

**IN THE INCOME TAX APPELLATE TRIBUNAL "B", BENCH KOLKATA**

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

**आयकरअपीलसं./ITA Nos.737 & 738/Kol/2018**

**(निर्धारणवर्ष / Assessment Years:2009-10 & 2013-14)**

<b>M/s Peerless Hospitex Hospital &amp; Research Centre Ltd.</b>	<b>Vs.</b>	<b>DCIT, Circle-11(2), Kolkata</b>
<b>360, Panchsayar, Kolkata-700084</b>		
<b>स्थायीलेखासं./जीआइआरसं./PAN/GIR No.: AABCP 7225 L</b>		
<b>(Appellant)</b>	<b>..</b>	<b>(Respondent)</b>

Appellant by : Shri S. K. Tulsiyan, Advocate, Shri S. Dey, CA & Ms. Puja Somani, CA  
Respondent by : Smt. Ranu Biswas, Addl. CIT

सुनवाईकीतारीख/ Date of Hearing : 15/10/2019

घोषणाकीतारीख/Date of Pronouncement : 11/12/2019

**आदेश / ORDER**

**Per Dr. A. L. Saini:**

The captioned two appeals filed by the assessee, pertaining to assessment years 2009-10 and 2013-14, are directed against the separate orders passed by the learned Commissioner of Income Tax (Appeals)-4, Kolkata (in short the Id. 'CIT(A)'], in appeal No. 525/CIT(A)-4/C-11/(2)/2015-16 and 1369/CIT(A)-4/C-11(2)/15-16, which in turn arise out of separate assessment orders passed by the Assessing Officer u/s 154/ 251/ 143(3) of the Income Tax Act, 1961 ( in short the 'Act').

2.Since, the issues involved in these two appeals are common and identical; and these appeals pertain to the same assessee,therefore, these appeals have been clubbed and heard together and a consolidated order is being passed for the sake of convenience and brevity.

3. First we take assessee's appeal in ITA No. 737/Kol/2018, for A.Y. 2009-10.

The Grounds of appeal raised by the assessee are as follows:

1. That on different grounds both the Ld.A.O. and the Ld.CIT(A) erred in rejecting the assessee's rectification petition claiming that in computing its Adjusted Book Profit for Asstt. Year 2009-10 in terms of Sec.115JB of the I.T.Act, its brought forward unabsorbed business losses relating to Asstt. Years 1996-97,1997-98 and 1998-99 totaling Rs.2,95,24,689/- should have been set off with its Net Profit as per its Profit & Loss Account for the said Assessment Year in terms of Explanation (iii) below Sec. 115JB of the I.T.Act.

2. That the Ld. A.O. erred in rejecting the assessee's above-mentioned claim on the ground that since the unabsorbed business losses relating to Asstt. Years 1996-97,1997-98 and 1998-99 arose more than 8 years back, the said losses could not be set off with the Net Profit relating to Asstt. Year 2009-10.

2.(a) That while rejecting the assessee's claim of set off of Brought forward unabsorbed business losses, the Ld. A.O. failed to take into account that the restriction, contained in Sec.72 of the I.T. Act on carrying forward the unabsorbed business losses for more than 8 years, does not apply in computing the Adjusted Book Profit u/s 115JB in view of the fact that Sec.115JB(1) starts with the words "Notwithstanding anything contained in any other provisions of this Act".

2.(b) That the Ld.CIT(A) erred in not deciding the objections raised by the Ld. A.O. as in Ground No.2 above but erroneously rejected the assessee's claim of set off the unabsorbed losses on a different ground.

3. That in Para-3.2.3 of his order the Ld.CIT(A) erred in holding that since the assessee had no Book loss or unabsorbed depreciation after setting off, the A.O. had rightly not allowed set off of Book Profit against the so called unabsorbed losses.

3.(a) That in Para-3.2 of his orders the Ld.CIT(A) was not justified in observing that the entire Brought forward losses and depreciation had been adjusted against its General Reserve in the assessee's Books of Accounts and therefore, as far as its Books of Accounts were concerned, there was no unabsorbed losses or depreciation remaining as on 31.03.2009 in its account prepared under the Companies Act.

3.(b) That the Ld.CIT(A) erred in holding that there was no brought forward unabsorbed losses in the Assessee's Books of Account as on 31.03.2009 merely because the assessee's Statutory Auditor set off such Brought forward business losses with its General Reserve instead of showing these two item separately.

4. That since both the Ld. A.O. and the Ld.CIT(A) erred in rejecting the assessee's claim of set off its unabsorbed business losses relating to Asstt. Years 1996-97,1997-98 and 1998-99 totaling Rs.2,95,24,689/- on different grounds which were both untenable, the Ld. A.O. may kindly be directed set off its Brought forward unabsorbed business losses with the Net Profit relating to Asstt. Year

2009-10 and re-compute its adjusted Book Profit for Asstt. Year 2009-10 as per law.

5. That, the appellant craves leave to alter, amend, rescind and substitute any of the above-mentioned grounds and add any further grounds before or at the time of hearing of the appeal.

4. The facts of the case which can be stated quite shortly are as follows: The assessee company is running a hospital and providing treatment to the patients. The assessee filed its return of income on 23-09-2009 showing a total income of Rs. Nil. The return of income was processed u/s 143(1) of the Act. Later, the case of the assessee was selected for scrutiny, and Ld AO framed assessment under section 143(3) of the Act wherein he disallowed a sum of Rs. 1,25,83,682/- u/s 40(a)(ia) of the Act on account of non-deduction of TDS on payments made to National Neuroscience Centre.

5. Aggrieved by the order of the assessing officer the assessee carried the matter in appeal before the learned CIT(A). The learned CIT(A) vide his order dated 04-03-2014 enhanced the disallowance to Rs. 1,70,28,307/-, thus an additional sum of Rs.44,44,625/- (Rs.1,70,28,307- Rs.1,25,83,682), was disallowed by him.

6. Thereafter, in pursuance of the learned CIT(A) order dated 04-03-2014, the learned AO passed the order u/s 251/143(3) of the Act dated 12-08-2014 wherein the benefit of deduction of Rs.2,95,24,689/- on account of brought forward losses in the computation of Book Profits as per item No.(iii) of Explanation 1 to section 115JB of the Act was not allowed. Since this was a mistake apparent from records, therefore, the assessee filed a rectification petition u/s 154 of the Act dated 02-09-2014 requesting the learned AO to rectify the computation of adjusted book profits and allow the deduction of Rs.2,95,24,689/-, being lower of brought forward loss and unabsorbed depreciation. A copy of Form 29B issued by an independent Chartered Accountant was also submitted before the AO along with the petition. A copy of the petition and Form 29B is enclosed as page 1 to 5 of the paper book. The break up of Rs. 2,95,24,689/- is as follows:

<b>FY</b>	<b>Unabsorbed Loss before depreciation</b>
1996-97	77,20,905/-
1997-98	1,38,28,783/-
1998-99	79,75,001/-
	<b>2,95,24,689/-</b>

7. Subsequently, order u/s 154 / 251 / 143(3) of the Act dated 01.04.2015 was passed. In the said order, the benefit of deduction of Rs. 2,95,24,689/- on account of brought forwards losses in the computation of book profits as per item No. (iii) of Explanation 1 to section 115JB of the Act was not allowed for the reason that the unabsorbed losses arose more than 8 years back. The assessing officer held as follows:

*“In return of income filed by the assessee company for A.Y. 2009-10, the assessee company had claimed deduction of Rs. 2,95,24,869/- in computation of MAT u/s 115JB, on verification of records it is seen that the amount claimed by the assessee is related to the loss brought forward or unabsorbed depreciation for A.Y. 1996-97, 1997-98, 1998-99. As the unabsorbed loss arises more than 8 years back, therefore the claim of the assessee is not accepted.”*

Thereafter, the AO computed book profit under section 115JB of the Act, as follows:

*“As per u/s 143(3) dated 28/12/2011*

<i>Book profit u/s 115JB</i>	<i>Rs. 2,80,83,898/-</i>
<i>Add Provision for doubtful debt</i>	<i>Rs. 49,03,249/-</i>
<b><i>Adjusted Book Profit</i></b>	<b><u><i>Rs. 3,29,87,147/-</i></u></b>
<i>Tax on above</i>	<i>Rs. 32,98,715/-</i>

*Hence tax on book profit is more than normal tax, hence tax will be charged on book profit.”*

8. Aggrieved by the stand so taken by the Assessing Officer, the assessee carried the matter in appeal before the Id. CIT(A) who has confirmed the action of the assessing officer. The findings of the Ld CIT(A) is given below:

*“3.2.3 In view of the above discussion it is clear that since the assessee has no book loss or unabsorbed depreciation after setting off, therefore, the Assessing Officer has rightly not allowed set off of book profit against so called unabsorbed losses. Though the Assessing Officer has not allowed the same on different reasoning.”*

9. Aggrieved by the order of the Id. CIT(A), the assessee is in appeal before us.

10. Before us, Ld. Counsel Shri. S.K. Tulsian submitted that, the B/F business losses of Rs. 2,95,24,869/- relating to Asstt. Years 1996-97,1997-98 and 1998-99,were eligible for deduction in computing the adjusted Book Profit of the Assessee for Asstt. Year 2009-10.The brought forward(b/f) business losses cannot

be adjusted after 8 years in view of the provisions of Section 72 of the Income Tax Act, is applicable for computation of income Tax under normal provisions of the Act. Section 115JB does not contain the provisions of brought forward(b/f) business losses and there set off. Section 115JB(1) of the Act starts with the word "notwithstanding anything contained in any other provision of this Act". Therefore, the b/f business losses cannot be carried forward for more than 8 years is not applicable in computing the Book Profit u/s 115JB of the Act.

The Ld Counsel also submitted that only for the purpose of presentation and disclosure, the assessee company has been showing capital receipt of Rs.18,69,57,957/- (received by the assessee on account of waiver of loan) every year under the head "Reserve and Surplus" and the said capital receipt has never been adjusted against unabsorbed losses. Therefore, findings Id CIT(A) that said capital receipt of Rs.18,69,57,957/- has been adjusted with unabsorbed losses, is wrong. It is therefore prayed by the Id Counsel that the Ld .A.O may be directed to deduct the B/F business losses, of Rs. 2,95,24,869/- while computing book profit under section 115JB of the Act.

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

12. We heard both the parties and carefully gone through the submission put forth on behalf of the assessee along with the documents furnished and the case laws relied upon, and perused the fact of the case including the findings of the Id CIT(A) and other material available on record. We note that solitary grievance of the assessee in this appeal is that Id. Assessing Officer erred in rejecting its claim of deduction of Rs. 2,95,24,689/- on account of brought forward business losses in terms of item no. (iii) of Explanation 1 below section 115JB(1) of the I.T. Act, in computing the Adjusted Book Profit of Rs.3,29,87,147/-. We note that the learned AO had disallowed the claim of the assessee on the pretext that the brought forward losses cannot be set off after a period of 8 years since the losses of

Rs.2,95,24,689/- pertains to FY 1996-97, 1997-98 and 1998-99. With respect to the allegation of the learned AO that the brought forward losses cannot be set off after a period of 8 years it was submitted by the assessee before the learned CIT(A) that the limitation period of 8 years do not apply to MAT provisions contained in Chapter XII-B (section 115J to 115JB) of the Act since the said sections starts with a Non-Obstante Clause. We note that the submissions of the assessee in this respect were not at all discussed by the learned CIT(A) in his order. Instead, he dismissed the appeal of the assessee on an altogether new ground that the entire brought forward losses has been adjusted against General Reserve in the books of accounts.

We note that Ld. A.O. has rejected the claim of the assessee on the ground that the aforesaid business losses arose more than 8 years back and hence the assessee could not be brought forward and set off in Assessment Year 2009-10. We note that the period of 8 years, which is mentioned in section 72 of the Act, in respect of b/f business losses, is applicable to compute the normal tax under the Income Tax Act and it does not apply to section 115 JB of the Act. Section 115JB of the Act is a code itself. Section 115-JB(1) starts with the word "notwithstanding anything contained in any other provision of this Act". If so, section 72 in terms of which the b/f business losses cannot be carried forward for more than 8 years is not applicable in computing the Book Profit u/s 115-JB, in as much as there is no similar provision in Sec. 115JB itself. Section 115-JB of the Act is a stand-alone provision which does not contain any provision about carry forward of B/F business losses, while computing the Book Profit u/s 115-JB of the Act. Therefore, it is abundantly clear by reading the provisions of section 115JB of the Act that while computing book profit the assessee company is entitled, to deduct the B/F business losses relating to Asstt. Years 1996-97,1997-98 and 1998-99 all totaling to Rs.2,95,24,689/-.

13. We note that learned CIT(A) has misunderstood the facts of the case and the presentation of General Reserve in the audited accounts. The assessee was not afforded an opportunity during appellate proceedings to controvert the findings of the learned CIT(A). The assessee came to know about the dismissal of the appeal,

only after receiving the appellate order, on an altogether new ground that the entire brought forward losses of Rs. 2,95,24,689/- has been adjusted against General Reserve. The Id Counsel submitted before us that brought forward losses of Rs.2,95,24,689/- were never adjusted with the General Reserve in the preceding previous years. The Schedule-II of General Reserveas per audited books of accounts of the assessee company as on March 31,2007, as on March 31,2008, and as on March 31,2009 are given below:

Position of General Reserve as on March 31, 2007

<b>SCHEDULE — II RESERVES AND SURPLUS</b>			
<b>General Reserve</b>			
Balance as per Last Account	—	—	—
Add : Addition on account of waiver of Secured Loan pursuant to Scheme of Arrangement (Note 5 of Schedule XX)	18,69,57,957	—	—
Less : Debit Balance of Profit and Loss Account (As per Annexed Account)	(13,23,50,897)	—	—
		5,46,07,060	—
<b>Revaluation Reserve</b>			
Balance as per Last Account	14,46,56,461	15,12,49,361	—
Less : Adjustment for Disposal/Write off of fixed assets	1,44,486	33,22,097	—
	14,45,11,975	14,79,27,264	—
Less : Transfer to Profit and Loss Account (Note 1 of Schedule IV)	30,83,522	32,70,803	—
		14,14,28,453	14,46,56,461
		<u>19,60,35,514</u>	<u>14,46,56,461</u>

Position of General Reserve as on March 31, 2008

<b>SCHEDULE — II RESERVES AND SURPLUS</b>			
<b>General Reserve</b>			
Balance as per last Account	18,69,57,957	—	—
Add : Addition on account of waiver of Secured Loan pursuant to Scheme of Arrangement	—	18,69,57,957	—
Less : Debit Balance of Profit and Loss Account (As per Annexed Account)	(12,91,27,310)	(13,23,50,897)	—
		5,78,30,647	5,46,07,060
<b>Revaluation Reserve</b>			
Balance as per Last Account	14,14,28,453	14,46,56,461	—
Less : Adjustment for Disposal/Write off of fixed assets	—	1,44,486	—
	14,14,28,453	14,45,11,975	—
Less : Transfer to Profit and Loss Account on account of depreciation (Note 1 of Schedule IV).	30,79,635	30,83,522	—
		13,83,48,818	14,14,28,453
		<u>19,61,79,465</u>	<u>19,60,35,514</u>

Position of General Reserve as on March 31, 2009

<b>SCHEDULE — II</b>				
<b>RESERVES AND SURPLUS</b>				
General Reserve				
Balance as per last Account	18,69,57,957		18,69,57,957	
Less : Debit Balance of Profit and Loss Account (As per Annexed Account)	(11,28,53,660)	7,41,04,297	(12,91,27,310)	5,78,30,647
Revaluation Reserve				
Balance as per Last Account	13,83,48,818		14,14,28,453	
Less : Adjustment for Disposal/Write off of fixed assets	3,48,087		—	
	13,80,00,731		14,14,28,453	
Less : Transfer to Profit and Loss Account on (Note 1 of Schedule IV)	30,79,780	13,49,20,951	30,79,635	13,83,48,818
		<u>20,90,25,248</u>		<u>19,61,79,465</u>

We note that the unabsorbed business loss before depreciation arose to the assessee company in the financial years 1996-97, 1997-98 and 1998-99. However, there was no General Reserve in these years as evident from the audited accounts of the assessee company for these years as enclosed at page 8-62 of the paper book.

Now we shall examine the audited figures of General Reserve of the assessee company, as noted above. We note that “Reserves and Surplus” shown by the assessee company in audited accounts in Schedule-II, as noted above, does not contain any balance in the head “General Reserve” till 31.03.2006. In the year 2006-07 (relating to AY 2007-08), the assessee company credited a sum of Rs.18,69,57,957/- in the General Reserve account on account of waiver of secured loan pursuant to Scheme of Arrangement and debited a sum of Rs.13,23,50,897/- on account of Debit Balance in the profit and loss account. Hence, the closing balance of General Reserves was Rs.5,46,07,060/- as on 31-03-2007. In the immediately next year (FY 2007-08 relating to AY 2008-09) on 01-04-2007, the amount of Rs.18,69,57,957/- (and not the amount of Rs.5,46,07,060/-) was brought forward and shown under the head ‘General Reserve—‘Balance as per Last Account’. This clearly transpires that the assessee had not adjusted the brought forward losses/debit balance of Profit and Loss account with the General

Reserve in the financial year 2006-07. The closing balance of General Reserves as on 31-03-2008 was Rs.5,78,30,647/- after making the adjustment for Debit Balance in the Profit and Loss A/c for that year. Again, in the immediately next year (FY 2008-09 relating to AY 2009-10) on 01-04-2008, the amount of Rs. 18,69,57,957/- (and not the amount of Rs.5,78,30,647/-) was brought forward and shown under the head 'General Reserve - Balance as per Last Account'. This clearly transpires that the assessee had not adjusted the brought forward loss/debit balance of Profit and Loss account with the General Reserve in the financial year 2007-08 relating to AY 2008-09.

The Id Counsel for the assessee submitted before us that even in FY 2017-18, the amount of Rs.18,69,57,957/- was brought forward and shown under the head 'General Reserve - Balance as per Last Account'. A sum of Rs.30,00,00,000/- was transferred to General Reserves from Retained Earnings and the closing balance as on 31-03-2018 was Rs.21,69,57,957/-. In FY 2018-19, the opening balance of General Reserves was Rs.21,69,57,957/- and after transferring a sum of Rs.1,30,42,043/- to General Reserves from Retained Earnings, the balance as on 31-03-2019 was Rs.23,00,00,000/-. The above audited accounts of the company clearly suggest that the assessee had never adjusted the brought forward losses/debit balance of Profit and Loss account with the General Reserve till 31-03-2019, being the last audited accounts as on date.

14. We note that although the assessee has reduced the amount of Debit Balance of Profit and Loss A/c from Opening balance of Rs. 18,69,57,957/- standing in General Reserves in AYs 2007-08, 2008-09 and 2009-10, however the same was done only for accounting purposes to conform with the presentation of accounts guidelines stipulated in Schedule VI of the Companies Act, 1956. The Schedule VI of the Companies Act, 1956 stipulates that the Debit balance of the profit and loss account needs to be reduced from General Reserves and the Credit Balance of the profit and loss account to be added to the General Reserves. The relevant Form of Balance Sheet as per Schedule VI of the Companies Act, 1956 is reproduced below:

*Reserves and Surplus:*

*Capital Reserves.*

*Capital Redemption Reserve.*

*Share Premium account (cc).*

*Other reserves specifying the nature of each reserve and the amount in respect thereof*

*Less: Debit balance in profit and loss account (if any)*

*Surplus, i.e. balance in profit and loss account after providing for proposed allocations,namely:-*

*Dividend, bonus or reserves.*

*Proposed additions to reserves.*

*Sinking Funds.]*

As evident from the above, the assessee had actually carried forward the amount of Rs.18,69,57,957/- to the next years and not the net amount after adjustment of debit balance in the Profit and Loss account. If the debit balance of profit and loss account would have been adjusted against General Reserve in the FY 2007-08 (AY 2008-09), then the opening balance as on 01-04-2008 would not have been Rs. 18,69,57,957/-. As such, it is clear that the assessee had not adjusted the brought forward losses of earlier years with the General Reserves. Hence, the observation of the learned CIT(A) that the entire brought forward losses has been adjusted against General Reserve in books of accounts is not correct.

15. Now we shall examine whether waiver of a loan is capital receipt or revenue receipt? We note that this issue is no longer *res integra*. Waiver of a loan certainly cannot be reckoned as transaction of a kind usually taken but it is an item of exceptional and non-recurring nature. A capital surplus on account of waiver of loan in no way can be recorded as operational profit or profit which is to be included in the profit & loss account. For that we rely on the judgment of the Coordinate Bench of ITAT, Mumbai in the case of **JSW Steel Ltd vs ACIT** reported in [2017] 82 taxmann.com 210 (Mumbai - Trib.) wherein it was held as follows:

*“Clause (3)(xii)(b) of Part II of schedule also shows that what is to be included in the profit & loss account is in respect of transactions of an account, not usually undertaken by the company or undertaken in circumstances of an exceptional or non-recurring nature, if material in amount. This clearly indicates that only those items can be regarded as part of the profit & loss account which is in respect of similar type of transaction and not which are exceptional in nature. Waiver of a loan certainly cannot be reckoned as transaction of a kind usually taken but it is*

*an item of exceptional and non-recurring nature. A capital surplus on account of waiver of loan in no way can be recorded as operational profit or profit which is to be included in the profit & loss account. There can be absolutely no question for accounting in the Profit and Loss Account something which cannot be regarded as income, profit or gain. This view is further reiterated by the interpretation clause 7 appearing in Part III of Schedule VI of the Companies Act. [Para 15]*

*A capital surplus thus, in respect of waiver of loan amount cannot be regarded as amount available for distribution through the profit & loss account. This follows from the very definition of expression 'capital reserve' that it must be accounted directly to the credit of the capital reserve account instead of being credited to the profit & loss account so as to ensure that it is not left for being distributed through the profit and loss account.[Para 15]*

*From above analysis and discussion of the various provisions of the Companies Act as well as Accounting Standards it can be ostensibly deduced that an item of 'capital surplus' can never be a part of profit & loss account albeit it is a part of a capital reserve as the waiver of a loan taken for acquisition of a capital asset is a capital receipt falling within the category of capital surplus which is non-recurring and exceptional item which is to be disclosed as per the requirement of the Companies Act. Further it is quite pertinent to note that, clause (ii) of Explanation -I of section 115JB is also an indicator of the intention of the legislature and also the scheme of the section that the incomes which are treated as exempt under the Act are to be excluded from the profit & loss account. [Para 16]*

*Waiver of loan, utilized for purchasing plant and machinery, represented capital receipt forming part of capital reserve and, thus, it could not be added back while computing book profit under section 115JB. Amount borrowed by a company on capital account, i.e. for acquisition of a capital asset cannot be reckoned as a nature of trading liability as envisaged in section 41(1), and, therefore, its subsequent remission cannot be deemed as income under said provision.”*

It is abundantly clear from the judgment of the Coordinate Bench (supra) that waiver of a loan is a capital receipt therefore, it cannot be adjusted with brought forward business losses.

Based on the facts narrated above, we note that section 115-JB of the Act is a stand-alone provision which does not contain any provision about carry forward of B/F losses, while computing the Book Profit u/s 115-JB of the Act. Audited accounts of the company clearly suggests that the assessee had never adjusted the brought forward losses/debit balance of Profit and Loss account with the General Reserve. In view of the above, it is clear that the sum of Rs. 18,69,57,957/- credited in the General Reserve account was a Capital Receipt hence, it should not

to be considered in computation of book profit u/s 115JB of the Act. The Ld. A.O. failed to take into account that the restriction, contained in Sec.72 of the I.T. Act on carrying forward the unabsorbed business losses for more than 8 years, does not apply in computing the Adjusted Book Profit u/s 115JB of the Act. Therefore, we direct the AO to allow the claim of the assessee for adjusting the unabsorbed losses of Rs.2,95,24,689/- with the book profits under section 115-JB of the Act, for the year.

16. In the result, appeal of the assessee (in ITA No.737) is allowed.

17. Now we take assessee's appeal in I.T. A. No. 738/Kol/2018 for A.Y. 2013-14 wherein the grounds of appeal raised by the assessee are as follows:

*1. That, on the facts and in the circumstances of the case, the Ld.CIT(A) erred in sustaining the Ld. A.O.'s order disallowing payment of Referral fees of Rs.39,38,184 to the Doctors by the Appellant.*

*1(a) That, while dismissing the appellant's ground on this issue, the Ld.CIT(A) failed to notice that the Medical Council Regulations were applicable to the Doctors in medical profession and registered with the said Council and not to others like the appellant Hospital.*

*1(b) That since neither the Ld. A.O. nor the Ld.CIT(A) established that the payment of the Referral fees to the Doctors by the Appellant was an offence or prohibited by any law as provided in Explanation-2 below Sec.37(l) of the I.T. Act, the Ld.CIT(A) was not justified in upholding the disallowance of Rs.39,38,184 paid by the Appellant to the Doctors for referring their patients to the Appellant Hospital.*

*1(c) That the CBDT Circular No.5/2012 dated 01.08.2012 referred to and relied on by the Ld.CIT(A) in his appellate order does not reflect the correct legislative intention of the Explanation-2 below Sec.37(l) of the I.T. Act and therefore the same was not binding on him.*

*1(d) That as the Referral fees paid to the Doctors by the Appellant Hospital were undoubtedly for the promotion of its business interest i.e. for commercial expediency, the Ld.CIT(A) erred in not deleting the disallowance of Rs.39,38,184 made by the Ld A.O.*

*1(e) That the requirements of commercial expediency override even the illegality of expenses as provided in Explanation-2 below Sec.37(l) of the I.T. Act as held by the Hon'ble Tribunal in the case of Pranav Construction Co.-vs.-ACIT reported in 61-TTJ-145 (Mum.) and consequently the Referral fees paid by the Appellant on account of commercial expediency should have been held as admissible by the Ld.CIT(A).*

2. That, the appellant craves leave to alter, amend, rescind and substitute any of the above-mentioned grounds and add any further grounds before or at the time of hearing of the appeal.

18. Brief facts qua the issue are that during the scrutiny proceedings, the AO noticed that the assessee had debited Rs. 55,65,464/- in Profit and Loss account on account of "Referral to Doctors", under the head 'Miscellaneous expenses included in other expenses' (vide note No. 28 to the Audited Financial Statements). In this regard, the assessee was asked to furnish detailed notes on "Referral fees paid to doctors". The assessee vide its written submission dated 07.09.2015, stated that: "*This type of expenses generally incurred by Hospital for encashment of in-patient and outdoor collection through those doctors who are often refer the name of this Hospital to their patient for available of better treatment.*" A list showing name of such doctors and payments made to them was also submitted. From perusal of explanation and details furnished by the assessee in respect of "Fees paid to referral doctors", it was observed by AO that the payments made to those doctors for professional services rendered by them. Accordingly, a show cause notice was issued to assessee stating that why such payments to doctors may not be disallowed u/s 37(1) of the I T Act, 1961 being expenses prohibited by law. In response to the show cause notice, the assessee company furnished a written submission stating as follows:

*"At the outset, it is submitted that the entire sum of Rs. 55,65,464/- was not paid to the Doctors. Kindly find enclosed two lists as List-1 & List-2. As per List-1, a total amount of Rs. 39,38,184/- was paid to the Doctors and as per List-2 a total sum of Rs. 16,27,280/- was paid to others consisting of individuals as well as Agencies who are not from medical profession. It may be mentioned that a large number of patients from Bangladesh come to Kolkata for better treatment. The Agencies/individuals contact them for arranging treatment of patients in Hospital and Shelter for their escorts at reasonable prices. They get commission from both the Patients and Hospitals. The persons who are not in medical profession ( as per list-2) are not covered by Indian Medical Council Regulation or explanation below Sec 37(1) of the I T Act. The CBDT Circular No-5/2012 referred to by you is also not applicable to them. The payments to such agencies/individuals by the assessee are for commercial expediency. Consequently, such expenses should be allowed as business promotion expenses."*

The assessee submitted before AO that a total amount of Rs. 39,38,184/- was paid to the Doctors engaged in medical profession who had recommended their own patients to the hospital for better treatment and such payments are not covered by

Explanation below section 37(1) of the I. T. Act and consequently the same should not be disallowed. However, Ld AO rejected the contention of the assessee and held that payments to doctors is a clear violation of prohibition mandated by the Indian medical Council vide the amendment to the IMC (Professional Conducts, Etiquette and Ethics) Regulation, 2012 dated 10.12.2009, and, accordingly, referral fees paid to Doctors amounting to Rs. 55,65,464/- was disallowed and added back to total income of the assessee.

19. On appeal, Ld. CIT(A) confirmed the addition made by assessing officer. Aggrieved by the order of the Id. CIT(A), the assessee is in appeal before us.

20. Shri S.K. Tulsiyan, Id. Counsel for the assessee, submitted before us that the entire sum of Rs. 55,65,464/- was not paid to the Doctors. Out of total amount of Rs. 55,65,464/-, the amount of Rs. 39,38,184/- was paid to the Doctors and a sum of Rs. 16,27,280/- was paid to others consisting of individuals as well as Agencies who are not from medical profession. The Ld Counsel stated that a large number of patients from Bangladesh come to Kolkata for better treatment. The Agencies/individuals contact them for arranging treatment of patients in Hospital and Shelter for their escorts at reasonable prices. They get commission from both the Patients and Hospitals. The persons who are not in medical profession are not covered by Indian Medical Council Regulation or explanation below Sec 37(1) of the I. T. Act. The payments to such agencies/individuals by the assessee are for commercial expediency. Consequently, such expenses should be allowed as business promotion expenses. The assessee admits that a total amount of Rs. 39,38,184/- was paid to the Doctors engaged in medical profession who had recommended their own patients to the hospital for better treatment, such payments are not covered by Explanation below section 37(1) of the I T Act and consequently the same should not be disallowed.

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

22. We heard both the parties and carefully gone through the submission put forth

on behalf of the assessee along with the documents furnished and the case laws relied upon, and perused the fact of the case including the findings of the Id CIT(A) and other materials available on the record. The Id Counsel submitted that referral fees of Rs.39,38,184/- was paid to the doctors who referred their patients to the assessee hospital and the said referral fees was paid on account of sales promotion of the assessee hospital and as such the said expense was fully allowable u/s 37 of the Act. The Id Counsel further submitted that the amount of Rs.39,38,184/- debited under the account head 'Referral to Doctors' have been incurred wholly and exclusively for the purpose of the business of the assessee company which, in the present case, runs and operates a hospital and is accordingly allowable as deduction u/s 37 of the Act while computing its total income for the year under consideration.

On the other hand, Id DR submitted before us that assessing officer had rightly placed reliance on Circular No.5/2005 dated 01-08-2012 issued by CBDT wherein it was categorically stated that any kind of freebies given to doctors and other medical professionals by a pharmaceutical company was not allowable u/s 37(1) of the Income-tax Act. The AO further held that payment of referral fees to doctors is a clear violation of prohibition mandated by the Indian Medical Council and accordingly held that referral fees paid to the doctors amounting to Rs.39,38,184/- is not allowable expenditure u/s 37 of the Act.

The Id Counsel stated before us that as per the regulations framed by the Medical Council of India (hereinafter referred to as the 'MCI') namely, Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulation, 2002 and the amendment made thereto from time-to-time, it is very clear that a medical practitioner shall not receive *inter alia* any cash or monetary grant from any pharmaceutical and allied healthcare industry in individual capacity under any pretext. However, the said restriction limits itself at that and *does not further prohibit* a pharmaceutical and allied healthcare industry *from making payments of such sum etc. to medical practitioners*. The MCI regulations has thus put an ethics prohibition upon the medical practitioners not to accept freebies like gifts, fee,

travel arrangement etc. but the said MCI regulations is completely silent so far as medical companies (*like the assessee company in the present case who runs a hospital*) incurring expenses are concerned. Therefore, it does not prohibit the said companies from incurring such expenditure for the purpose of furtherance of their business. Nowhere in the said regulation it has been mentioned that such regulation or code of conduct will cover pharmaceutical or healthcare sector or other allied industry in any manner. Hence, the aforesaid regulations of Medical Council apply only in case of medical practitioners and not in case of hospitals/pharmaceutical company. The Id Counsel submitted that MCI itself has admitted before the Hon'ble Delhi HighCourt the case of Max Hospital us. MCI [IT Appeal Nos. 6429 & 6428 (Mumbai) of 2012], that the MCI Regulations. 2002 has jurisdiction to take action only against medical practitioners and not to health sector industry. The relevant extract of the judgment is quoted below:

*“The Petitioner's grievance is twofold. Firstly, that since the Medical Council of India (Professional Conduct, Etiquette and Ethics) Regulations, 2002 (the Regulations) have been framed in exercise of the power conferred under Section 20-A read with Section 33 (m) of the Indian Medical Council Act,1956, these regulations do not govern or have any concern with the facilities, infrastructure or running of the Hospitals and secondly, that the Ethics Committee of the MCI acting under the Regulations had no jurisdiction to pass any direction or judgment on the infrastructure of any hospital which power rests solely with the concerned State Govt. The case of the Petitioner is that the Petitioner hospital is governed by the Delhi Nursing Homes Registration Act, 1953. It is urged that in fact, an inspection was also carried out on 22.07.2011 by Dr. R.N. Dass, Medical Superintendent (Nursing Home) under the Directorate of Health Services, Govt, of NCT of Delhi and the necessary equipments and facilities were found to be in order which negates the observations dated 27.10.2012 of the Ethics Committee of the MCI. It is also the plea of the Petitioner hospital that the Petitioner was not provided an opportunity of being heard and thus the principles of natural justice were violated.*

7. In the counter affidavit filed by the Respondents, it is not disputed that the MCI under the **2002 Regulations has jurisdiction limited to taking action only against the registered medical practitioners**. Its plea however, is that it has not passed any order against the Petitioner hospital therefore; the Petitioner cannot have any grievance against the impugned .....

8. It is clearly admitted by the Respondent that it has no jurisdiction to pass any order against the Petitioner hospital under the 2002 Regulations. In fact, it is stated that it has not passed any order against the Petitioner hospital. Thus, I need not go into the question whether the adequate infrastructure facilities for appropriate post-operative care were in fact in existence or not in the Petitioner hospital and whether the principles of natural justice had been followed or not while passing the impugned order. Suffice it to say that the observations dated 27.10.2012 made by the Ethics Committee do reflect upon the infrastructure facilities available in the Petitioner

hospital and since it had no jurisdiction to go into the same, the observations were uncalled for and cannot be sustained.”

23. Having gone through the above noted judgment in the case of *Max Hospital (supra)*, we that regulation issued by Medical Council of India is *qua* the doctors/medical practitioners and not for the pharmaceutical companies. As a logical corollary to it, if there is any violation or prohibition as per MCI regulation in terms of section 37(1), r.w. *Explanation 1*, then it is only meant for medical practitioners and not for pharmaceutical companies or other allied health care industries for claiming the expenditure. Accordingly, insofar as the assessee company is concerned the impugned expenditure on payment of referral fees to the doctors cannot be said to be ‘*in violation*’ to the aforesaid regulations of the Indian Medical Council. The said expenditure has been incurred wholly and exclusively for the purpose of carrying on its business.

At the cost of repetition, we state that in the instant case, the learned AO has disallowed the said payments on the alleged notion that the said expense is a clear violation of prohibition mandated by the Indian Medical Council. We note that at this juncture it would be befitting to discuss section 37(1) of the Act. Section 37 of the Income tax Act, 1961 is a residuary section for allowability of business expenditure and the same is given below:

*“37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.*

*Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.*

*Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of subsection (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.”*

Condition for allowance under section 37(1) of the Act are as follows:

- a. Such expenditure should not be covered under the specific section i.e. sections 30 to 36.
- b. Expenditure should not be of capital nature
- c. The expenditure should be incurred during the previous year.
- d. The expenditure should not be of personal nature.
- e. The expenditure should have been incurred wholly or exclusively for the purpose of the business or profession.
- f. The business should be commenced.

If all the above conditions are satisfied, the assessee is entitled to claim deduction u/s 37 of the Act.

Further, the disallowance under Explanation 1 rests on the following conditions precedent:

- (1) It should be an expenditure; and
- (2) It should have been incurred for any purpose which is an offence or which is prohibited by law.

The word 'offence' and 'prohibited by law' are not defined under the Income-tax Act, 1961 however, it is defined in section 3(38) of the General Clauses Act, 1897. In this regard it would be relevant to refer here, the judgment of the Hon'ble Delhi High Court in the case of *CIT vs Desiccant Rotors International Pvt. Ltd* [2012] 347 ITR 32 (Del). In this case, the Court observed as follows:

*"Dilating on this submission, she argued that the expression "offence" and "prohibited by law" occurring in the Explanation to section 37(1) of the Act are not defined in the Act. However, section 3(38) of the General Clauses Act, 1897, defines "offence" to mean "any act or omission made punishable by law for the time being in force". The Calcutta High Court in the case of Susanta Mukherjee v. Union of India [1975] 94 CWN 412 after referring to section 3(38) of the General Clauses Act read with articles 13(3), 366(10) and 372(1) of the Constitution of India and the decision of the Supreme Court in the case of Edward Mills Co. Ltd. v. State of Ajmer, AIR 1955 SC 25, observed in paragraph 13 of the judgment:*

*"13. It is abundantly clear from the foregoing references to various provisions of the Constitution that a person cannot be convicted of an offence except for violation of law in force at the time of commission of the act charged as an offence. Therefore, in my opinion, the word 'any law for the time being in force' as*

*occurring in section 3(38) of the General Clauses Act, 1897, must be construed as 'any law for the time being in force' in India. Obviously, it has no reference to any law of other countries of the world.*

*14. According to her, similarly, the expression "prohibited by law" can only mean prohibited by law in force in India. **The expression "prohibited by law" as used in the Explanation to section 37(1) has the same contextual import as the expression "forbidden by Law " as used in section 23 of the Indian Contract Act, 1872.***

Therefore, Id Counsel submitted before us that in the present case, all the conditions prescribed in section 37 of the Act are complied with. The Explanation to section 37(1) of the Act is not applicable since the payment of referral fess is neither an offence nor prohibited by law. Hence, the said payment of referral fees to doctors is an allowable expense u/s 37(1) of the Act.

24. The Ld Counsel stated that CBDT Circular referred by the learned AO has no relevance in the present case since the said circular is not backed by any enabling provision either under the Income Tax Act or under the Indian Medical Council Regulations and as such impinges on the conduct of the pharmaceutical and allied health sector industries in carrying out its business. For that Id Counsel relied on the judgment of the Coordinate Bench of the ITAT, Mumbai in the case of *Aristo Pharmaceuticals (P.) Ltd. vs ACIT reported in [2019] 107 taxmann.com 119 (Mumbai - Trib.)*. In this case, the entire issue of payment of referral fees to doctors by health industry was discussed in detail and it was held as follows:

*“On perusing the regulations issued by the Medical Council of India, it is found that the same lays down the code of conduct in respect of the doctors and other medical professionals registered with it, and are not applicable to the pharmaceuticals or allied health sector industries. The scheme of the Indian Medical Council Act, 1956 neither deals with nor provides for any conduct of any association/society and deals only with the conduct of individual registered medical practitioners. In the backdrop of the aforesaid facts, it emerges that the applicability of the MCI regulations would only cover individual medical practitioners and not the pharmaceutical companies or allied health sector industries.*

*Perusal of the CBDT Circular No. 5/2012,dated 1-8-2012 reveals that the freebies' provided by the pharmaceutical companies or allied health sector*

industries to medical practitioners or their professional associations in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 shall be inadmissible under section 37(1), as the same would be an expense prohibited by the law. **However, the censure/action as had been suggested on the violation of the code of conduct is only for the medical practitioners and not for the pharmaceutical companies or allied health sector industries. Thus, it is viewed that the regulations issued by MCI are qua the doctors/medical practitioners registered with MCI, and the same shall in no way impinge upon the conduct of the pharmaceutical companies. As a logical corollary to it, if there is any violation or prohibition as per MCI regulation in terms of Explanation to section 37(1), then the same would debar the doctors or the registered medical practitioners and not the pharmaceutical companies and the allied healthcare sector for claiming the same as an expenditure.**

The CBDT as per its Circular No. 5/2012, dated 1-8-2012 had enlarged the scope and applicability of Indian Medical Council Regulation, 2002, by making the same applicable even to the pharmaceutical companies or allied healthcare sector industries. It is viewed that such an enlargement of the scope of MCI regulation to the pharmaceutical companies by the CBDT is without any enabling provision either under the Income Tax Act or under the Indian Medical Council Regulations. **The burden imposed by the CBDT vide its aforesaid Circular No. 5/2012, dated 1-8-2012 on the pharmaceutical or allied health sector industries, despite absence of any enabling provision under the Income Tax law or under the Indian Medical Council Regulations, clearly impinges on the conduct of the pharmaceutical and allied health sector industries in carrying out its business.** Thus, in the absence of any sanction or authority of law on the basis of which it could safely be concluded that the expenditure incurred by the assessee-company on sales promotion expenses by way of distribution of articles to the stockists, distributors, dealers, customers and doctors, is in the nature of an expenditure which had been incurred for any purpose which is either an offence or prohibited by law it is concluded that the same would not be hit by the Explanation to section 37(1). Alternatively, it is viewed that it is a trite law that a CBDT Circular which creates a burden or liability or imposes a new kind of imparity, cannot be reckoned retrospectively. It is viewed that though a benevolent circular may apply retrospectively, but a circular imposing a burden has to be apply prospectively only.

Thus, in the backdrop of the aforesaid settled position of law as regards the prospective applicability of an oppressive circular, it is viewed that as the CBDT as per its Circular No. 5/2012, dated 1-8-2012 had enlarged the scope of Indian Medical Council Regulation, 2002, and had made the same applicable to the pharmaceutical companies, thus the same cannot be reckoned to have a retrospective effect. Thus, in terms of aforesaid observations it is viewed that the aforementioned CBDT Circular No. 5/2012, dated 1-8-2012 would not be applicable to the case of the assessee for assessment year 2011-12.

Thus, in terms of aforesaid observations it is concluded that the assessee was duly entitled for claim of sales promotion expenses incurred on the distribution of articles to the stockists, distributors, dealers, customers and doctors. Thus, the order of the Commissioner (Appeals) sustaining the disallowance of the sales promotion expenses is set aside.

*In this view of the matter and consistent with view taken by the coordinate bench in assessee's own case for assessment year 2011-12, it is viewed that there is no error in the findings recorded by the Commissioner (Appeals) insofar as deletion of addition made by the Assessing Officer towards sales promotion expenses and hence, the findings of the Commissioner (Appeals) are upheld and the appeal filed by the revenue is dismissed. [Para 10]*

*As regards appeal filed by the assessee, since the Tribunal had already considered the issue and deleted total addition made by the Assessing Officer, by following the order of the Tribunal for assessment year 2011-12, the Assessing Officer is directed to delete the addition sustained by the Commissioner (Appeals). [Para 11]*

*In the result, appeal filed by the assessee is allowed and appeal filed by the revenue is dismissed. [Para 12]”*

25. Similarly, the Coordinate Bench of ITAT Mumbai in the case of **DCIT vs PHL Pharma (P.) Ltd.** reported in [2017] 78 taxmann.com 36 (Mumbai - Trib.) held that referral fees paid to doctors is an allowable expense u/s 37 of the Act. Relevant extract of the judgment is quoted below:

*“Section 37(1) of the Income-tax Act, 1961 - Business expenditure - Allowability of (Illegal expenses) - Assessment year 2010-11 - Assessee was a pharmaceutical company engaged in business of providing pharma marketing consultancy and detailing services to develop mass market for Pharma products - During assessment proceedings, Assessing Officer noted that assessee had debited advertisement and sales promotion expenses, customer relationship management expenses, key account management expenses, gift articles and cost of free samples in profit and loss account - Assessing Officer disallowed above expenditure in terms of Explanation to section 37(1) in view of Circular No. 5 of 2012; wherein CBDT referred to amendment to 'Indian Medical Council Regulations, 2002', brought from 10-12-2009, imposing prohibition of medical practitioner and their professional associations from taking any gift, travel facility, hospitality, cash or monetary grant from pharmaceutical and allied health sector industries - Whether MCI Regulation 2002 provides limitation/curb/prohibition only for medical practitioners and not for pharmaceutical companies and hence it could not have had any prohibitory effect on pharmaceutical company like assessee - Held, yes - Whether expenses incurred by assessee could not be reckoned as freebies given to doctors as they were purely promotional materials which were distributed to doctors for brand recognition and not for purpose of granting gift or any other form of inducement to doctors - Held, yes - Whether thus expenditure being purely for business purpose had to be allowed as business expenditure and were not impaired by Explanation 1 to section 37(1) - Held, yes [Paras 6,8, 10 & 11] [in favour of assessee]”*

From the above judgments of the Coordinate Benches, we note that the action as

had been suggested on the violation of the code of conduct is only for the medical practitioners and not for the pharmaceutical companies or allied health sector industries. Thus, it is viewed that the regulations issued by MCI are qua the doctors/medical practitioners registered with MCI, and the same shall in no way impinge upon the conduct of the pharmaceutical companies. As a logical corollary to it, if there is any violation or prohibition as per MCI regulation in terms of Explanation to section 37(1), then the same would debar the doctors or the registered medical practitioners and not the pharmaceutical companies and the allied healthcare sector for claiming the same as an expenditure. In view of the above judicial precedents, the expenditure incurred on account of Referral Fees paid to Doctors is allowable as deduction u/s 37(1) of the Act. Hence, we direct the Assessing Officer to delete the addition of Rs. 39,38,184/- paid to the Doctors as referral fees.

26. In the result, both appeals of the assessee( in ITA No. 737 & 738/Kol/2018) are allowed.

**Order pronounced in the Court on 11.12.2019**

**Sd/-**  
**(A.T.VARKEY)**  
**न्यायिकसदस्य / JUDICIAL MEMBER**

**Sd/-**  
**(A.L.SAINI)**  
**लेखासदस्य / ACCOUNTANT MEMBER**

दिनांक/ Date: 11/12/2019  
(SB, Sr.PS)

Copy of the order forwarded to:

1. M/s Peerless Hospitex Hospital & Research Centre Ltd.
2. DCIT, Circle-11(2), Kolkata
3. C.I.T(A)-
4. C.I.T.- Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.
6. Guard File.

True copy

By Order

Assistant Registrar  
ITAT, Kolkata Benches

