

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "J" MUMBAI**

**BEFORE SHRI SAKTIJIT DEY (JUDICIAL MEMBER) AND
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)**

**ITA No. 1903/MUM/2016
Assessment Year: 2012-13**

DCIT, Circle 7(1)(1),
Room No. 23, Ground
Floor, Aayakar Bhavan,
M.K. Road,
Mumbai-400020.

Appellant

M/s Geetanjali Trading
& Investment Pvt. Ltd.
Vs. 3A, Barodawala
Mansion, 81, Dr. Annie
Besant Road, Worli,
Mumbai-400018
PAN No. AAACG3265A

Respondent

**C.O. No. 281/MUM/2017
Assessment Year: 2012-13**

M/s Geetanjali Trading
& Investment Pvt. Ltd.
3A, Barodawala
Mansion, 81, Dr. Annie
Besant Road, Worli,
Mumbai-400018
PAN No. AAACG3265A

Appellant

DCIT, Circle 7(1)(1),
Room No. 23, Ground
Floor, Aayakar Bhavan,
M.K. Road,
Mumbai-400020

Respondent

Assessee by : Mr. H.N.Motiwalla,AR
Revenue by : Mr. Rajeshwar Yadav, DR

Date of Hearing : 06/04/2018
Date of pronouncement : 09/05/2018

ORDER

PER N.K. PRADHAN, AM

The appeal by the Revenue and the cross objection by the assessee are directed against the order of the Commissioner of Income Tax (Appeals)-13, Mumbai [in short 'CIT(A)'] and arise out of the order passed by the Assessing Officer (AO) u/s 143(3) of the Income Tax Act 1961, (the 'Act'). As common issues are involved, we are proceeding to dispose them off by a consolidated order for the sake of convenience.

2. Broadly stated, the 2nd and 3rd ground filed by the Revenue and the cross objection raised by the assessee relate to the disallowance made by the AO u/s 14A.

2.1 The 2nd & 3rd grounds of appeal filed by the Revenue read as under:

2. Whether on the facts and in the circumstances of the case and in law, the Id. CIT(A) erred in directing the AO to allow netting of interest income against the interest expenses while calculating the disallowance u/s 14A read with rule 8D without appreciating the fact that rule 8D does not specify the netting off interest income with interest expenses.
3. On the facts and in the circumstances of the case and in law, the Id. CIT(A) erred in directing the AO to allow netting of interest income against the interest expenses while calculating the disallowance u/s. 14A read with rule 8D without appreciating the fact that the assessee has not proved the nexus of interest income with interest expenses.

2.2 The following is the cross objection raised by the assessee:

On the facts and in the circumstances of the case, whether addition could be made u/s 14A r.w. Rule 8D amounting to Rs.167.07 crores, while computing the book profit u/s 115JB of the Act.

2.3 The Assessing Officer (AO) observed that the assessee had not considered the disallowance under Rule 8D(2)(i) of the Income Tax Rules, 1962 (the Rules). Further, the assessee had considered the interest payment and demat charges under Rule 8D(2)(ii) and Rule 8D(2)(iii) respectively and not under Rule 8D(2)(i). Also, the assessee had not considered the investment appearing under the head 'stock-in-trade' as investment for the purpose of Rule 8D. Therefore the AO computed the disallowance u/s 14A r.w. Rule 8D at Rs.167,07,01,651/- [Rs.166,87,95,688/- under Rule 8D(2)(i) and Rs.19,05,963/- under Rule 8D(2)(iii)]. The AO assessed the book profit of the assessee u/s 115JB at Rs.673,79,75,518/- by making addition *inter alia* of the disallowance u/s 14A of Rs.167,07,01,651/-.

2.4. Aggrieved by the order of the AO, the assessee filed an appeal before the Ld. CIT(A). The Ld. CIT(A) confirmed the entire working of the AO u/s 14A r.w. Rule 8D subject to allowance of deduction on account of interest earned to the tune of Rs.69,79,655/- against the interest expenditure incurred, subject to verification by the AO.

2.5. Before us, the Ld. counsel of the assessee relies on the order of the Special Bench of the Tribunal in *ACIT v. Vireet Investment (P.) Ltd.* (2017)

82 taxmann.com 415 (Delhi-Trib.) (SB) submitting that computation under clause (f) of Explanation 1 to section 115JB(2), is to be made without resorting to computation as contemplated u/s 14A r.w. Rule 8D.

On the other hand, the Ld. DR supports the order passed by the AO.

2.6. We have heard the rival submissions and perused the relevant materials on record. In the instant case, the AO has made a disallowance of Rs.167,07,01,651/- u/s 14A while making an assessment of book profit u/s 115JB. In *Vireet Investment (P.) Ltd.* (supra), the question before the Special Bench was whether the amount or amounts of expenditure relatable to exempt income as contemplated in clause (f) to *Explanation 1* to section 115JB(2) could be arrived at by resorting to provisions of section 14A or not. The Special Bench of the ITAT held that computation under clause (f) of *Explanation 1* to section 115JB(2) is to be made without resorting to computation as contemplated u/s 14A r.w. Rule 8D.

Facts being identical, we follow the above decision of the Special Bench and allow the cross objection filed by the assessee.

3. Simultaneously, the AO has made an addition of Rs.167,07,01,651/- u/s 14A while arriving at the normal computation of income. In appeal the Ld. CIT(A) confirmed the entire working of the AO u/s 14A r.w. Rule 8D subject to allowance of deduction on account of interest earned to the tune of Rs.69,79,655/- against the interest expenditure incurred, subject to verification by the AO.

3.1 We are of the considered view that the decision in *Godrej & Boyce v. DCIT* [2010] 194 Taxman 203 (Bom.); *Godrej & Boyce Manufacturing Company Ltd. v. DCIT* (2017) 81 taxmann.com 111 (SC); *HDFC Bank Ltd. v. DCIT* [2016] 67 taxmann.com 42 (Bom) and *Maxopp Investment Ltd. v. CIT* (2018) 91 taxmann.com 154 (SC) have relevance in the instant case and these are to be examined.

In view of the above position of law which is relevant to the instant case, we set aside the order of the Ld. CIT(A) in respect disallowance made u/s 14A by the AO in normal computation of income. So, we direct the AO to recompute the disallowance u/s 14A by following the decisions delineated above and then make addition, if any, to the normal income disclosed by the assessee.

4. To summarize, the ground of appeal filed by the Revenue against the disallowance of Rs.167,07,01,651/- made u/s 14A to the book profit u/s 115JB is dismissed. Accordingly, the cross objection raised by the assessee is allowed. The ground of appeal filed by the Revenue against the disallowance of Rs.117,57,29,548/- made by the AO u/s 14A to the normal computation of income is allowed for statistical purposes.

5. The 1st ground raised by the Revenue in this appeal reads as under:

Whether on the facts and in the circumstances of the case and law, the Ld. CIT(A) is right in deleting the adjustment made to the book profit u/s. 115J of the Act on account of conversion of investment to stock-in-trade which was not credited to the profit and loss account in contravention of sub-clause (xi) (a) of clause (3) of Part-II of Schedule VI of the Companies Act, 1956.

5.1 In a nutshell, the facts are that the assessee converted part of its investments into stock-in-trade during the year under consideration. The same resulted in profit of Rs.673.47 crores. The AO observed that the assessee did not route the profit through the profit and loss account and directly credited the same to the capital reserve account. The AO relied on the decision in *CIT v. Veekaylal Investment Co. P. Ltd.* (2001) 116 Taxman 104 (Bom), wherein it is held that the income from capital gains should be included for the purpose of computing book profit u/s 115J of the Act. Relying on the provision in section 115JB(2), the AO held that the assessee failed to comply and prepare its accounts in accordance with Part II and III of Schedule VI of the Companies Act 1956. In view of the above, the AO made an addition of Rs.673.47 crores while arriving at the book profit u/s 115JB of the Act.

5.2 Aggrieved by the order of the AO, the assessee filed an appeal before the Ld. CIT(A). The Ld. CIT(A) held that (i) the conversion of the said investment in shares into stock-in-trade is not a transaction as there are no two parties to it, the result of such conversion done entirely at the end of the assessee can possibly not result in any income/profit, (ii) the action of the AO of prematurely treating the impugned amount as capital gain effectively renders the provisions of section 45(2) otiose, (iii) the Hon'ble Supreme Court has held in *Apollo Tyres v. CIT* 255 ITR 273 (SC) that the AO is not empowered to disturb the profits as shown in the profit and loss account except as provided for in *Explanation 1* to section 115JB.

The Ld. CIT(A) has further held that *Explanation 1* to section 115JB mandates specific increases and reductions to the profits disclosed. The sole increase which comes into play in the present context is as per clause (b) of *Explanation 1* to section 115JB of the Act viz “the amount carried to any reserves, by whatever name called, other than a reserve specified under section 33AC”. However, this is subject to the caveat after clause (j) viz. only “if any amount referred to clauses (a) to (i) is debited to the profit and loss account”. Thus the Ld. CIT(A) observed that in absence of any specific debit to the P&L account, the capital reserve in the case at hand falls out of the consideration of clause (b) of *Explanation 1* to section 115JB of the Act.

In view of the above reasons, the Ld. CIT(A) held that the assessee was not found to be liable to have its book profits u/s 115JB increased to the extent of the credit to its capital reserve account. Therefore, the Ld. CIT(A) reversed the action of the AO of increasing the assessee’s book profit by an amount of Rs.673.47 crores.

5.3 Before us, the Ld. DR relies on the decision in *Indo Rama Synthetics (I) Ltd. v. CIT* (2011) 196 Taxman 539 (SC), *Veekaylal Investment Co.* 249 ITR 597 (Bom) and *DCIT v. Bombay Diamond Co.* 33 DTR 59 and the requirement as to profit and loss account as per Schedule VI to the Companies Act.

On the other hand, the Ld. counsel of the assessee relies on the decision in *Apollo Tyres Ltd. v. CIT* (2002) 255 ITR 273 (SC) and the Notification on Revised Schedule VI to the Companies Act, 1956.

5.4 We have heard the rival submissions and perused the relevant materials on record. The reasons for our decisions are given below.

We begin with the submission of the Ld. DR. In *Indo Rama Synthetics (I) Ltd.* (supra), the assessee-company was engaged in the business of manufacturing yarn and polyester. During the previous year ending 31.03.2000 relevant to the assessment year 2000-01, its fixed assets were re-valued resulting in increase in the net book value of such assets by Rs.2,88,58,19,000/- which was credited to the re-valuation reserve. Consequently, the balance sheet for that assessment year resulted in enhancement of cost of fixed assets by the said amount with corresponding credit to re-valuation reserve. For the previous year ending 31.03.2001, relevant to the assessment year 2001-02, the profit and loss account showed the charge of depreciation at Rs.1,27,57,06,000/- which was reduced by transfer from re-valuation reserve to the extent of Rs.26,11,74,000/- resulting in a net debit on account of depreciation of Rs.1,01,45,32,000/-. The AO, while computing the book profit u/s 115JB, did not allow reduction of the aforesaid amount of Rs.26,11,74,000/- on the ground that the re-valuation reserve stood created in the assessment year 2000-01 and had not been added back while computing the book profit in that year in terms of the proviso to clause (i) of *Explanation* to section 115JB. That order was upheld by the CIT(A), the Tribunal and the High Court. On further appeal the Hon'ble Supreme Court held :

“24. The matter could be examined from another angle. To recapitulate the facts, the fixed assets of the assessee were re-valued in the earlier assessment year 2000-01 (*i.e.*, financial year ending 31-3-2000) and amount of

enhancement in valuation was Rs. 2,88,58,19,000 which was credited to the revaluation reserve. In other words, at the time of revaluation of assets, the said figure of Rs. 2,88,58,19,000 was added to the historical cost of assets on the asset side of the balance sheet and in order to equalize both sides of the balance sheet the revaluation reserve to that extent was created on the liability side. Thus, the figure of profit remained untouched so far as the revaluation of assets to the tune of Rs. 2,88,58,19,000 is concerned. The profits were not increased by the said amount when the asset was revalued. During the assessment year in question, *i.e.*, assessment year 2001-02, an amount of Rs. 26,11,74,000, being the differential depreciation, was transferred out of the said revaluation reserve of Rs. 2,88,58,19,000 and credited to the P & L Account which the Assessing Officer disallowed by placing reliance on the proviso to clause (i) of the *Explanation* to section 115JB(2). Consequently, the Assessing Officer added back the said amount of Rs. 26,11,74,000 to the net profits. We agree with the Assessing Officer under the provisions, as they then existed, certain adjustments were required to be made to the net profit as shown in the P & L Account. One such adjustment stipulated that the net profit shall be reduced by the amount(s) withdrawn from any reserves, if any such amount is credited to the P & L Account. Thus, if the reserves created had gone to increase the book profits in any year when the provisions of section 115JB were applicable, the assessee became entitled to reduce the amount withdrawn from such reserves if such withdrawal is credited to P & L Account. Now, from the above facts, it is clear that neither the said amount of Rs. 2,88,58,19,000 nor Rs. 26,11,74,000 had ever gone to increase the book profits in the said year ending 31-3-2000 (being the financial year). Thus, when such amount(s) has not gone to increase the book value at the time of creation of reserve(s), there is no question of reducing the amount transferred from such revaluation reserves to the P & L Account. Thus, the proviso to clause (i) of the *Explanation* to section 115JB(2) comes in the way of the claim for reduction made by the assessee. In our view, the

reduction under clause (i) to the *Explanation* could have been availed only if such revaluation reserve had gone to increase the book profits. As the amount of revaluation reserves had not gone to increase the book profits at the time it was created, the benefit of reduction cannot be allowed. One more fact needs to be highlighted. In this case, as indicated above, the revaluation reserve stood created during the earlier assessment year 2000-01. It has been vehemently argued on behalf of the assessee that creation of such reserve did not impact the profits of that year. The facts enumerated hereinabove shows that though the profit was not impacted, depreciation as the head of A/c was impacted. By inter play of the balance sheet items with Profit & Loss A/c items the assessee, as stated above, has sought to project the loss of Rs. 7,38,09,000 as profit of Rs. 18,73,65,000.

In the instant case, the impugned entry passed on 31.03.2012 was only a book entry by which there was re-valuation of shares on account of their conversion from investment to stock-in-trade. During the relevant assessment year, no amount being differential depreciation was transferred out of said revaluation reserve and was credited to profit & loss account. In view of the above facts, the case of the assessee is distinguishable from the above decision relied on by the Ld. DR.

5.4.1 In *Veekaylal Investment Co.* (supra) relied on by the Ld. DR, the Hon'ble High Court held that if for computing the total income under the normal provisions, the capital gains computed u/s 45 has to be taken into account, it was not understood how in computing the book profits u/s 115J, the assessee could exclude capital gains. In the instant case, there is no capital gains computed u/s 45 of the Act and therefore the above case-law is clearly distinguishable.

5.4.2 In *Bombay Diamond Co.* (supra), the assessee earned a capital profit of Rs.10.38 crores on sale of rights to immovable property which was directly credited to the capital reserves in the balance sheet instead of routed through profit and loss account. The accounts of the assessee-company were duly certified by the auditors. The AO took the view that by not crediting the capital profit to the P&L account, the assessee had contravened sub-clause (xi)(a) of clause (3) of Part II of the Schedule VI to the Companies Act and that he was, therefore, entitled to add the capital profit to the 'book profit'. On appeal, the CIT(A) reversed the order of the AO on the ground that AO had no jurisdiction to go beyond the net profit shown in the P&L account except to the extent provided in the Explanation to section 115JB. On appeal by the Revenue, the Tribunal upheld the stand of the AO on ground that as the assessee had not routed the capital profits through the P&L account and directly credited to the balance sheet, its accounts were not prepared in the manner provided in Part II and Part III of the Schedule VI to the Companies Act. The Tribunal held that as the assessee had bypassed the provisions of Schedule VI and directly credited to the reserve account, the AO had the power to re-work the book profit.

To re-capitulate, it has been held in the above case that if capital profits are credited to the capital reserves account in the balance sheet, they have to be added to the 'book profits' for the purposes of section 115JB.

In the instant case, the assessee has not earned a capital profit on sale of rights to immovable property which was directly credited to the

capital reserves in the balance sheet instead of being routed through profit and loss account. In view of the above facts, the case of the assessee is distinguishable from the above decision relied on by the Ld. DR.

5.4.3 Let us examine the present issue from another angle. There is a specific provision of the Act in section 45(2) regarding capital gain on conversion of capital asset into stock-in-trade. Upto assessment year 1984-85, conversion of capital asset by the assessee into stock-in-trade of his business was not treated as a transfer and no capital gain was taxable. However, from the assessment year 1985-86 onwards the conversion of capital asset into stock-in-trade is treated a 'transfer' within the meaning of section 2(47). However, section 45(2) provides that although such conversion of capital asset into stock-in-trade will be transfer of the previous year in which the asset is so converted but the capital gain will not arise in the previous year in which the asset is converted, it will arise in the previous year in which such converted asset is sold or otherwise transferred. Indexation of cost of acquisition and improvement, if required, will be done till the previous year in which such conversion took place. Further, the fair market value of the asset, as on the date of such conversion, shall be deemed to be full value of the consideration of the asset. The sale price minus market value as on the date of conversion shall be treated as business income of taxed under the head 'Profits and gains of business and profession'.

Thus regard has to be paid to the above specific provision of the Act in section 45(2).

5.4.4 In *Apollo Tyres Ltd.* (supra), relied on by the Ld. counsel of the assessee, the assessee-company, while determining its net profit, had provided for arrears of depreciation in its profit and loss account which according to the revenue was not in accordance with Parts II and III of Schedule VI to the Companies Act, 1956. Hence, the Assessing Officer, while considering the case of the assessee-company u/s 115J, recomputed the said profit and loss account of the company so as to exclude the provisions made for arrears of depreciation. On appeal, the Tribunal held that an Assessing Officer has no authority to reopen the accounts of company which are certified by the auditors of the company as having been maintained in accordance with the provisions of the Companies Act and which have been accepted in the general meeting of the company as well as by the Registrar of Companies. On reference, the High Court reversed the Tribunal's order. On appeal, the Hon'ble Supreme Court held that "the Assessing Officer while computing the income u/s 115J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has limited power of making additions and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to section 115J."

5.4.5 Relying on the decision in *Apollo Tyres Ltd.* (supra) and the ramification of section 45(2) of the Act, we uphold the order of the Ld. CIT(A) and dismiss the 1st ground of appeal of the Revenue.

It is made clear that all the case-laws relied on by both sides have been duly taken into consideration while deciding the matter. The omission of reference to some of such cases in the order is either due to their irrelevance or to ease the order from the burden of the repetitive *ratio decidendi* laid down in such decisions.

6. In the result, the appeal of the Revenue is partly allowed, whereas the cross objection raised by the assessee is allowed.

Order pronounced in the open Court on 09/05/2018.

Sd/-
(SAKTIJIT DEY)
JUDICIAL MEMBER

Sd/-
(N.K. PRADHAN)
ACCOUNTANT MEMBER

Mumbai;

Dated: 09/05/2018

Rahul Sharma, Sr. P.S.

Copy of the Order forwarded to :

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

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai