

**IN THE HIGH COURT OF PUNJAB & HARYANA AT
CHANDIGARH**

Income Tax Appeal No. 44 of 2003 (O&M)
Date of Decision: 19.09.2016

Commissioner of Income Tax (Central) Ludhiana ..Appellant

versus

M/s Hero Cycles Limited, Ludhiana ..Respondent

**CORAM: HON'BLE MR. JUSTICE S.J.VAZIFDAR, CHIEF JUSTICE.
HON'BLE MR. JUSTICE DEEPAK SIBAL, JUDGE.**

Present : Mr. Zora Singh Klar, Senior Standing Counsel,
for the appellant

Mr. Akshay Bhan, Senior Advocate with
Mr. Alok Mittal, Advocate, for the respondent.

S.J.VAZIFDAR, CHIEF JUSTICE

This is an appeal against the order of the Income Tax Appellate Tribunal in respect of the assessment year 1991-92.

2. The assessee filed its return of income declaring an income of about ₹ 10.78 crores. The assessment was completed under section 143(3) of the Income Tax Act, 1961 (for short 'the Act'). The Assessing Officer made several additions. The Commissioner of Income Tax (Appeals) sustained the additions in some respects and deleted certain other additions. The Department and the assessee filed appeals before the Tribunal. The Tribunal by the impugned order allowed the assessee's appeal and dismissed the appeal filed by the revenue.

3. According to the appellant, the following substantial questions of law have arise in this appeal:-

- (i) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding the amount of ₹ 1,18,408/- spent on articles

presented to dealers as an allowable business expenditure?

- (ii) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting expenses on foreign travel of Directors wives?
- (iii) Whether on the facts and in the circumstances of the case, the ITAT was right in law in holding that interest from others and also from IDBI constitute profit of the business for the purpose of computing deduction under section 80HHC?
- (iv) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting the addition of ₹ 77,85,059/- made on account of advances of interest free loans to the associated concerns whereas the assessee company was paying huge interest on the borrowed?
- (v) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting the proportionate management expenses allocated against dividend income for purpose of computation of deduction u/s 80M?
- (vi) Whether on the facts and in the circumstances of the case, the ITAT was right in law in confirming the order of the learned CIT(A) in deleting the addition of ₹ 8,79,145/- made on account of closing stock, spares, tools etc.

4. The appeal was admitted by an order dated 07.03.2003. We presume, therefore, that it was admitted on all the questions of law raised by the appellant. We will deal with each of them separately. We will deal with questions (ii) and (v) at the end.

Re; Question No. (i)

5. It was agreed that this question is liable to be answered in favour of the assessee in view of the judgments of this Court in *Commissioner of Income Tax v. Avery Cycle Industries Ltd. [2008] 296 ITR 393 (P&H)*, *Avon Cycles Pvt. Ltd. v. Commissioner of Income Tax [1999]*

238 ITR 85 and the judgment dated 30.01.2015 passed by a Division Bench of this Court in ITA No. 192 of 2001 *Commissioner of Income Tax (Central) Ludhiana v. M/s Hero Cycles Ltd. Ludhiana*.

Question No. (i) is accordingly answered in favour of the assessee.

Re: Question No. (iii)

6. It was agreed that the answer to this question follows our decision in the assessee's case in ITA No. 52 of 2003 *Commissioner of Income Tax (Central) Ludhiana v. M/s Hero Cycle Ltd. Ludhiana*. The question is accordingly answered in favour of the department. The Assessing Officer is directed to pass a fresh assessment order considering the interest under the head "Income from other sources" for all purposes.

Re: Question No. (iv)

7. It is agreed that the answer to this question follows the decision of this Court dated 30.01.2015 in ITA No. 119 of 2004 *Commissioner of Income Tax (Central) Ludhiana v. M/s Hero Cycles Ltd. Ludhiana*.

8. The question is, therefore, answered in the same terms, namely, that the order of the Tribunal setting-aside the disallowance is set-aside and that of the CIT(A) is restored. The Assessing Officer is directed to consider the disallowance in terms of the order of the CIT (A) after examining the nexus between the borrowed funds and the diversion thereof in the form of interest free loans.

Re: Question No. (vi)

9. It is agreed that this question ought to be answered in favour of the appellant and against the assessee in view of the judgment of the Division Bench of this Court dated 30.01.2015 in ITA No. 68 of 2001 in

Commissioner of Income Tax (Central) v. M/s Highways Cycle Indus. Ltd. Ludhiana. It is clarified, however, that the assessee shall be entitled for any adjustment or benefit on account thereof.

Re: Question No. (ii)

“Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting expenses on foreign travel of Directors wives?”

10. Mr. Klar, learned counsel appearing on behalf of the appellant-Department agreed that the traveling expenses of a Director's spouse may constitute business expenses if business expediency for the same is established. He, however, contended that the assessee had not produced any evidence to establish the same.

11. The assessee claimed an amount of ₹ 2,24,204/- as foreign traveling expenses in respect of its Directors' wives who traveled with the Directors while they were on business tours. The Assessing Officer noted that the assessee had given a note in the auditors report that this expenditure was incurred under the contractual obligations and under normal business practice. The Assessing Officer rejected the same as being unsatisfactory.

The CIT(A) noted that the assessee had not furnished any details as to the tour on which the Directors' wives had accompanied them, as to which of the Director's wife had undertaken the tour and whether or not the business of the assessee necessitated the Directors' wives undertaking the tour. It was rightly observed that whether the expenditure incurred is for the purpose of the business or not would depend on the facts of each case.

The Tribunal reversed this decision and directed the Assessing Officer to delete the disallowance on the ground that it had dealt with the

similar issue in ITA Nos. 990 of 1993 and 1054 of 1993 in respect of the assessment year 1990-91.

12. We are unable to uphold the decision of the Tribunal in this regard. The issue cannot be decided on the basis of the result of the assessment proceedings relating to the same question in another assessment year. Whether a Director's spouse has traveled with him for business purpose or not, is essentially a question of fact not only in respect of each year but in respect of each tour. One visit may be for business purpose and another visit may not be for any business purpose whatsoever. The decision of the Tribunal, therefore, is incorrect for the nature and purpose of the visits that the Tribunal considered in respect of the assessment year 1990-91, would be different from the visits that the Tribunal had to consider in respect of the present assessment year.

13. We hasten to add that there may be cases where the tour in a given year may be of the same nature in another year or other years. That would also depend upon the facts of each case. The burden of proving the same is, however, on the assessee. The respondent has not established such a case.

14. The question is, therefore, answered in favour of the appellant/Department. The decision of the Assessing Officer to delete the disallowance is upheld.

Re: Question No.(v)

- (v) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting the proportionate management expenses allocated against dividend income for purpose of computation of deduction u/s 80M?

15. Section 80(M)(1)(ii) and 80AA of the Act, as they stood at the relevant time, read as under:-

“80M. Deduction in respect of certain inter-corporate dividends:-

1. Where the gross total income of a domestic company in any previous year, includes any income by way of dividends from another domestic company, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of such domestic company, a deduction of an amount equal to:-

i)

ii) In the case of any other domestic company, so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the first mentioned domestic company on or before the due date.

..... ..

80-AA. Computation of deduction under Section 80-M

Where any deduction is required to be allowed under Section 80-M in respect of any income by way of dividends from a domestic company which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, the deduction under that section shall be computed with reference to the income by way of such dividends as computed in accordance with the provisions of this Act (before making any deduction under this chapter) and not with reference to the gross amount of such dividends.”

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16. Admittedly, Section 80M applies only to income from other sources. Both the counsel agreed that in view of the judgment of the Supreme Court in *Distributors (Baroda) P. Ltd. vs. Union of India and others*, [1985] 155 ITR 120, it is the net dividend on which the deduction is to be determined for the purpose of Section 80M. Therefore, in the first instance, the assessee's dividend income would have to be computed under section 56. From that the deductions permissible under sections 57 to 59 would have to be determined. The difference between the two would yield the net dividend. In other words, the benefit under section 80M would be to

the extent that the net dividend received by the assessee does not exceed the dividend distributed.

17. The assessee received dividend of ₹ 6,60,000/- from M/s Munjal Showa Ltd and ₹ 16,61,398/- from M/s Hero Honda Motors Ltd. According to the assessee, no interest had been paid in the assessment year in question, namely, 1991-92 as the loans had been repaid before 1st April, 1990.

18. Mr. Mittal contended that in the present case the assessee's gross dividend is also the net dividend as the assessee has not incurred any expenses for earning the dividend received. No amount had been borrowed and no interest was paid in connection therewith.

18. The Assessing Officer's decision to deduct the proportionate management expenses for the purpose of section 80M must be upheld in view of the judgment of a Division Bench of this Court in *Commissioner of Income-Tax vs. Mahavir Spinning Mills Ltd.*, [2009] 308 ITR 445 (P&H). Question (iii) and the answer of the Division Bench thereto are as under:-

“(iii) Whether on the facts and law, the hon'ble income-tax Appellate Tribunal was justified in holding that deduction under section 80M was to be allowed without allocating personal and administrative and financial expenses proportionately for computing the net dividend income referred to in section 80AA of the Income tax Act?

.....

9. In view of the judgments of the hon'ble Supreme Court in *Distributors (Baroda) P. Ltd.* [1985] 155 ITR 120 and *United General Trust Ltd.* [1993] 200 ITR 488 (SC) Question No.(iii) has to be answered in the favour of the Revenue.”

19. The Assessing Officer enumerated under a table the management expenses incurred by the assessee debited under the head “Administrative expenses”. The computation in this regard reads as under:-

“The management expenses incurred by the assessee debited under the head administrative expenses (Annexure XVII) which relate to dividend income also are as under:-

1. Rent paid	5,41,300
2. Donation	1,13,844
3. Rates & Taxes	1,80,118
4. Director's Meeting fee	4,000
5. Audit fee	66,000
6. Directors' Remuneration	21,92,348
7. Fee in other capacity	20,000
8. Cost Auditors remuneration	25,000/-
9. Misc. expenses	
(i) Consultation	87,037
(ii) Management	
Consultation fee	<u>30,000</u> <u>1,17,037</u>
Total:	<u>32,59,658</u>

Total Management expenses as worked out above are Rs.32,59,658/- Proportionate management expenses incurred for earning dividend income are as under:-

$$\frac{32,59,658 \times 6,59,96,415}{52,25,98,252} = \text{Rs.4,11,647/-}$$

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52,25,98,252

Deduction us. 80M is computed as under:-

Gross dividend received	Rs.23,21,400
Less: Proportionate management expenses as per the Hon'ble Supreme Court judgment in the case CIT vs. United General Trust Ltd. (200 ITR 488)	<u>Rs. 4,11,647</u>
	19,09,753
Deduction us. 80M (Dividend distributed by the Assessee Rs. 61,90,068/-)”	Rs. 19,09,753

20. The CIT (Appeals) upheld the Assessing Officer's decision to consider the management expenses as well as the computation thereof. The CIT (Appeals) observed that after having made an investment, the process

does not come to an end, as the investments have to be monitored constantly in order to safeguard the interest of the investors, *i.e.* the assessee.

21. The Tribunal observed that as per Section 14 the income under the Act had to be computed under different heads; that deduction of expenditure allowable under each head of income had been provided for separately under the respective heads of income in Chapter IV; that dividend income is assessable under the head 'income from other sources' as per section 56(1) and that deductions under this head are allowable under section 57. Section 57(1) as it stood at the relevant time provided that the income chargeable under the head from other sources shall be computed after making the deductions mentioned therein. In the case of dividends, section 57(i) provided for the deduction *inter-alia* of any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing such dividend on behalf of the assessee. In the case of dividends section 57(iii) further provided for a deduction *inter-alia* of any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income.

22. The Tribunal then observed that the assessee had not incurred any expenditure to earn the dividend income and that it had not even incurred any expenditure for the purpose of realizing the dividend. It was further observed that the assessee had not claimed any deduction under section 57 of the Act and that the Assessing Officer had not allowed any deduction while computing income by way of dividend.

This observation is without any basis. In the computation of income, there is no bifurcation of expenses for the investment. The assessment order merely states; “Subject to above income of the assessee is computed as under:-

Income returned by the assessee	
Before deduction under Chapter VIA	Rs.11,54,50,241/-
.....”	

Additions are thereafter made and deductions as per Chapter VIA are noted. The assessment order does not indicate any bifurcation of the expenses for the investments.

23. The Tribunal thereafter held that section 80(M) does not authorize an Assessing Officer to estimate the expenditure and recompute the income by way of dividend for the purpose of deduction allowable under section 80(M) of the Act.

24. Where the assessee does not provide any bifurcation of the expenditure incurred in respect of its income, the Assessing Officer has no option but to estimate the expenditure and to recompute the income by way of dividend to arrive at the deduction that may be allowed under section 80M of the Act. Assuming that some portion of the expenditure is attributable to the dividend earned, the Assessing Officer must estimate the extent thereof. If the assessee furnishes proof or details of such expenditure to the satisfaction of the the Assessing Officer he may accept the same. however, the assessee does not furnish a bifurcation of the expenses or any reasonable basis for arriving at the same, the Assessing Officer has no option but to make a reasonable estimate of the same.

25. The Tribunal’s observation that when an assessee claims that it has not incurred any expenditure for earning the dividend income, the onus

of proof lies on the Assessing Officer to prove otherwise namely that the assessee has incurred the expenditure is correct. The Tribunal's further observation that the Assessing Officer had not brought out any material or evidence on record which may establish that the assessee had incurred any expenditure for the purpose of earning the dividend, is, however, incorrect. In cases such as this, the Assessing Officer is justified in presuming that some expenditure had been incurred for the purpose of earning the dividend. Even if the investments yielding the dividend are in group companies, it cannot be said that no expenditure for making the investments which yielded the dividend had been incurred. For instance there is a decision making process that is undertaken before making the investment. Group companies do not blindly invest in each other. Even the decision whether or not to invest in the group companies requires application of mind. If the investment is merely to yield the dividend the management of the investing company is bound to apply its mind as to whether it would be a prudent investment or not. Even if an investment is only for the larger benefit of the group itself or for the benefit of the particular company in the group, the management of the investing company would have to apply its mind on a variety of issues including as to whether the investment would serve this purpose; whether the investment would be detrimental to the investing company and to weigh the pros and cons of such investment for itself and for the members of the group. Further the management of the funds on a regular basis and monitoring the investment even in group companies would be imperative. It is not even the assessee's case that there was an over all policy decision by which the investments had to be made irrespective of the facts and circumstances obtaining at any given point of time. Indeed it would be

difficult to envisage such a situation. In cases such as this, therefore, there would arise a justifiable presumption that some expenditure would be required for the purpose of earning dividend on such investments. The onus would then shift to the assessee to establish that no expenditure whatsoever was incurred for earning the dividend. The Assessing Officer was, therefore, justified in coming to the conclusion that the assessee had incurred expenditure towards earning the said dividend. The assessee has not furnished any material in this regard. As we observed earlier, the Assessing Officer must, therefore, estimate the same if he satisfied that some expenditure for earning the dividend had been incurred.

26. The manner in which the expenditure is computed by the Assessing Officer cannot be faulted.

The only question is whether the management expenses incurred were correctly computed. For this purpose the Assessing Officer noted the management expenses incurred by the assessee under the head *“administrative expenses (Annexure XVII) which relate to dividend income also are as under:-.....”*. He has then tabulated such expenses. We set out the table earlier while referring to the assessment order. The assessment order at the foot of the table states that the total management expenses are ₹ 32,59,658/-. It was not contended on behalf of the assessee that these are the total management expenses. In other words it was not contended that the assessee did not incur any management expenses other than in the sum of ₹ 32,59,658/-. We presume, therefore, that the management expenses worked out by the Assessing Officer were those relating only to the investment business.

28. Lastly, the Tribunal held that the Assessing Officer cannot be permitted to take a contrary stand while computing the income from dividend under section 56 and by allowing deductions under section 80M.

29. Mr. Mittal, the learned counsel appearing on behalf of the assessee supported this findings by contending that the management expenses had already been deducted by the Assessing Officer in the computation of income under the head “profits and gains of business or profession”. He contended that having done so the same cannot be taken into consideration while computing deductions under section 80M which relate only to income from other sources.

30. We are unable to agree. The deductions under section 80M must be computed in accordance with the provisions of section 80M. If the Appellate Authorities find that the expenses liable to be deducted have been considered under the wrong head, they must direct the Assessing Officer to rectify that error for all purposes. We have by our judgment passed today in ITA No. 52 of 2003 *Commissioner of Income Tax (Central) Ludhiana v. M/s Hero Cycles Ltd. Ludhiana*, held that where income is considered under the wrong head in the computation of income, the Assessing Officer must be directed to pass a fresh assessment order after considering it under the correct head for all purposes including for the purpose of computation of income for deductions under section 80HHC. It would follow then that the same rule ought to apply also to expenses which are entitled to be deducted. They must be deducted qua/in respect of the correct head of income. In the present case the expenditure incurred to yield dividend under section 80M must be deducted under section 57(i)(iii) of the Act.

31. In the circumstances question (v) is answered in favour of the department and against the assessee.
32. The appeal is accordingly disposed of.

(S.J.VAZIFDAR)
CHIEF JUSTICE

19.09.2016
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(DEEPAK SIBAL)
JUDGE

Whether speaking/reasoned	√Yes/No
Whether reportable	√Yes/No

