

4.2 The learned CIT(A) erred in not deciding that, these payments were not disallowable under Section 40(a)(i) of the Act as the payments made are not taxable in India and therefore the withholding tax provisions would not apply.

4.3 The learned CIT(A) has erred in not upholding the deductibility of expenses in light of the submissions filed by the Appellant during the appellate proceedings.

Ground 5: Payment of Sales Commission

5.1 The learned CIT(A) has erred in not upholding the Appellant's claim for deduction of Rs.3,527,095 towards sales commission on merits.

5.2 The learned CIT(A) has erred in not deciding that, these payments were not disallowable under Section 40(a)(i) of the Act as the payments made are not taxable in India and therefore the withholding tax provisions would not apply.

5.3 The learned CIT(A) has erred in not upholding the deductibility of expenses in light of the submissions filed by the Appellant during the appellate proceedings.

The Appellant submits that each of the above grounds is independent and without prejudice to one another.

Further, the Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before, or at the time of, hearing of the appeal. **"**

10. The issues raised in the assessee's appeal are regarding disallowance of certain expenses.

11. We have heard the Senior Counsel as well as the learned departmental representative and considered the relevant material on record. At the outset, we note that an identical issue came for consideration before this Tribunal in the assessee's own case (supra) for the assessment year 2007-08 and the Tribunal, in para.7 has observed as under:

> "7. Consequent to the dismissing of the revenue's appeal, merits of the disallowance of the expenditure claimed by the assessee would only become academic as rightly held by the CIT(A). Disallowance of the expenditure would only increase the claim of deduction /s 10B of the Act and therefore decision on the merits of the disallowance is only academic at this stage. In view of the same, we do not see any reason to adjudicate these issues at this stage. The assessee's appeal is also dismissed. "

For the year under consideration, the facts are identical as well as the issue of deduction u/s 10B has been decided in favour of the assessee and therefore, to maintain the rule of consistency on earlier finding/observation of the Tribunal, we concur with the view of the Tribunal for the assessment year 2007-08 that the merits of disallowance of various expenses becomes academic when the claim of deduction u/s 10B has been decided in favour of the assessee. Accordingly, the appeal of the assessee is dismissed.

12. In the result, the appeal of the revenue as well as the appeal of the assessee are dismissed.

Pronounced in the open court on 27th November, 2015.

sd/-	sd/-
(Abraham P George)	**(Vijay Pal Rao)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

eksrinivasulu

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore