IN THE HIGH COURT OF JUDICATURE AT CALCUTTA

SPECIAL JURISDICTION (INCOME TAX)

ORIGINAL SIDE

RESERVED ON: 29.03.2023
DELIVERED ON:13.04.2023

CORAM:

THE HON'BLE MR. ACTING CHIEF JUSTICE T.S. SIVAGNANAM

AND

THE HON'BLE MR. JUSTICE HIRANMAY BHATTACHARYYA

ITAT/259/2022

(IA NO: GA/02/2022)

PRINCIPAL COMMISSIONER OF INCOME TAX-2, KOLKATA

VERSUS

BALMER LAWRIE AND COMPANY LIMITED

Appearance:-
Mr. Vipul Kundalia, Senior Advocate.
Mr. Amit Sharma, Advocate.

.....For the Appellant.

Mr. Pratyush Jhunjhunwala, Advocate.
Mr. Mrigank Kejriwal, Advocate.

.....For the Respondent.

JUDGMENT

(Judgment of the Court was delivered by T.S.SIVAGNANAM, ACJ.)

1. This appeal filed by the revenue under Section 260A of the Income Tax Act, 1961 (the Act) is directed against the order dated 31.10.2019 passed by the Income Tax Appellate Tribunal "C" Bench Kolkata (tribunal) in ITA No. 111/Kol/2018 and ITA No. 98/Kol/2018 for the assessment year 2012-2013. The revenue has raised the following substantial questions of law for consideration:-

> *1) Whether the Learned Tribunal erred in law in holding that the prior period expenses of Rs. 4,08,23,000/- as an allowable expense in the instant assessment year which is patently wrong in as much as the assessee is following mercantile systems of accounting and as such the prior period expenses cannot be allowed during the assessment year in question.*
> *2) Whether the Learned Tribunal erred in law in allowing Rs. 11.82 crores as provision for diminution in the value of investment which is an unascertained liability ignoring Remand Report of Assessing Officer as such the order of the Tribunal is perverse and absurd?*

2. We have heard Mr. Vipul Kundalia, learned senior standing counsel assisted by Mr. Amit Sharma, learned standing counsel for the appellant department and Mr. Pratyush Jhunjhunwala, advocate assisted by Mr. Mrigank Kejriwal, learned advocate for the respondent assessee.

3. Two issues arise for consideration in this appeal. The first being prior period expenses to the tune of Rs. 4,08,23,000/- and the second issue being provision for diminution in the value of investment to the tune of Rs. 11,82,37,000/-. The assessee in its return of income for the assessment

year under consideration claimed Rs. 4,08,23,000/- as prior paid adjustment and in the details thereof, the same had been stated as general expenditure in nature. The assessing officer called upon the assessee to explain as to why prior period expenditure be not disallowed. The assessing officer records that the assessee did not offer any explanation. The assessing officer while completing the assessment under Section 143(3) of the Act by order dated 17.02.2015 observed that the according to the accounting standard, the expenses are debited to the profit and loss account on accrual basis and the unpaid expenses are made provisions in the balance sheet and any expenses accrued but not settled during any year are debited in the year of accrual and any deviation on settlement is charged in the profit and loss account as income or expenses as applicable in the following years. The assessing officer therefore held the assessee having not followed the mercantile system of accounting in respect of prior period expenses debited in the profit and loss account for the current year the same is not allowable expenditure. Aggrieved by such order, the assessee preferred appeal before the Commissioner of Income Tax Appeal-6, Kolkata CIT(A), contending that the expenditure though related to earlier period but got crystallized during the year under consideration and incurred wholly and exclusively for the purpose of carrying on business and hence is deductable. The assessee stated that in response to the specific queries raised by the assessing officer, he had submitted the details of prior period expenses vide letter dated 29.01.2015, however, the assessing officer erroneously recorded that no explanation was submitted by the assessee. Further the assessee contended that during the course of assessment, detail breakup of the expenses

relating to the prior period, liability in respect of which crystallized during the relevant previous years was submitted to the assessing officer on 30.01.2015 by giving justification for each one of them. The said details were also furnished before the CIT(A). Further the assessee contended that under the mercantile system of accounting deduction is allowed on the basis of accrual of liability and once liability accrues, it has to be allowed irrespective of the fact whether the amount was actually paid in the year or not. The assessee placed reliance on the decision of the Hon'ble Supreme Court in ***Nonsuch Tea Estate Limited Versus Commissioner of Income Tax*** [1] and the decision of this court in ***Commissioner of Income Tax Versus West Chusick Coal Company Limited*** [2]. Reliance was also placed on the decision of the High Court of Delhi in ***Commissioner of Income Tax Versus Exxon Mobil Lubricants Private Limited*** [3] wherein it was held that where liability of the assesses arose and was crystallized in the current year, the assessee was entitled to allowance of that expenditure only in the current assessment year. Further by referring to Section 145 of the Act, the assessee submitted that the said provision is a mandatory provision which compels the department to accept the system or method of accounting regularly employed by the assessee for ascertaining the profits from the business or profession carried on by him or the income from other source subject to its being the proper method of reflecting the true or correct profits. After referring to the item No. 7 of Accounting Standards- II (AS II), it was stated that the statute itself prescribes the manner of disclosure of expenses

[1] [1975] 98 ITR 189 (SC)
[2] 129 ITR 62 Cal
[3] [2010] 8 taxmann.com 249 (Delhi)

relating to prior period, which arises in the previous year as a separate item. It was therefore contended that non-compliance of such disclosure by the assessee would render the books of accounts to be rejected. Further it was contended that in terms of the accounting standards prescribed by the CBDT and the Institute of Chartered Accountant of India (ICAI), the assessee like any other corporate, prepared its account and disclosed relevant details of "prior period items" on a regular basis since the inception of the accounting standard. Therefore the appellant contended that the expenses which have been solely and exclusively incurred during the previous year for carrying out its business should be allowed as deductable expenditure under Section 37 of the Act. Further on facts the assessee contended that they are engaged in the activity of project execution and engineering services through its engineering division and out of the sum of Rs. 408.23 lakhs, 398.69 lakhs pertain to various costs of services booked by the engineering and project division on account of various expenditure and cost which crystallized during the financial year under the reference. Further it was stated that of the aggregate of Rs. 398.69 lakhs, Rs. 208.92 lakhs pertain to costs of ONGC SCOPE Minar Project, the execution of which was completed in the financial year 2006-2007, however the sub-contractor has raised claims for damages, interest etc. and arbitration proceedings were initiated and by award dated 19.08.2010, the learned arbitrator awarded a sum of Rs. 45.05 lakhs to M/s. Interiors India and this award was contested by the assessee before the High Court of Delhi. Though the award was contested the assessee as measure of prudence and in accordance with the accounting principles of conservatism, the claims has cost escalation and other

statutory dues as claimed by the contractor, recognized Rs. 15.00 lakhs in the books of accounts during the year under consideration as its measure of definite ascertain liability towards Interior India. In respect of other contractors, relating to the ONGC SCOPE Minar Project, liability has also been crystallized during the year under consideration. Further it was stated that in executing the works for M/s ONGC Limited bills of the assessee had been withheld aggregating to Rs. 129.10 lakhs as security deposit and redemption money with the contractee at various point of time which being no longer recoverable from M/s. ONGC Limited, has been written off as irrecoverable during the financial year under consideration. Further the assessee pointed out that in respect of other project executed by them, the sub-contractors had lodged claim for additional work under taken and refund of liquidated damages earlier deducted from its bill and the matter is still under arbitration and apprehending that the arbitrator may pass an award, the assessee provided for sum of Rs. 17.00 lakhs as liability on this project, having accrued and crystallized during the previous year. Similarly for another project in West Bengal, a sum of Rs. 13.36 lakhs was forfeited by the contractee during the previous year. Further the assessee contended that they were faced with the order passed by the appellate authority under the Indirect Taxes Act at Kerala for the financial year 2009-2010 on 30.03.2011 and considering the meager amount involved, the assessee made the payments of Rs. 4.78 lakhs. Further in respect of projects executed at Qatar which was completed by engaging sub-contractors, liability for payment to the sub-contractors in respect of on-going project was provided during the year under consideration despite the completion of

having taken place in the earlier year. Similarly with regard to the sub-contractors relating to the HPCL projects, liability towards the sub-contractors crystallized during the year under consideration. The assessee also enclosed the copies of the awards passed by the arbitrators with regard to the two contractors. Further the assessee contended that similar expenses was disallowed by the assessing officer for the assessment year 2002-2003 however, the CIT(A) by order dated 29.09.2005 deleted the entire amount of such disallowance treating the same as deductable expenditure under Section 37 of the Act. Further the assessing officer in regular assessment for the year 2003-2004, allowed the entire amount of expenses relating to prior period which crystallized during the relevant previous year. Further the assessee pointed out that the CIT(A) has allowed similar relief to the assessee for the assessment years 2005-2006, 2007-2008, 2008-2009, 2009-2010, 2010-2011 and 2011-2012. Therefore, the assessee submitted that the entire disallowance of Rs. 4,08,23,000/- being the expenditure towards prior period expenses debited in the profit and loss account of the assessee may be deleted. The CIT(A) having taken note of the factual position and also that in the earlier assessment years, the CIT(A) has granted relief, agreed with such decision and allowed the entire prior period expenses. Aggrieved by the same, the revenue has preferred the appeal before the tribunal.

4. The tribunal after taking note of the factual position noted that the CIT(A) has taken specific note of the fact that the expenses claimed by the assessee as prior period, the liability to pay had crystallized during the relevant previous year and therefore the claim was allowed. Further the

tribunal noted that no appeal was preferred by the revenue against the orders of the CIT(A) for the assessment years 2007-2008 to 2009-2010 and the appeals filed by the revenue for the assessment years 2010-2011 and 2011-2012 were dismissed by the tribunal. Further the tribunal has pointed out that the revenue was unable to bring any material or fact to disprove the assessee's explanation furnished before the authorities in support of its claim that liability to pay expenses charged under the head "prior period" crystallized during the financial year 2011-2012. Further on perusing the details furnished by the assessee with regard to those expenses, the tribunal noted that the assessee had claimed deduction in respect of items which were revenue in nature and therefore fully allowable in arriving at its business income. Further the learned tribunal has pointed out that the revenue did not controvert the contention raised by the assessee that no deduction in respect of these expenses was allowed in the prior years and the tax rate in the earlier years and in the year under consideration were same and therefore irrespective of the year of deduction allowed, the revenue's effect was taxed neutral. The learned tribunal also referred to the decision of the High Court of Gujarat in ***PCIT Versus Adani Enterprises Limited Tax Appeal No. 566 of 2016*** and found the said decision to be relevant to the facts and circumstances of the case. Thus, we find that the learned CIT(A) and the learned tribunal has examined the facts and granted relief to the assessee and more importantly that for the earlier assessment years i.e. 2005-2006, 2009-2010, the revenue has accepted the orders passed by the CIT(A). Though the appeal was filed before the tribunal for the assessment years 2010-2011 and 2011-2012, the same were dismissed.

Thus, a consistent view is required to be adopted in the absence of any material placed by the revenue before the required tribunal to show that there was any distinguishing feature in the assessment year under consideration to make a departure from the earlier view.

5. The learned senior standing counsel submitted that merely because the assessee was state undertaking, it cannot be stated that it cannot do any wrong and the learned tribunal did not examine the facts of the case. We do not agree with the said submission as we have found that both the CIT(A) as well as the tribunal has examined the facts. In fact, the examination of facts by the CIT(A) is more elaborate and more importantly as noted by the tribunal, the revenue was not able to place any material to disprove that the assessee explanation furnished before the authorities in support of its claim that the liability to pay the expenses charged under the head "prior period" crystallized during the financial year 2011-2012. Thus, we find that no substantial question of law arises for consideration under the head prior period expenses.

6. The next issue is with regard to the provision for diminution in the value of investments. In the return of income, the assessee claimed Rs. 11,82,37,000/- as provision for diminution in the value of investments. The assessing officer held that by no such imagination can provisions be treated as allowable expenditure and the claim of the assessee is absurd and accordingly disallowed the same. The assessee carried the matter on appeal before the CIT(A) and after referring to the Memorandum of Articles of Association of company with which one of the objects of the assessee was to lend money to such persons and on such terms as to expedite and in

particular to customers and others having dealing with the company and to guarantee overdraft and loans, it was contended that in the course of carrying on that business the assessee from time to time lends money to its subsidiary and group concerns against payment of interest and such interest income has all along been assessed as the assessee's business income. It was stated that during October 1990, the assessee promoted a new company called Indian Container Leasing Company Limited and held 40% of its equity shares capital and the remaining shares were held by financial institutions. During 1996, the leading multinational company in container leasing came in as an investor and the new company issued fresh equity shares to the said multinational company which amounted to 27.26% of its share capital and as a result of the said issue, the assessee shareholding in the new company came down to 29.09% and that of the financial institutions also came down to 43.65%. In 2003, the multinational company exited from the new company and its shareholding was acquired by the financial institutions whose aggregate shareholding went up to 70.91% and remaining 29.09% being held by the assessee. By virtue of rights issued in 2009, the assessee shareholding went up to 34.78%.In the year 2009 financial institutions wanted to exit from the new company and their holdings were partly acquired by the assessee and partly by one of its joint ventures and consequent to such acquisition the assessee's shareholding in the new company increased to 50% and the balance 50% being held by the assessee's Joint Venture Company. Further the assessee contended that apart from the manufacturing operations, the assessee is engaged in the business of container freight station etc. and in the year

2006, the assessee gave its specialty container division to the new company for running it on leave and license basis and subsequently the division was sold by the assessee to the new company as going on concern with effect from 01.04.2007. During 2008, the assessee extended the inter corporate loan of Rs. 3 crores at interest rate of 9.51% per annum to the new company and in December 2008, the assessee gave its freight container repair and refurbishment division to the new company under the license to operate for and behalf of the assessee. The new company obtained a loan of Rs. 7.11 crores from financial institutions and subsequently the financial institutions sought for repayment of the said loan and they approach the assessee for inter corporate loan of Rs. 7.3 crores on similar terms as the earlier loan of Rs. 3 lakhs in order to pay to the financial institutions. The assessee thus gave an interest-bearing loan of Rs. 7.3 crores to the new company (Transafe Services Limited) in April 2009. During 2009, the financial irregularities were deducted in transafe leading to its liquidity position being adversely affected and it was unable to service its debt obligations and approached the lenders for restructuring its debt. The corporate debt restructuring cell in its decision dated November 18, 2010 stipulated that the assessee as the promoters should infuse fresh contribution of Rs. 7.8 crores of which Rs. 6 crores would be converted into 0.001% optionally convertible cumulative redeemable preference shares and the remaining Rs. 1.8 crores would remain as unsecured interest bearing loans. The existing interest bearing loan of Rs. 7.30 crores given by the assessee was also to be converted into preference shares. Thus, the total amount of Rs. 13.30 crores was converted into preference shares because of the decision of the corporate debt

restructuring cell. During the financial year 2011-2012, it was found that the net worth of the transferee was substantially eroded and stood of Rs. 5.55 crores as against the share capital of Rs. 49.99 crores because of losses of Rs. 44.44 crores. Accordingly, the book value of each preference shares of the face value of Rs. 10 held by the assessee amounted to Rs. 1.11 per share. Thus, out of the sum of Rs. 13.30 crores advanced by the assessee, the erosion had taken place to the extent of Rs. 11.82 crores. Therefore, the Board of Directors of the assessee resolved to make a provision of Rs. 11.82 crores in the account of the assessee for the financial year ended March 31, 2012. In its account, the said sum of Rs. 11.82 crores was debited to the profit and loss account for the year ended March 31, 2012 and the identical amount was reduced from the investment value of preference shares of Rs. 13.30 crores thereby reducing the amount to Rs. 1.48 crores. During July 2013, the transferee made reference to the BIFR which was registered on November 25, 2013. Thus, the assessee contended that what the assessee had advanced was actually an interest bearing loan and it was compelled to accept its conversion into preference shares because of the direction of the RBI corporate debt restructuring cell. The assessee placed reliance on the decision of the Hon'ble Supreme Court in ***Vijaya Bank Versus Commissioner of Income Tax*** [4] where similar accounting as made by the assessee was held as amounting to writing off of the debt. In support of the claim under Section 28/37 of the Act as business laws, reliance was placed on the decision of the Hon'ble Supreme Court in ***Badridas Daga Versus***

[4] [2010] 190 Taxman 257 (SC)

Commissioner of Income Tax [5]. Thus, the assessee contended that the sum of Rs. 11.82 crores is allowable both in the normal computation as well as in computing book profit under Section 115JB of the Act. The CIT(A) after considering the above factual details pointed out that the assessee case revolves around the fact that out of its loan of Rs. 13.00 crores advanced for the purpose of its business, Rs. 11.82 crores had turned bad and though investment was initially propelled by business expediency and was subsequently thrust on the assessee by reason of the RBI's corporate debt restructuring cell's decision. Further CIT(A) pointed out that additional material which was referred to the assessing officer has not elucidated any rebuttal in the remand report dated 07.03.2017. Taking note of the factual position and following the decision in ***Vijaya Bank*** and ***Badridas Daga,*** the assessee's appeal was allowed and the disallowance of Rs. 11,82,37,000/- was directed to be deleted by the assessing officer both in the normal computation and in the computation of the book profit. Aggrieved by such decision, the revenue carried the matter on appeal to the tribunal. The tribunal noted that the primary contention raised by the revenue is on the premise that the assessee's claim was not permissible because in its profit and loss account the amount was charged by way of "provision" and therefore it should not be construed to be in the nature of crystallized loss permissible as deduction in arriving at taxable income of the relevant year. The tribunal notes that such contention raised by the revenue was negated by the Hon'ble Supreme Court in ***Rotork Controla***

[5] (1958) 34 ITR 10 (SC)

India Private Limited Versus Commissioner of Income Tax [6] and allowed claim for provisions for warrantees by observing that the provision is allowable item if the liability is measured using a substantial degree of estimation. In the said decision, three contingencies were pointed out as to when the provision is recognized namely (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an out of flow of resource will be required to settle the obligation; (c) a reliable estimate can be made of the amount of the obligations. The Hon'ble Supreme Court held that if all these conditions are not made, then no provision can be recognized. Bearing the said legal principle in mind, the tribunal tested the facts of the assessee's case and found that the principle transaction leading to the claim was one of the granting loan to subsidiary to promote assessee's own business of freight containers. Further the tribunal noted that in order to diversify its business, the assessee had co-promoted the subsidiary to which the assessee had advanced interest bearing loans and the interest when charge was assessed as "business income" and therefore the tribunal found that the transaction was in the course and for the purpose of the promoting the assessee's business. The tribunal also noted that consequent to granting of loans due to extraordinary and compelling circumstances, (direction of the RBI corporate debt restructuring cell) the loan was converted into preference shares but such fact by itself did not change or alter the basic character of the transactions. More importantly, the tribunal on facts found that the preference shares in transferee were not acquired by the assessee for the purpose of earning dividend and capital appreciation

[6] 180 Taxman 422 (SC)

but the preference shares were acquired as per the directions of the CBR cell of RBI which was binding on the assessee being the promoter of the subsidiary. Furthermore, that the assessee had recognized the loss incurred in its books only after it was found that almost the entire net worth of the subsidiary was eroded. The contention of the revenue before us is that whatever direction was given by the CDR cell cannot be construed to be a dictate but it is more in the nature of a conciliatory direction. We are unable to persuade ourselves to agree with the said submission because the directive is from the corporate debt restructuring cell of the Reserve Bank of India and binding upon the assessee more so it being a public sector undertaking. Furthermore, the tribunal found that since the provision was for ascertaining loss in note No. 10 of the audited account the value of the investment in transafe was disclosed at Rs. 147.63 lakhs that is after knitting off the loss provided in the profit and loss account of the relevant year. Thus applying the decision of the Hon'ble Supreme Court in ***Vijaya Bank*** it was held that there is no infirmity in the order passed by the CIT(A).The tribunal also referred to the decision of the coordinate bench of the tribunal in the case of ***West Bengal Electronics Industry Development Corporation Limited*** in ITA No. 1945/Kol/2013 dated 24.08.2018 we find that in the said order passed by the coordinate bench of the Tribunal, reliance has been placed on the decision of the High Court of Madras in the case of ***Commissioner of Income Tax Versus Tamil Nadu Industrial Investment Corporation Limited*** [7] wherein one of the substantial questions of law was whether the tribunal had enough material

[7] [2017] 88 Taxmann.com 528 (Mad)

to hold and was it right in holding that the loans to the company in liquidation had become bad debts and ought to be written off. In the said case the assessee ***Tamil Nadu Industrial Investment Corporation Limited*** was a state government undertaking and had made certain investment in shares of industrial companies and lend money to those companies and it sought to write off the advances given and value of investment in those industrial companies and claim the same as deduction in its returns wherein it was held as follows:-

> *Question Nos 1 and 3 challenge the conclusions of the tribunal relating to facts and would have to be tested on the touchstone of perversity. The tribunal has noted that valuation of the shares is effected in order to ensure a prepare deplication of the value of the asset in the balance sheet. A note prepared for the consideration of the Board in TIIC B.No. 13587-88 dated 21.07.1987 has been placed before us. A detailed analysis has been undertaken therein with respect to various items identified and sought to be written off in view of the doubtful character of recovery of loans and investments. Investments in the shares of six industrial companies were undertaken by way of underwriting of issue of shares. Upon finding that the net worth was negative, it was proposed to write off 100% of such investment in five cases. In the matter relating to one defaulter, M/s. Southern Brick Works Limited, the recommendations for write-off was only 50% of the investment, in view of a proposal for take of the entity by M/s. Vinichem Private Limited.*
>
> *The note also proposes the write off of an amount of Rs. 33.82 lakhs being 90% of the advances made to two companies, M/s. Upper India Bearings Limited and M/s. Nedumbalam Samiappa Annapoorani Mills Limited, where creditors had approached the High Court seeking their winding up and receivers had been appointed.*

The need for an criteria adopted for the valuation of the shares as well as the efforts taken and measures adopted by the assessee company for recovery of the advances have been duly noted by the tribunal. The erosion of capital leading to a fall in value of shares has been established. We are thus of the view that the conclusion of the tribunal in this regard are well founded and are not vitiated by perversity. Question Nos 1 and 3 are answered against the Department and in favour of the assessee.

7. The learned tribunal after considering the aforementioned decision found that the facts of the assessee's case are more or less similar. Since transferee was a subsidiary promoted for furtherance of the assessee's freight container business and in furtherance of such business the loan were advanced from which interest income was earned and such interest income was assessed under the head "business". Further under compelling circumstances as by the direction of the RBI such loans were converted into preference shares which consequently eroded in value because of the law sustained by the subsidiary. Therefore, the tribunal held that merely because loss was debited under the nomenclature "provision" did not alter the basic character of the transaction and the loss incurred due to non recoverability of the amount advanced in the ordinary course of business could not have been disallowed by the assessing officer. With regard to the objection raised by the revenue to the relief granted by the CIT(A) while computation of book profit under Section 115JB, the tribunal rejected such objection raised by the revenue by rightly placing reliance on the decision of

the High Court of Gujarat in ***Principal Commissioner of Income Tax Versus Torrent Private Limited*** [8] wherein it was held as follows:-

> *In terms of the accounting standards, in view of the decline in the value of the provisions created in the current year (as shown at page 57 of the paper book) the carrying amount of such investments has been reduced and in case of provisions where there was a rise in the value, the provisions are written back and the net amount of provision has been debited to the profit and loss account. Thus, in so far as the provision for diminution of value of investment to the extent of Rs. 13.85 crores is concerned, the same has actually been reduced from the asset side of the balance sheet and therefore is in the nature of the write off. Under the circumstances, the amount of Rs. 13.85 crores though bearing the nomenclature of provision for diminution of value of investment, having been actually written off, cannot be added to the book profit under section 115JB(2)(i) of the Act.*

8. Thus, the tribunal rightly took note of the decision of the Gujarat High Court and after re-appreciating the factual position, affirmed the orders passed by the CIT(A) and therefore we are of the view that no substantial question of law arises for consideration on the said issue.

9. In the result, the appeal filed by the revenue is dismissed on the ground that no substantial question of law arises for consideration.

(T.S. SIVAGNANAM)
ACTING CHIEF JUSTICE

I Agree.

(HIRANMAY BHATTACHARYYA, J.)

(P.A- SACHIN)

[8] 266 Taxman 151 (Guj)