IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'B, HYDERABAD

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
and
SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

I.T.A. No. 1384/Hyd/2011 – A.Y. 1997-98
I.T.A. No. 1385/Hyd/2011 – A.Y. 1998-99
ITA No. 1386/Hyd/2011 –A.Y. 1999-2000

M/s. Dr. Reddy's Laboratories Ltd., Hyderabad PAN: AAACD7999Q	vs.	The Addl. CIT Circle-1(2) Hyderabad
Appellant		Respondent

I.T.A. No. 1289/Hyd/2011
Assessment year 1999-2000

The Asst. CIT Circle-1(2) Hyderabad	vs.	M/s. Dr. Reddy's Laboratories Ltd., Hyderabad PAN: AAACD7999Q
Appellant		Respondent

Assessee by: Sri S. Raghunathan
Revenue by: Sri K. Gnana Prakash

Date of hearing: 26.09.2012
Date of pronouncement: 31.10.2012

O R D E R

PER CHANDRA POOJARI, AM:

ITA Nos. 1384 to 1386/Hyd/2011 are by the assessee directed against different orders of the CIT(A)-II, Hyderabad and ITA No. 1289/Hyd/2011 is by the Revenue directed against the order of the CIT(A)-II, Hyderabad dated 26.4.2011 for assessment years 1997-98 to 1999-2000.

2. The common ground in all the three appeals of the assessee is with regard to treatment of loss arising from the purchase and sale of shares whether as speculation loss in view of the explanation to section 73 of Income-tax Act, 1961 or as business loss. Facts of the case in all the three years are similar. In earlier occasion the assessee came in appeal before this Tribunal on this issue. The Tribunal considered this issue elaborately for A.Y. 1997-98 in ITA No. 621/Hyd/2000 and remitted the issue back to the file of the Assessing Officer vide order dated 24th August, 2007 by holding as follows:

> *"21. We have duly considered the rival contentions and the material on record. At the outset. it would be pertinent to refer to the decision of the Special Bench in the case of Concord Commercials (P) Ltd. (supra). At paragraph 24, the Bench observed as follows:*
>
> "The two kinds of exceptions provided in Explanation to section 73 are based on two independent tests laid down in the Explanation Itself. The test to be applied on the first category of company is the character of its gross total income. The test laid down in the case of the second category of company is the nature of the principal business carried on by it. In the first category, where the test is that of the character of gross total income the other test relating to the nature of principal business carried on by it does not apply. Likewise in the second category of company where the test is the nature of the principal business carried on by it the test of the gross total income does not apply. The two exceptions provided in Explanation to Section 73 are governed by two different tests laid down In the said explanation itself. Therefore. the examination of the exceptions provided in Explanation to section 73 is to be done strictly In accordance with the tests laid down In the Explanation."
>
> *In the present case, the learned counsel for the assessee has rested his arguments on the second exception. On the other hand, the revenue has tried to advance its case on the basis of exception. In fact, in all the cases relied upon by the learned Departmental Representative, it is only the first exception*

which has been considered by the Courts and the Tribunal. In none of the cases, the second exception has come up for consideration. As a matter of fact, even in the case before the Special Bench (supra), the Tribunal laid down the tests for the first exception. However, since it was not concerned with the second exception, the tests for the same have not been laid down and, therefore, our task in this appeal becomes quite onerous. Needless to say, if it was the first exception which was to be considered, the case is undoubtedly caught within the mischief of the Explanation to section 73. However, as mentioned earlier, it is the second exception on which the assessee has tried to rest its case and accordingly, we proceed to adjudicate on the same.

22. If one goes by the language in the Explanation to S. 73, the expression used is ".... or a company the principal business of which is .....". The question we pose to ourselves is whether the provision contemplates that there can be only one principal business or there can be more than one principal business as well. To our mind, perhaps that may not be the case, because, there can be situations wherein business 'A' may constitute 45% of the turnover and business 'B' may constitute 47% of the turnover and balance 8% may be some other business or other income in year one. IN year two, it may just be the opposite, i.e., business 'B' may constitute 45% and business 'a' may constitute 47% of the turnover. Then can it be said that in year one, business 'B' is the principal business and in year two, business 'A' is the principal business. The point we are trying to drive home is that in a case like above, will the principal business keep changing from year to year, that is, if one goes merely by the turnover criterion. The issue poses a problem because as per the decision of the Special Bench the composition of total income will not be the criterion if the assessee's case falls within the second exception. Is it then that one takes an overall view of the company, say, the composition of gross receipts. The deployment of funds in each segment of business, the steps taken by the company to step up any other business, as in the case before us and so on. One also needs to consider as to why a company cannot have more than one principle business. Many other questions may crop up while considering the above questions. All such questions need to be addressed to and which have not been considered by the revenue as they have gone by the income criterion only and which criterion, as per the decision of the Special Bench. cannot be applied when one is considering the matter under second exception in the Explanation to section 73 of the Act. Since we do not have the views of the revenue on this aspect of the matter, we deem it proper to restore the issue back to the

file of the Assessing Officer with the direction to consider it afresh keeping in view the decision of the Special Bench and also the questions posed by us above. The Assessing Officer shall give due opportunity of being heard to the assessee in this regard."

3. The Assessing Officer while passing consequential order re-examined the entire issue. The assessee's principal business is not covered by any exception and he treated the loss on buying and selling of shares as speculation loss. On appeal, the CIT(A) observed that the principal business of the assessee company is not advancing loans and buying and selling of shares is nothing but speculation business of the assessee as the principal business of the assessee is manufacture, sale, deal in export and import in all types of chemicals and drugs. The CIT(A) confirmed the order of the Assessing Officer. Against this the assessee is in appeal before us.

4. The learned AR submitted that the assessee company amended its MOA in August 1994 to include investment and finance as one of its main objects. During the month of June, 1995, merger of Standard Equity Fund Ltd., which is an investment and finance company, took place with the assessee company. Being so in this assessment year under consideration the assessee's principal business includes investment and financing. He further drew our attention to the earlier order of the Tribunal cited supra wherein it was mentioned that there can be more than one principal business. According to him one has to consider overall view of the company i.e., composition of gross receipts, deployment of funds in each segment of business, etc. He submitted that deployment of funds as follows:

Figures in Rs. Crores

	31.3.1995	31.3.1996	31.3.1997	31.3.1998	Total
Fixed assets	45	67	87	109	308
Capital WIP	5	8	13	7	33
Investment + leasing	106 (102+4)	83 (80+3)	77	51	317

5. He contended that the above chart shows the funds deployment was made in investment and financing activities as one of the main object and further Standard Equity Fund Ltd., whose main business is only investment and financing, is merged with the assessee company in June, 1995. According to him, the fund deployed in investment activities is above 50% and investment and financing activities are one of the principal objects and earlier order of the Tribunal if applied in true sense this issue before the Tribunal has to be decided in favour of the assessee. He relied on the order of the Tribunal in the case of Amon Portfolios Pvt. Ltd. Vs. DCIT (92 ITD 324) wherein it was held that the CBDT circular No. 204 dated 24th July, 1976 assumes significance as contemporaneous expotio in the relevant context and the interpretation of the explanation to section 73. It should take into consideration the objective beyond its introduction as was highlighted by the said circular. For this proposition it was relied upon the judgement of Supreme Court in the case of K.P. Verghese vs. ITO (131 ITR 597). He submitted that According to the Tribunal, though deeming provision was to be construed strictly, the construction of the section could not exclude consideration such as the objective for which it was introduced. Since there was no material to show that the assessee as a company, controlled by a business house, and that the share transactions had been effected with a view to manipulate and reduce taxable income, the Tribunal held that

loss should be treated as normal business loss and be allowed to set off against other business profit of the assessee. While repeating the above arguments for the A.Y. 1998-99, he submitted that the lower authorities have not properly considered the Special Bench decision in the case of Concord Commercial Pvt. Ltd. (95 ITD 117) in true spirit. Finally the learned AR relied on the submissions made before the CIT(A).

6. On the other hand, the learned DR supported the orders of the Assessing Officer and CIT(A).

7. We have heard both the parties and perused the material on record. We have carefully gone through the order of the Tribunal in the case of Amon Portfolio Pvt. Ltd. In that case the assessee claimed a loss of Rs. 2,94,832 as normal business loss. However, the same was treated by the lower authorities as speculation loss. On further appeal, the Tribunal held it as normal business loss on the reason that the assessee is a share broker and also indulges in purchase and sale of shares on its own account and the loss was relating to the own trading. Absolutely, there is no material brought on record by the Assessing Officer to show that the assessee is a company controlled by a business house and the share transactions have been effected with a view to manipulate and reduce its taxable income. In other words, there is no evidence to show that the requirement of para 19.2 of the circular No. 204 dated 24th July, 1976 issued by the CBDT are satisfied. Being so, the order of the Tribunal relied on by the assessee company is having no consequence to the facts of the present case. In the present case, as observed by the CIT(A), the assessee is engaged in the manufacture, selling,

dealing and export and import of all types of chemicals and drugs. The primary fact shows that the assessee is a company controlled by a business house and after considering these facts elaborately the lower authorities invoked the ratio laid down by the Supreme Court in the case of McDowell Co. Ltd. Vs. ITO (154 ITR 148). Further the circular cited supra gives the scope and effect to the explanation to section 73 of the Act. From the circular it is clear that the object of these provisions is to curb the device being resorted by some business houses to manipulate and reduce the table income by booking speculation loss. A plain reading of the section makes it clear that this section cannot be invoked in a case where there is a profit from speculation transactions. In the case of Amon Portfolios Pvt. Ltd., the Tribunal not decided the issue where a company whose main business was not that of banking or granting of loans and advances or that a company whose gross total income did not consist of "interest on securities, income from house property, capital gains, income from other sources" incurs loss on the purchase and sale of shares. According to the explanation to section 73 such loss would be deemed to be a speculative loss of the company which could not be deducted from any other business of the assessee. Hence the said decision is not applicable to the facts of the present case.

8. A speculation transaction and the loss arising out of the speculative transaction have to be considered in the light of provisions of section 73 along with the explanation to that section. This provision treats the speculative transaction carried on by the assessee as distinct and separate business if the nature of such transaction is such that, it constitutes a

business. This is provided under explanation 2 to section 28 of the Act. Likewise, the definition of the term "speculative transaction" is provided in section 43(5) of the Act in a substantive manner. The ambit and scope of speculative transaction and speculative loss need to be confined with the limit provided by the law contained in the above mentioned provisions. But, further to take care of any device that may be attempted by business houses controlling group of companies for the purpose of reducing the tax incidence, the law as emended by explanation to section 73 of IT Act, 1961. The said explanation is a deeming provision whereby the transactions of a company dealing in purchasing and sale of shares shall be treated as speculative transaction, subject to two exceptions. The said explanation reads as follows:

> *"Explanation.—Where any part of the business of a company [other than a company whose gross total income consists mainly of income which is chargeable under the heads 'Interest on securities', 'Income from house property', 'Capital gains' and 'Income from other sources'], or a company the principal business of which is the business of banking or the granting of loans and advances consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares."*

9. The transaction of purchase and sale of shares would be held as speculative business only if the company was hit by the explanation to section 73 of the Act. The implication of the explanation is that if a company incurs a speculation loss in a manner deemed in the explanation such loss shall not be set off except against profit and gains, if any, of another speculation business.

10. But, the explanation has provided two exceptions. The first exception is available in the case of a company whose gross total income consists mainly of income which is chargeable under the head "interest on securities", "income from house property", "capital gain" and "income from other sources". The second exception is in the case of a company whose principal business is business of banking or granting loans and advances.

11. The first category of exception is identified by the composition of its gross total income. If the gross total income of the company mainly consists of income falling under the above mentioned heads, explanation to section 73 does not apply. If the gross total income of the company is mainly made up of income under the head "profit and gains of business or profession" it is hit by the mischief of explanation to section 73. Therefore, the first exception is made on the basis of the composition of its gross total income. The second exception is concerned, the thrust is made on the nature of business carried on by the company. If the company is carrying on as its principal business, the business of banking or granting of loans and advances, explanation to section 73 does not apply. The company is excluded from the ambit of explanation on the basis of nature of principal business carried on by it. The two kinds of exceptions provided in explanation to section 73 are based on two independent tests laid down in the explanation itself. Therefore, we have to see the applicability of the exceptions provided in the explanation. As seen from the facts of the present case, though the assessee made a plea that the it is carrying on multiple business as principal business, but the facts do not support

the plea of the assessee. In our opinion, in the present case the assessee's principal business is to manufacture, sell, deal, export and import of all types of chemicals and drugs and not advancing of loans. For clarity we will reproduce the data for A.Y. 1997-98 year ending on 31.3.1997:

(Rs. In '000)

Income	1996-97	1998-99
Sales	24,99,359	33,16,200
Other income	23,874	35,663
Total	25,23,233	33,51,863

12. In the A.Ys. 1997-98 and 1998-99 there is no income from sale of investment but only loss. Same is the position for A.Y. 1999-2000. This income of the assessee does not consist mainly of income chargeable under the head "income from other sources" in these assessment years. The explanation to section 73 is, therefore, very much applicable to the assessee company and the loss suffered by the assessee in the purchase and sale of shares is deemed to be a speculative loss of the assessee company and should not be entitled for any deduction from the business income of the assessee. The assessee's contention that the assessee is having multiple principal businesses is devoid of merit. The evidence brought on record by the Department as recorded in the orders of the lower authorities totally goes against the assessee and the lower authorities passed the consequential orders giving effect in conformity with the Tribunal order cited supra. Accordingly, we dismiss all the three appeals of the assessee in ITA Nos. 1384 to 1386/Hyd/2011.

13. Now we will take up the Revenue appeal in ITA No. 1289/ Hyd/2011. The grievance of the Revenue in this appeal

is with regard to allowing the claim of the assessee with reference to bad debts. In this assessment year under consideration, the assessee claimed bad debts written off at Rs. 15,95,43,000 and advances written off at Rs. 89,69,003. The CIT(A) allowed the claim of the assessee placing reliance on the order of the Tribunal in assessee's own case for A.Y. 2000-01 in ITA No. 621/ Hyd/2000 dated 24.8.2007. He also placed reliance on the order of the Tribunal Special Bench in the case of Oman International Bank SAOG. Against this the Revenue is in appeal before us.

14. The learned DR submitted that the debts not came into existence in the case of banking or money lending business and there is violation of FEMA and being so, the write off in violation of another law of the country cannot be allowed as bad debt.

15. On the other hand, the AR submitted that the claim of bad debt u/s. 36 to the extent of Rs. 15,76,40,347 in respect of certain sales made to foreign companies viz., M/s. Organica Reddy Pharma, Hong Kong Ltd. – Rs. 6,23,46,786 and M/s. Ooo Reddy Biomed Ltd., Russia at Rs. 9,52,93,561. According to him there is approval from RBI to write off these amounts and the same has to be allowed.

16. We have heard both the parties and perused the material on record. Section 36(2)(iii) reads as follows:

> *"Section 36(2)(iii): Any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year), but the Assessing Officer had not allowed it to be deducted on the ground that it*

had not been established to have become a bad debt in that year;"

17. A debt arising in the course of business activity is to be considered as bad debt if it is written off in the books of account as per the provisions of section 36(2)(iii) of the Act. In the present case the assessee submitted that it had obtained permission from RBI vide letter dated 30th March, 1999. The letter reads as follows:

"RESERVE BANK OF INDIA
SECRETARIAT ROAD, SAIFABAD,
HYDERABAD - 500 004

Exp/6076/05.02 98-99 *March 30, 1999*

The Branch Manager
State Bank of India
Industrial Finance Branch
Somajiguda
Hyderabad 500082

Dear Sir,

Reduction in invoice value –
Dr. Reddy's Laboratories Ltd., Hyderabad

Please refer to your letter 98/82 dated 31st December, 1999 on the above subject. We convey our approval for Reduction in invoice value to the extent of US$ 5,328,470/- in respect as per enclosed list. You may release the duplicate GPs of the invoices concerned after receipt of the reduced value quoting this reference on the GR duplicate.

2. The reduction in invoices value is granted subject to the condition that the exporter has surrendered proportionate export incentives, if any, availed in respect of the relative shipments.

Yours faithfully
Sd/-
(M. CHANDRASHEKARAN)
ASST. GENERAL MANAGER"

18. In view of the above letter, the assessee could claim that portion of debt as bad debts on fulfilment of the conditions laid down in that letter. Accordingly, in respect of bad debts, we direct the Assessing Officer to examine this issue in the light of the above letter and decide the issue afresh. The assessee is directed to adduce necessary evidence as the assessee has failed on earlier occasion to furnish necessary evidence. This issue cannot be considered as covered by the earlier order of the Tribunal in the absence of necessary evidence furnished by the assessee. The Revenue appeal is allowed for statistical purposes.

19. In the result, all the three appeals of the assessee are dismissed and the Revenue appeal is allowed for statistical purposes.

Order pronounced in the open court on 31st October, 2012.

Sd/-	**Sd/-**
(ASHA VIJAYARAGHAVAN)	**(CHANDRA POOJARI)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, dated 31st October, 2012
tprao

Copy forwarded to:

1. Dr. Reddy's Laboratories Ltd., 8-2-337, Road No. 3, Banjara Hills, Hyderabad-500 034.
2. The Addl. CIT, Circle-1(2), 4th Floor, Aayakar Bhavan, Hyderabad.
3. The Asst. CIT, Circle-1(2), Hyderabad.
4. The CIT(A)-II, Hyderabad.
5. The CIT-I, Hyderabad.
6. The DR – B Bench, ITAT, Hyderabad