IN THE INCOME TAX APPELLATE TRIBUNAL "D", BENCH KOLKATA

BEFORE SHRI A. T VARKEY, JM &DR. A.L.SAINI, AM

आयकरअपीलसं./**ITA No.667/Kol/2014**

(**निर्धारणवर्ष /** Assessment Year: 2008-09

D.C.I.T, Circle-1 Kolkata	**Vs.**	**M/s The Hooghly Mills Co. Ltd.** 10, Clive Row, Kolkata – 1.
स्थायीलेखासं./जीआइआरसं./PAN/GIR No. : AAACT 9780 F		
(Revenue/Department)	**..**	**(Assessee)**

Assessee by : Shri S. Jhajharia, CA
Revenue/Department by : Shri Kalyan Nath, ACIT

सुनवाईकीतारीख/ **Date of Hearing** **: 07/09/2017**

घोषणाकीतारीख/**Date of Pronouncement** **: 04/12/2017**

आदेश / O R D E R

Per Dr. Arjun Lal Saini, AM:

The captioned appeal filed by the Revenue, pertaining to Assessment Year 2008-09, is directed against an order passed by the ld. Commissioner of Income Tax(Appeals) in Appeal No.259/CC-VII/CIT(A)C-I/10-11, dated 31.01.2014, which in turn arises out of an order passed by the Assessing Officer u/s 143(3) of the Income Tax Act, 1961(hereinafter referred to as the 'Act'), dated 27.12.2010.

2.The Revenue has raised the following grounds of appeal:

"1.That, on the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition of Rs.2,30,00,000/- made by the Assessing Officer u/s 2(22)(e).

2.That, on the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition made by the Assessing Officer u/s 36(i)(va) read with section 2(24)(x) in respect of employee's contribution to PF/ESI for an amount of Rs.1,32,86,580/-.

3.That, on the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition of Rs.1,30,70,800/- made on account of gratuity liability.

4.That, on the facts and in the circumstances of the case, the CIT(A) is not justified in deleting the addition of Rs.12,23,842/- made by the Assessing Officer u/s 14A of the Income Tax Act read with rule 8D of the Income Tax Rules, 1962.

5. The appellant craves leave to amend, modify and later any grounds of appeal during the course of hearing of this case."

3. **Ground No.1 relates to addition of Rs.2,30,00,000/-made by the Assessing Officer u/s 2(22)(e) of the Act.**

3.1. The brief facts qua the issue are that assessee company filed his return of income, on 30.09.2008 showing total loss of (-)Rs.6,83,32,840/-. The assessee company carried on a business of manufacturing of jute goods in different varieties. The company owns five jute mills namely Hoohgly Unit, Gondalpara Unit, Waverley Unit, Bowreah Unit & India Unit. The assessee company also runs, a small plastic unit namely Menakshi Poly Jute. During the assessment proceedings, the Assessing Officer noted that the assessee accepted a loan of Rs.2,30,00,000/- from Mega Resources Ltd, in which subsidiary of the assessee company, namely Hooghly Mills Projects Ltd, was having a share holding of 13,90,100/- equity shares out of total paid up equity shares of Rs.1,20,00,000/- being more than 10% of such paid up shares. The assessing officer treated that loan of Rs.2,30,00,000/-,as a deemed dividend under section 2(22)(e) of the Income Tax Act and therefore he added Rs.2,30,00,000/- to the income of the assessee.

3.2 Aggrieved by the addition made by the Assessing Officer u/s 2(22)(e), at Rs.2,30,00,000/-, the assessee filed an appeal before the CIT(A), who has allowed the assessee's appeal. The ld. CIT(A) observed that the assessee company held 2,21,500 equity shares of the lending company M/s Mega Resources Ltd having total paid-up equity shares of 1,20,00,000. The share-holding of the assessee company thus constituted 1.7% of the total paid-up equity shares of the lending company which has not been disputed by the AO. In other words, the assessee company was holding less than 10% of the voting power as required in section 2(22)(e) of the Act. However, the AO had invoked section 2(22)(e) on the ground that assessee's subsidiary company M/s Hooghly Mills Projects Ltd held more than 10% of the voting power. The AO had given no reasons as to why he had considered the share-holding of the subsidiary company for computing the voting power of the assessee company. The ld CIT(A) observed that the AO had not even discussed the issue in his assessment order. The AO has simply stated that assessee's subsidiary company held more than 10% of the voting power; and then, invoked section 2(22)(e) of the Act, to assess the loan of Rs.2.30 crores as dividend income in the hands of the assessee. The assessee submitted before the CIT(A) that section 2(22)(e) was not applicable in the case of the assessee company as it was holding only 1.7% of the voting power in the lending company M/s Mega

Resources Ltd. Therefore, based on these facts, the CIT(A) deleted the addition of Rs.2.30 crores.

3.3 Not being satisfied with the order of CIT(A), the Revenue is in appeal before us. The ld DR for the Revenue has primarily reiterated the stand taken by the Assessing Officer, which we have already noted in our earlier para and is not being repeated for the sake of brevity.

3.4. On the other hand, the ld. Counsel for the assessee has submitted before us that the assessee has share holding merely 1.7%, therefore, it does not come in the purview of section 2(22)(e) of the Act. The counsel pointed out that the Assessing Officer simply stated that assessee's subsidiary company held more than 10% of the voting power and then, invoked section 2(22)(e) to assess the loan of Rs.2.30 crores as dividend income in the hands of the assessee, which is not as per the scheme of section 2(22) (e) of the Act. The ld. Counsel pointed out that section 2(22(e) was not applicable in the case of the assessee company as it was holding only 1.7% of the voting power in the lending company M/s Mega Resources Ltd.

3.5 Having heard the rival submissions and perused the materials available on record, we are of the view thataddition of Rs.2.30 crores, made by the assessing officer, as deemed dividend income in the hands of the assessee, is not in accordance with the bare provisions of section 2(22) (e) of the Act. The shareholding of assessee's subsidiary company to invoke the provisions of section 2 (22) (e) of the Act. We are of the view that section 2(22)(e) was not applicable in the case of the assessee company, as it was holding only 1.7% of the voting power in the lending company M/s Mega Resources Ltd. We note that the AO has erred in law as well as on facts in considering the share holding of the subsidiary company for computing the voting power of the assessee, therefore we are of the view that the AO has misconstrued the provisions of section 2(22)(e) of the Act. The requirement of section 2(22)(e) is that the assessee should be holding not less than 10% voting power. The provisions of section 2(22)(e) is applicable only to a person who is the beneficial holder of shares having not less than 10% of the voting power. But, in the assessee`s case under consideration, we find that the assessee is not holding shares in excess of the prescribed limit and consequently, the provisions of section 2(22)(e) are not applicable. Respectfully following the judgment of coordinate Bench, Mumbai, in the case of BhaumikColour (P) Ltd 313 ITR (ITAT)

146, wherein it was held that section 2(22)(e) has created a fiction whereby the definition of "dividend" has been enlarged to include even loans and advances; and so, the legal provision has to be given a strict interpretation. Secondly, the definition of "dividend" as given in section 2(22)(e) is an inclusive definition and the AO was not competent to enlarge the same by importing things which do not form part of such legal fiction. In view of the above, the AO was not justified in considering the share-holding of the subsidiary company for the purposes of invoking section 2(22)(e). The Assessing Officer has not disputed the fact that the assessee company was having 1.7% share-holding in the lending company. As the assessee company was holding less than 10% of the voting power in the lending company, the provisions of section 2(22)(e) is not attracted in its case.

Therefore, considering the factual position, we are of the view that the order passed by the ld. CIT(A) does not contain any infirmity. Therefore, we confirm the order passed by the ld. CIT(A).

3.6 In the result, the appeal filed by the Revenue (in Ground No.1), is dismissed.

4. **Ground No.2 raised by the Revenue relates to addition made by the Assessing Officer u/s 36(i)(va) read with section 2(24)(x) in respect of employee's contribution to PF/ESI for an amount of Rs.1,32,86,580/-.**

4.1 The brief facts qua the issue are that the assessing officer, from the tax audit report of the assessee, found out that as per column 21(i) of Audit report in form no.3CA & 3CD, out of the total outstanding of Employers' contribution towards family Pension Fund and Provident Fund as on 1.4.2006 was at Rs.3,74,26,843/- and employee's contribution of Rs.12,90,273/-, Rs.1,32,86,580/- and Rs.Nil respectively have been paid during the year (up to 31.03.2007). The assessing officer noted that under section 36(1)(va) any sum received by the assessee from any of his employees to which the provisions of sub-clause (24) of section 2 apply, if such is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date, shall be allowed in computing the income referred to in section 28.These amounts were paid out of the accumulated liability. As the amount was not credited by the assessee to the employees' account on or before the due date, as explained below sub-clause (va) of clause (1) of section 36, deduction was not admissible. Since the employee's contribution is not allowed

under section 43B on payment basis but under section 36(1)(va) read with section 2(24)(x) and section 43B is attracted in case of employer contribution only.
Therefore, deduction of Rs.1,32,86,580/- as claimed by the assessee in the computation u/s 43B on payment basis was disallowed by AO, since section 43B is not applicable for payment of employee's contribution.

4.2 Dissatisfied with the order of the Assessing Officer, the assessee carried the matter to the ld. CIT(A) who allowed the claim of the assessee. The ld. CIT(A) observed that the Assessing Officer has made the addition on the ground that the sum of Rs.1,32,86,580/- was related to the employee's contribution. The CIT(A) noted the computation of income that sum of Rs.1,32,86,560/- which was disallowed in earlier year was claimed u/s 43B on payment basis. The ld CIT(A) held that even employee's contribution is allowable u/s 43B on payment basis. In view of the above, the disallowance of Rs.1,32,86,580/- was deleted by CIT(A).

4.3. Not being satisfied with the order of the ld. CIT(A), the Revenue is in appeal before us, on this issue. The ld DR for the Revenue has primarily reiterated the stand taken by the Assessing Officer, which we have already noted in our earlier para and is not being repeated for the sake of brevity.

4.4. On the other hand, the ld. Counsel for the assessee has submitted that the Assessing Officer had made the disallowance out of miss-conception and without properly appreciating the Tax Audit Report. In the Tax Audit Report it has been very clearly and distinctly mentioned that "out of the total outstanding of Employers' Contribution towards Family Pension Fund and Provident Fund as on 01.04.2006 Rs.3,74,26,843/- and Employees' contribution of Rs.12,90,273/-, Rs.1,32,86,580/- and Rs. Nil respectively has been paid during the year (upto 31.03.2007)". The counsel pointed out that the amount of Rs.1,32,86,580/- paid during the year related to "Employers' Contribution: towards Family Pension Fund and Provident Fund and no payment out of outstanding amount in respect of employees contribution of Rs.12,90,273/- had been paid during the year and not a single paisa out of outstanding Employees contribution of Rs.12,90,273/- was included in payment of Rs.1,32,86,580/- and hence the entire disallowance made by the Assessing Officer is bad, illegal, unjustified and uncalled for and hence the entire amount of Rs.1,32,86,580/- paid during the year being in connection with employers contribution only was fully allowable u/s.43B and hence the question of any

disallowance did not arise. The ld counsel also pointed out that similar disallowance had been made by the Assessing Officer in his earlier assessment order i.e. for the Assessment Year 2004-05 which was fully allowed by the CIT(A) Kolkata.

4.5 Having heard the rival submission and perused the materials available on record, we are of the view that the question of disallowance of Rs.1,32,86,580/- does not arise, especiallyin case of employer`s contribution, because u/s 43B of the Act, the amount is allowable on the basis of actual payment, irrespective of the year to which it relates. At this juncture, it is relevant to quote the provisions of section 43B (a) of the Income Tax Act, which reads as follows:

> *"43B.Certain deduction to be only on actual payment:*
> *(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees."*

Therefore, based on the provisions of section 43B(a) of the Act, it is abundantly clear that employer`s contribution to provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, is allowable on actual payment basis.

We note that the Assessing Officer had made the addition on account of employee's contribution, which is factually incorrect. However, the material on record suggests that the same is related to the employer's contribution which was allowable u/s 43B. Therefore, considering the factual position, as explained above, we do not find any infirmity in the order of CIT(A), therefore, we confirm the order of CIT(A).

4.6 In the result, the appeal filed by the Revenue (in Ground No.2) is dismissed.

5. **Ground No.3 raised by the Revenue relates to addition of Rs.1,30,70,800/- made on account of gratuity liability.**

5.1 The brief facts qua the issue are that during the assessment proceedings,it was noted by the AO, from Para 19B(5)(b) of Notes on Accounts that the assessee had not provided for gratuity liability in respect of employees retired/terminated during the year amounting to Rs. 1,30,70,800/- in the Books of accounts. The note further mentioned that the gratuity liability for the year was neither ascertained nor provided in the books of accounts. Itwas also noted from column 11(a) of the Tax Audit report that the assessee company has consistently followed cash system in

respect of gratuity. However, assessee company has claimed deduction in respect of gratuity payable under section 40A(7) of the Act in the computation of income furnished along with the return, though not provided in the books of accounts to the tune of Rs.1,30,70,800/-, therefore assessing officer disallowed the same.

5.2 Not being satisfied with the addition made by the assessing officer, the assessee filed an appeal before the CIT(A), who has deleted the addition made by the assessing officer. Aggrieved by the addition made by the CIT(A), the Revenue is in appeal before us.

5.3.The ld Counsel for the assessee has submitted before us that gratuity is a statutory liability payable under the Gratuity Act 1971 and the same is allowable even if no provision for the same have been made in this accounts. It is further stated by the Counsel that the provisions of section 43B were also not applicable because the amount was not payable by way of contribution to any gratuity fund or any other fund but was actually payable to retiring employees during the previous year relevant to Assessment year 2008-2009.

5.4.On the other hand, ld DR for the Revenue has primarily reiterated the stand taken by the Assessing Officer, which we have already noted in our earlier para and is not being repeated for the sake of brevity.

5.5 Having heard the rival submissions perused the material available on record, we note that, assessee`s issue under consideration is fully covered in favour of the assessee, by the judgment of the jurisdictional ITAT in earlier years. The coordinate Bench Kolkata in assessee's own case in the ITA No.1285/Kol/2007 Assessment Year 2001-02 and ITA No.1286/Kol/2007, Assessment Year 2002-03 allowed the claim of the assessee, holding that the liability for gratuity in respect of those employees who had retired during the year is allowable u/s 40A(7)(b), even if no provision for the same had been made in the accounts. Respectfully, following the judgment of Jurisdictional ITAT, Kolkata in assessee own case, we are of the view that the order passed by the ld. CIT(A) does not contain any infirmity. Therefore, we confirm the order passed by the ld. CIT(A).

5.6 In the result, the appeal filed by the Revenue (in Ground No.3) is dismissed.

6. **Ground No.4 raised by the Revenue relates to addition of Rs.12,23,842/- made by the Assessing Officer u/s 14A of the Income Tax Act r.w.r 8D of the Income Tax Rules, 1962.**

6.1 The brief facts qua the issueare that during the assessment proceedings, the assessing officer found that the assessee have received exempted dividend income of Rs.14,35,675/-. The AO asked the assessee to explain why provisions of section 14A would not be applicable. The assessee submitted that Rs.10,000/-, had already considered as expenses for earning of dividend. After hearing the assessee`s explanation, the AO computed the disallowanceU/s 14A at Rs.12,17,890/- and disallowed u/s.14A for earning exempted dividend income being ½ of average investment as per rule 8D (2) (iii).

6.2. Aggrieved by the addition made by the Assessing Officer u/s.14A at Rs.12,17,890/-, the assessee carried the matter to the ld. CIT(A) who allowed the claim of the assessee and deleted the addition made by AO. Aggrieved by the order of CIT(A), the Revenue is in appeal before us.

6.3 We have heard both the parties and perused the materials available on record, we are of the view that disallowance under rule 8D (2) (iii) should be restricted to 0.5% of only those investments which yielded tax free income during the relevant previous year. We note that in the assessee`s case under consideration, the Assessing Officer found that the assessee had received during the year, dividend income of Rs.14,35,675/-. The assessee submitted at the assessment stage that it had already considered expenses of Rs.10,000/- towards earning of dividend income. The Assessing Officer, however, made disallowance of Rs.12,17,890/- by invoking rule 8D(2)(iii) of the I.T. Rules.

We note that assessee`s case under consideration relates to Rule 8D (2) (iii) of I.T. Rules, where the disallowance is restricted to 0.5% of the average investments. Here average investment means those investments which yielded exempted income. That is, dividend bearing securities. We are of the view that considering the judgment of jurisdictional ITAT 'A' Bench, Kolkata in the case of REI Agro Ltd. in ITA No.1331/Kol/2011 wherein it was held that the disallowance under rule 8D (2)(iii) should be restricted to 0.5 % of only those investments which yielded tax free income, during the relevant previous year.Therefore, following the judgment of the

Jurisdictional ITAT (supra), we direct the Assessing Officer to compute disallowance under Rule 8D(2)(iii) by restricting to those investments that have yielded tax free dividend income during the year.The CIT(A) has already directed the Assessing Officer to compute the disallowance under rule 8D (2)(iii), by considering only those investments that have yielded tax free dividend income during the year, therefore, we are of the view that order of CIT(A) does not contain any infirmity and hence we confirm the order passed by CIT(A).

6.4 In the result, the appeal filed by the Revenue (in Ground No.4) is dismissed.

7. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in the open court on this **04/12/2017.**

Sd/-	**Sd/-**
(A. T. VARKEY)	**(DR. A.L.SAINI)**
न्यायिक सदस्य / JUDICIAL MEMBER	**लेखा सदस्य / ACCOUNTANT MEMBER**

कोलकाता /Kolkata; दिनांक Dated 04/12/2017
RS,SPS

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. The Assessee– M/s The Hooghly Mills Co. Ltd.
2. The Revenue/Department - D.C.I.T, Circle-1 Kolkata
3. आयकरआयुक्त(अपील) / The CIT(A), :Kolkata.
4. आयकरआयुक्त/ CIT
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, **कोलकाता**/ DR, ITAT, Kolkata
6. गार्डफाईल / Guard file.

सत्यापितप्रति

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Senior Private Secretary,
Head of Office/D.D.O,
I.T.A.T, Kolkata Benches,
Kolkata.