

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "E", MUMBAI

Before Shri Saktijit Dey (JUDICIAL MEMBER)

AND

Shri G Manjunatha (ACCOUNTANT MEMBER)

I.T.A No.7012/Mum/2011 & I.T.A. No.6085/Mum/2013
(Assessment years: 2008-09 & 2010-11)

Sai Fragrance & Flavours Pvt Ltd, Summer Ville, 5 th Floor, Plot No.426, JN of 14 th & 33 rd Road, Khar (W), Mumbai-400 052 PAN : AADCS6400Q	vs	The ACIT-Cir.9(3), Mumbai
APPELLANT		RESPONDEDNT

Appellant by	Ms. Dinkle Hariya
Respondent by	Shri V Justin

Date of hearing	17-01-2018
Date of pronouncement	31-01-2018

ORDER

Per G Manjunatha, AM :

These two appeals filed by the assessee are directed against separate but identical orders of CIT(A)-20, Mumbai dated 03-08-2011 and 04-07-2013 for the assessment years 2008-09 and 2010-11. Since facts are identical and issues are common, these appeals were heard together and are disposed of by this common order, for the sake of convenience.

2. The brief facts of the case extracted from I.T.A No.7012/Mum/2011 are that the assessee company engaged in the business of

manufacturing fragrance and flavours filed its return of income for the assessment year 2008-09 on 29-09-2008 declaring total income of Rs.90,35,124. The case has been selected for scrutiny and accordingly notice u/s 143(2) and 142(1) of the Act were issued. In response to notices, authorized representative of the assessee attended and furnished requisite details. During the course of assessment proceedings, AO noticed that the assessee has earned interest income from loans and the same has been treated as receipts from business. The AO further noticed that the assessee has claimed various expenses to the extent of Rs.15,22,025 which includes administrative and operational expenses against interest income and offered net profit of Rs.90,25,337 under the head 'Income from business'. Therefore, called upon the assessee to explain as to why interest from loans shall not be treated as income from other sources and also expenses claimed against such interest income shall not be disallowed. In response to show cause notice, the assessee submitted that during the year under consideration its main business activity is money lending to another corporate and earn interest. Therefore, interest earned from loans has been rightly treated as business receipts. The assessee further submitted that though it has treated interest income in the previous financial year under the head "Income from other sources", because of change in facts and circumstances, it changed its business activity from

manufacturing of fragrance and flavours to financial service and it has discontinued its manufacturing operations from AY 2008-09 onwards. Therefore, its claim of interest income under the head 'Income from business' is in accordance with law. It was further submitted that it has claimed expenses against business receipts which are mainly in the nature of general administrative and other expenses incurred to keep corporate entity status of the assessee. Therefore, whether or not business is carried out, it required to incur these expenses to keep the corporate status, therefore, it has rightly claimed expenses against business receipts. The AO after considering relevant submissions of the assessee observed that during the year the assessee has not carried out any business activity and earned only interest income from loans and advances given to 7 parties. The AO further observed that the assessee has treated interest income under the head 'Income from other sources' in the earlier years and without there being any material change in facts treating interest income under the head 'Income from business' was not justified. Insofar as expenses claimed against interest income, the AO observed that there is no nexus between expenses incurred and income earned. As the assessee has discontinued its business operations, the question of incurring administrative and other expenses did not arise. Since the assessee has failed to prove nexus between interest income and expenditure, disallowed total expenditure and added

back to the total income and treated interest income under the head 'Income from other sources'.

3. Aggrieved by the assessment order, assessee preferred appeal before CIT(A). Before CIT(A), assessee reiterated its submissions made before the AO. The assessee further submitted that though it is engaged in the business of manufacturing of fragrance and flavours, it has discontinued its business activity and continued the business activity of money lending in accordance with its object clause in memorandum of association of the company and hence rightly treated interest income under the head 'Income from business'. The assessee further submitted that the assessee has treated interest income as its business receipts which is supported by the object clause of memorandum of association and also the tax auditor in his tax audit report specified the nature of business of the assessee as financial other relevant services which clearly indicates that its main business activity is earning interest income. Insofar as expenditure claimed against interest income, the assessee submitted that being a company which is an artificial juridical person, required to maintain the place of office to run its commercial activity whether or not business activity is carried out during the year under consideration. The expenditure incurred during the year like office rent, audit fees and other miscellaneous expenses are in the nature of day to day expenses required to keep the corporate status of the

assessee and, therefore, it has rightly claimed expenses against interest income. The CIT(A), after considering relevant submissions of the assessee observed that the assessee company has offered interest income as other income in its financial statements for the year under consideration. This implies that the same is not from its business operations. The assessee also failed to prove any kind of business activity conducted during the year so as to treat its interest receipts under the head 'Income from business'. The CIT(A) further observed that the assessee has treated interest income under the head 'Income from other sources' in the earlier years and without there being any material changes in the facts treating the same under the head 'Income from business' was not justified. As regards expenses claimed by the assessee, the assessee has not incurred expenditure wholly and exclusively for the business of the assessee which is evident from the impugned assessment order. Though the assessee has claimed certain expenses against interest income, failed to prove nexus between expenditure incurred and interest income. Therefore, the AO was right in disallowing expenditure incurred by the assessee and also treating interest income under the head 'Income from other sources'. Aggrieved by the order of CIT(A), assessee is in appeal before us.

4. The Ld.AR for the assessee submitted that the Ld.CIT(A) erred in confirming the action of the AO in computing the interest income under

the head 'Income from other sources' instead of profits and gains of business or profession without appreciating the fact that the assessee's business activity for the year under consideration is financial and other relevant services which is evident from the fact that the tax auditor in his report, reported the business activity of the assessee as such. The Ld.AR further submitted that though it was involved in the business of manufacturing fragrance and flavours, discontinued its business activity and continued to carry out the business activity of financial services in accordance with its main object clause in the memorandum of association, therefore, the AO was incorrect in treating interest income under the head 'Income from other sources' merely because in the earlier years interest income was considered under the head 'Income from other sources'. As regards expenditure claimed, the Ld.AR submitted that the expenditure claimed are in the nature of general administrative and overhead expenses including office rent, auditor's remuneration and conveyance and travelling and other miscellaneous expenses which are required to be incurred whether or not business activity is carried out by the assessee to keep the corporate entity status intact. Therefore, the AO was incorrect in disallowing expenditure by holding that the assessee has not carried out any business activity. In support of her arguments, she relied upon the decision of Hon'ble Calcutta High Court in the case of CIT vs Ganga Properties Ltd (1993)

199 ITR 94 (Cal).

5. On the other hand, the Ld.DR strongly supported the orders of authorities below. The Ld.DR further submitted that the assessee all along offered interest income under the head 'Income from other sources' and without any material changes in facts considered interest income under the head 'Income from business'. Therefore, the AO was right in treating interest income under the head 'Income from other sources'. As regards expenditure, since the assessee has discontinued its business operations, the AO was right in disallowing expenditure which were not incurred wholly and exclusively for the purpose of business of the assessee.

6. We have heard both the parties and perused the material available on record. The AO treated interest income under the head 'Income from other sources' on the ground that the assessee's main activity was manufacture of fragrance and flavours but not financial services. The AO further observed that the assessee has treated interest income under the head 'Income from other sources' in the earlier years and without any material change in facts, interest income has been treated under the head 'Income from business'. Similarly, the AO has disallowed expenditure incurred by the assessee on the ground that the assessee has not incurred expenditure wholly and exclusively for the business purpose which is evident from the fact that it has discontinued its

business activity. It is the contention of the assessee that though it was engaged in the business of manufacturing of fragrance and flavours, it has discontinued its manufacturing activity and continued to carry out financial services business which is evident from the fact that its activity was supported by the objects in memorandum of association and it was further supported by the report of the tax auditors where the tax auditor has specified the nature of business of the assessee as financial services. The assessee further contended that it has incurred various administrative and other expenses in the nature of office rent, auditor's remuneration, travelling and conveyance and other miscellaneous expenses to keep the corporate entity status whether or not the business activity is carried out in the year. Therefore, the AO was incorrect in disallowing expenditure incurred by holding that expenditure was not incurred wholly and exclusively for the purpose of business of the assessee.

7. Having heard both the sides and considered material on record, we find that the assessee was engaged in the business of manufacturing of fragrance and flavours. During the year, the assessee has discontinued its business operations. The assessee has earned interest income from inter corporate deposits and treated the same as other income in its financial statements. The assessee claims that it has changed its business activity from manufacturing to financial services which is

authorized by its memorandum of association, therefore, there is no error in treating interest income under the head income from business. We do not find any merit in the arguments of the assessee for the reason that all along the assessee has treated interest income under the head 'Income from other sources' and without any change in material facts, the same has been brought under the head 'Income from business' without any justification. We further notice that the assessee itself has treated interest income as 'other income' in its financial statements which clearly implies that the same is not from its business operations. Though the assessee claims that its activity is in accordance with its object clause in memorandum of association, on perusal of the memorandum of association we find that the assessee's main object is to manufacture fragrance and flavours. Though the assessee has financial service as an ancillary object to its main object, such activity is not the main business activity of the assessee. Therefore, we are of the considered view that there is no justification for treating interest income under the head 'Income from business'. Hence, we are of the considered view that the AO was right in treating interest income under the head 'Income from other sources'. Though the assessee has relied upon various judgments, on perusal of the decisions cited by the assessee we find that all are rendered in different facts and are not applicable to the facts of assessee's case.

8. Coming to the disallowance of expenditure claimed against interest income, the assessee has claimed various expenditure including office rent, auditor's remuneration, travelling and conveyance and other miscellaneous expenditure which are in the nature of general administrative and other expenses necessarily to keep the corporate status of the assessee whether or not the business activity is carried out during the year under consideration. The AO has disallowed expenditure only on the ground that the assessee has not carried out any business activity and expenditure are not incurred wholly and exclusively for the purpose of business of the assessee. We do not find any merit in the findings of the AO for the reason that whether the assessee has income under the head 'business' or not, expenditure incurred to maintain the corporate status of the assessee needs to be allowed. In this case, on perusal of the details of expenditure we find that the assessee has incurred office rent, auditor's remuneration and other small miscellaneous expenses which are mainly incurred to keep the corporate status of the assessee. Therefore, we are of the considered view that the AO was erred in disallowing expenditure incurred by the assessee. This legal proposition is supported by the decision of Hon'ble Calcutta High Court in the case of CIT vs Ganga Properties Ltd (supra) wherein it was observed that a limited company, even if it does not carry on its business, but it derives income from other

sources has to maintain its establishment for complying with statutory obligations so long as it is in operation and its name is not struck off from the register of Registrar of Companies or unless the company is dissolved which means cessation of corporate activities of the company for all practical purpose. So long as it is in operation, it has to maintain its status as a company and it has to discharge certain legal obligations and for that purpose it is necessary to maintain clerical staff and secretary or accountant and incur incidental expenses.

9. Coming to the case laws relied upon by the Ld.DR, the Ld.DR relied upon the decision of Madhya Pradesh High Court in the case of Perfect Battery Co Ltd vs CIT (1987) 166 ITR 196 (MP) and submitted that only expenditure incurred u/s 57(iii) in relation to earning of interest income is allowable whereas in this case, the assessee has incurred expenditure having no nexus between interest income and expenditure incurred. Therefore, the expenditure incurred by the assessee cannot be allowed as deduction u/s 57(iii) of the Act.

10. We have gone through the case laws relied upon by the Ld.DR in the light of facts of the present case and find that the case laws relied upon by the Ld.DR is in the context of claim u/s 57(iii) whereas the facts of the assessee's case are in relation to expenditure claimed u/s 37(1). Therefore, we are of the considered view that the case law relied upon by the Ld.DR is not applicable to the facts of the present case. The Ld.

DR relied upon the decision of Hon'ble Bombay High Court in the case of CIT vs Amritaben R Shah (1999) 238 ITR 777 (Bom) to argue that section 57(iii) is liable only of an expenditure laid out or expended wholly or exclusively for the purpose of making or earning the income referred to in that section, i.e. income from other sources. In this case, the assessee has incurred expenditure to keep corporate status which cannot be allowed u/s 57(iii) of the Income-tax Act, 1961. We find that the case before the Hon'ble Bombay High Court is on whether, the assessee could claim general administrative and other expenses which are having no nexus with interest income, u/s 57(iii) of the Act or not. But in this case, the assessee has claimed expenditure u/s 37(1), therefore, the case law relied upon by the Ld.DR is not applicable to the facts of the assessee's case.

11. In this view of the matter and considering the ratios of the case laws discussed above, we are of the considered view that the AO was erred in disallowing expenditure incurred by the assessee. Therefore, we direct the AO to allow expenditure claimed by the assessee u/s 37(1) of the Income-tax Act, 1961.

12. In the result, the appeal filed by the assessee in ITA No.7102/2011 is partly allowed.

ITA No. 6085/Mum/2013

13. In this appeal, the facts and issues involved are identical to the facts

and issues discussed in ITA No.7012/Mum/2011. The findings given by us in ITA No. 7012/Mum/2011 shall mutatis mutandis apply to this appeal also. Therefore, for the detailed discussion in the preceding paragraphs, we direct the AO to treat interest income under the head 'Income from other sources'. Accordingly, the grounds raised by the assessee challenging action of AO in treating interest income under the head 'Income from other sources' is dismissed and the ground raised by the assessee challenging disallowance of expenditure of Rs.1,14,050 has been allowed.

14. The assessee has filed a petition for admission of additional evidence taking a ground on allowability of bad debts written off in the light of the decision of Hon'ble Supreme Court in the case of TRF Ltd vs CIT (2010) 323 ITR 397 (SC) to argue that the assessee was entitled to claim of bad debt for the debtors written off during the year. The Ld.AR for the assessee submitted that additional ground raised by the assessee is a legal ground emanating from the orders of lower authorities and no new facts or evidence brought on record in support of additional ground. Therefore, the additional ground of appeal may be admitted and adjudicated on merits.

15. Having heard both the sides we find that additional ground raised by the assessee in the light of decision of Hon'ble Supreme Court TRF Ltd vs CIT (supra) is emanating from the orders of lower authorities and no

new facts or evidence has been brought on record. Therefore, we admit additional ground raised by the assessee and proceed to dispose of the issue on merits.

16. The Ld.AR for the assessee submitted that the Ld.AO was erred in disallowing bad debts written off during the year without appreciating the fact that the assessee has written off bad debts in the books of account and income from which has been offered to tax in the earlier years. The Ld.AR further submitted that the Hon'ble Supreme Court in the case of TRF Ltd vs CIT (supra) has held that once it has written off in the books of account, it is a sufficient compliance of provisions of section 36(1)(vii) and there is no need to prove whether debt has become really bad or not.

17. Having heard both the sides and considered material on record, we find that the assessee has written off bad debt amounting to Rs.5,00,129 and debited to P&L Account. The assessee further claims that the bad debts arise out of sales made in the earlier years and income from which has been offered to tax, therefore, bad debt written off is in accordance with the provisions of section 36(1)(vii) of the Income-tax Act, 1961. The assessee further claims that once bad debt is written off in the books of account, there is no need to prove whether debt has become really bad or not in the light of decision of Hon'ble Supreme Court in the case of TRF Ltd vs CIT(supra). We find merits in the arguments of the assessee

for the reason that the Hon'ble Supreme Court in the case of TRF Ltd vs CIT(supra) has held that once bad debt is written off in the books of account, then the assessee is not required to prove whether debt has really become bad or not; but the facts are not clear. The assessee has taken this plea by way of additional ground before the Tribunal for the first time. The AO did not have an occasion to examine the claim of the assessee in the light of provisions of section 36(1)(vii) and the decision of Hon'ble Supreme Court in the case of TRF Ltd vs CIT(supra). Therefore, we are of the considered view that the issue needs to be examined by the AO in the light of the decision of Hon'ble Supreme Court in the case of TRF Ltd vs CIT(supra). Hence, we set aside the issue to the file of the AO and direct him to decide the issue in the light of decision of Hon'ble Supreme Court in the case of TRF Ltd vs CIT(supra).

18. In the result, appeal filed by the assessee in ITA No.6085/Mum/2013 is partly allowed, for statistical purpose.

Order pronounced in the open court on 31st January, 2018.

Sd/-

sd/-

(Saktijit Dey)	(G Manjunatha)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai, Dt : 31st January, 2018

Pk/-

Copy to :

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

/True copy/

By order

Asstt. Registrar, ITAT, Mumbai