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**IN THE HIGH COURT OF KARNATAKA AT
BENGALURU**

DATED THIS THE 16TH DAY OF DECEMBER, 2015

PRESENT

THE HON'BLE MR JUSTICE VINEET SARAN

AND

THE HON'BLE MRS JUSTICE S SUJATHA

I.T.A.No.53/2009

BETWEEN:

SRI HARIRAM HOTELS (P) LTD.,
34/2, HARIRAM COMPLEX
K G ROAD, BANGALORE
REPRESENTED BY ITS DIRECTOR
SRI S VASUDEVAN, MAJOR APPELLANT

(BY SRI. S P BHAT & C BASAVIAIAH.ADV.)

AND

1. COMMISSIONER OF INCOME-TAX(III)
BANGALORE.
2. INCOME TAX OFFICER
WARD 12(2),BANGALORE. ...RESPONDENTS

(BY SRI E R INDRAKUMAR, SENIOR COUNSEL
& E I SANMATHI.ADV.)

THIS APPEAL IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 PRAYING TO SET ASIDE THE ORDER PASSED BY THE ITAT BANGALORE IN ITA NO.1012/BNG/2007, DATED 07/10/2003 CONFIRM THE ORDERS OF CIT (A) AND THE ASSESSING AUTHORITY IN THE INTEREST OF JUSTICE.

THIS APPEAL HAVING BEEN HEARD AND RESERVED FOR ORDERS ON 7.12.2015, COMING ON FOR PRONOUNCEMENT OF JUDGMENT THIS DAY, SUJATHA J., DELIVERED THE FOLLOWING:

J U D G M E N T

This appeal is directed against the order of the Income Tax Appellate Tribunal, Bangalore Bench "A" relating to the assessment year 2003-04.

2. The appeal was admitted to consider the following substantial question of law:

"Whether on the facts and circumstances of the case, the Tribunal is justified in holding that the income from capital gain should be included for the purpose of computing Book Profit under Section 115JB of the Income Tax Act, 1961?"

3. Facts in brief are:

The appellant/company was incorporated on 3.2.1992 with an object to commence business of running a hotel. It transpires that for this purpose, it had purchased a land measuring 2 acres 32 guntas at Mahadevapura through public auction from the appropriate authority of the Income Tax Department for Rs.26,60,000/-. The appellant borrowed unsecured loan of Rs.24.00 lakhs from its directors for meeting the purchase consideration of the land. As the Appellant/company could not commence the hotel project in the said land, it was decided to sell the land and the same was sold for Rs.1,22,50,000/- on 23.01.2003. In the books of accounts of the appellant, the loan was capitalized during the financial year ended on 31.03.2003. The appellant created the capital gain of Rs.51,71,820/- arising out of the sale of the land directly to the capital reserve and not to the profit and

loss account. The Assessing Officer took the view that the capital gains ought to have been included to the profit and loss account, according to the accounting standard referred to by him in the assessment order and hence, arrived at a conclusion that the profit shown in the profit and loss account should be increased by the amount of capital gain of Rs.51,71,820/-. The assessee objected to the inclusion of capital gain to the book profit. However, the Assessing Officer confirmed that the capital gain has to be shown in the profit and loss account, it cannot be straight away credited to the capital reserve.

4. On appeal before the Commissioner of Income Tax, the appellate authority, following the judgment of the Bombay High Court in the case **of COMMISSIONER OF INCOME TAX vs VEEKAYLAL INVESTMENT CO.(P) LTD. ((2001)249 ITR 597 (Bom)** has held that, even under clause 3(xii)(b) of Part II of

Schedule VI to the Companies Act, 1956 ('Companies Act', for short), profit or losses in respect of transactions of an exceptional or non-recurring nature are to be disclosed. Thus, held that capital gains should be included for the purpose of computing book profit. On further appeal by the assessee before the ITAT, the Tribunal confirmed the orders passed by the authorities following the judgment of the Bombay High Court in **Veekaylal's case** (supra) and held that capital gains should be included for the purpose of computing book profit. This order passed by the ITAT is challenged in the present appeal.

5. Learned counsel Sri.S P Bhat appearing along with Sri C Basavaiah for the appellant submitted that the authorities under the Income Tax Act,1961 (hereinafter referred to as the 'Act' for brevity) exceeded the jurisdiction in rescrutinising book profit, declared by the assessee and approved by the Registrar of Companies.

The Assessing Officer has no power to disturb the profit shown by the assessee in compliance with the standard of accounting to be maintained under the Companies Act. The provisions of Companies Act do not require any capital gain to be disclosed in the profit and loss account as a matter of sound accepted accounting practice, the assessee is entitled to treat the capital gain as a capital reserve.

The learned counsel would contend that the purpose of Parts II and III of Schedule VI of the Companies Act would be only for a limited purpose of empowering the assessing authority to rely upon the authentic statements of the account of the company. The company is obligated to maintain its accounts in the manner provided by the Companies Act, the same to be scrutinized and certified by the statutory auditors and will have to be approved by the Company in its general meeting and thereafter to be filed before the Registrar of

Companies who has a statutory obligation to examine and satisfy that the accounts of the company are maintained in accordance with the requirements of the Companies Act. In support of this contention, the learned counsel strongly places reliance on the Judgment of the Apex Court in ***APOLLO TYRES LTD. vs COMMISSIONER OF INCOME TAX (2002) 255 ITR 273.***

6. It is vehemently contended that all these statutory obligations that were required to be followed by the assessee in accordance with the Companies Act were followed. The only objection raised by the Income Tax Authorities was that capital gains cannot be directly taken into the account of the capital reserve, first, it has to be included in the profit and loss account for the purpose of computing book profit under Section **115JB** of the Act. The Act provides that income prepared in accordance with the Companies Act shall be 'deemed income' for the purpose of **Section 115JB** of the Act.

The Assessing Officer while computing the income under Section 115JB of the Act has no power to rescrutinise the books of accounts certified by the authorities under the Companies Act. The Authorities as well as the Tribunal not properly appreciating the Judgment relied on by the Assessee in the case of **Apollo Tyres** (supra), which is subsequent to the Judgment of **VEEKAYLAL** (supra), wrongly held that the capital gains should be included in the profit and loss account for the purpose of computing book profit.

7. The learned Counsel further places reliance on the Judgment of the Apex Court in the case of '**C.I.T. Vs. HCL COMNET SYSTEMS AND SERVICES LIMITED**' reported in **2008 [305] ITR 409** and the Judgment of the Calcutta High Court in the case of '**COMMISSIONER OF INCOME TAX. WEST BENGAL VS N. GUIN & COMPANY PVT LTD**' reported in **116 ITR 475**.

8. On the other hand, Sri. E.R. Indra Kumar, learned Senior Counsel assisted by Sri. E.I. Sanmathi appearing for the Revenue contended that the assessee has not followed standard accounting system in maintaining the books of accounts as per the Companies Act. Clause 3[XII](b) of Part II of Schedule VI to the Companies Act, contemplates that profit or losses in respect of transactions of a kind, not usually undertaken by the company or undertaken in circumstances of an exceptional or non recurring nature if, material in amount and miscellaneous income as per Clause-3(XII)(b) & [c] has to be disclosed in the profit and loss account which is mandatory requirement, as set out in these provisions under Schedule VI of the Companies Act, having not been followed, the Income Tax Authorities are justified in rescrutinizing the book profit as per Sub-section (2) of Section 115JB of the Act. It is further contended that the Judgment of ***Veekaylal***

(supra) is squarely applicable to the facts of the case, as such the authorities are justified in following the said Judgment, that the capital gains should be included in the profit and loss account for the purpose of computing book profit.

9. It is also submitted that the Judgments of the Apex Court in the case of ***Apollo Tyres*** (supra), and ***HCL Comnet Systems*** (supra), clarifies that the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the explanation to Section 115JB. Much emphasis is placed on the explanation appended to section 115JB to contend that the Income Tax Authorities are empowered to increase the net profit as shown in the profit and loss account prepared under Sub-section [2] of Section 115JB in the case of amounts carried to any reserves, by whatever name called, as specified in clause [b] of the said explanation. The

learned senior counsel has filed a memo placing on record the copy of Directors' Report to the Members and the Auditor's Report and placed reliance on these reports to substantiate his contention that Clause[d] of the Auditor's report specifies that the profit and loss account and balance sheet referred to in the report complies substantially in all material respects, except as stated in Note-B[2] on accounts which refers to transferring of the capital gain amount of Rs.51,71,819.20/- to capital reserve account instead of crediting to profit and loss account. Thus, it is argued that the books of accounts maintained by the assessee is not as per the standard of accounting to be maintained in accordance with the Companies Act as disclosed in the Auditor's report. In view of not maintaining the statutory accounts as per the Companies Act, the Income Tax Authorities have every right to rescrutinize the net profit as per the book profit. The Judgment passed by the Tribunal confirming the

orders of the Authorities is in accordance with the provisions of the Act and the same cannot be faulted with. As such, he seeks for dismissal of the appeal answering the question of law in favour of the Revenue.

10. Heard the learned Counsel appearing for the parties and perused the record.

11. Section 115JB of the Act during the relevant period provides that notwithstanding anything contained in any other provisions of this Act, in the case of an assessee being a company, the income tax payable on the total income as computed under the Act is less than $7\frac{1}{2}\%$ of the book profit, the tax payable for the relevant previous year shall be deemed to be $7\frac{1}{2}\%$ of such book profit. Thus, the assessee has to first compute the total income in accordance with the Act and if the total income is less than $7\frac{1}{2}\%$ of the book profit, then the assessee has to prepare profit and loss account for the previous year,

then fictionally, it will be deemed that its total income chargeable to tax would be an amount equal to 7½% of such book profit. The Income Tax Officer has computed the book profit and the regular income. As tax on regular income is more than tax on book profit, tax on regular income is adopted. The Authorities have consistently relied upon Clause 3 (XII[b]) of Part-II of Schedule VI to the Companies Act, to come to a conclusion that capital gains has to be mandatorily taken into profit and loss account while computing the book profit. That having not been done by the Assessee, the authorities have recomputed the book profit. At this juncture, it would be beneficial to refer to the Judgment of the Apex Court in **Apollo Tyres** (supra) which is rendered while dealing with an identical provision of Section 115J of the Act. It is held thus:

“Therefore, we are of the opinion, the Assessing Officer while computing the income under section 115J has only the power of

examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to section 115J.”

12. In the subsequent Judgment of the Apex Court in **HCL Comnet Systems** (supra), following the Judgment of **Apollo Tyres** (supra), it is held that the adjustment required to be made to the net profit disclosed in the profit and loss account for the purpose of section 349 of the Companies Act are quite different from the adjustment required to be made under the explanation to be made under section 115JA of the Act. For the purpose of section 115JA, the Assessing Officer can increase the net profit determined as per the profit and loss account prepared as per Parts II and III of

Schedule VI to the Companies Act only to the extent permissible under the explanation thereto.

13. The explanation appended to Section 115JB provides certain Items which if debited to the profit and loss account can be added back to the net profit for computing the book profit. Clause (b) of the said explanation provides for the amount carried to any reserves by whatever name called. In the present case, it is true that the capital gains are directly taken to capital reserve without taking the said amount of capital gain to the profit and loss account however, no such capital gain is debited to the profit and loss account, as such, the said explanation is not applicable to the facts of the present case.

14. We have noticed the auditor's report, certified with a qualification that the profit and loss account and balance sheet referred to in the report comply substantially in all material respects with the

applicable accounting standards referred to in Section 211(3C) of the Companies Act except the land and building sold during the year, the capital gain has been transferred directly to capital reserve account instead of crediting to profit and loss account, which in the opinion of the directors is more appropriate. However, it is not disputed that this auditor's report is accepted by the General Body, the books of account and the balance sheet are filed before the Registrar of Companies. It is also noticed by us that Clause 3(XII)(b) and (c) of Part II of Schedule VI of the Companies Act provides that profit and losses in respect of transactions of a kind, not usually undertaken by the Company or undertaken by the company or undertaken in circumstances of an exceptional or non-recurring nature, if material in amount and miscellaneous income, are required to be disclosed in the profit and loss account. Considering, the capital gain income falling under these clauses, it is

incumbent on the Company to disclose the said amount of capital gain in the profit and loss account. Section 211 of the Companies Act contemplates, form and contents of balance sheet and profit and loss account. Sub-sections 3(A),3(B) and 3(C) of Section 211 provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards, where the profit and loss account and balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and the balance sheet the following mainly:

- (a) the deviation from the accounting standards;
 - (b) the reasons for such deviation; and
- the financial effect, if any, arising due to such deviation.

15. For the purpose of Section (3C) of Sec.211 of the Companies Act, the expression “accounting standards” means the standards of accounting

recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949) as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of Section 210(A).

16. The proviso to the said Section 211(3)(C) of the Companies Act makes it clear that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the accounting standards until the accounting standards are prescribed by the Central Government under the sub-section 3(C). The Assessing Officer has placed reliance on the accounting standards, vide No.9949 dated 25.1.1996 and has held that the transaction of sale property should have been brought into the profit and loss account as an extraordinary item since the assessee has failed to follow the accounting standards,

determined the book profit after allowing the deduction towards cost as per provision to Section 115JB (2) of the Act. This order is confirmed by the appellate authority as well as by the ITAT. However, this exercise of the assessing authorities, in recomputing the book profit of the assessee is contrary to the principles of law laid down by the Apex Court in **Appollo Tyres** (supra). The Apex Court has held that the only power vested with the Assessing Officer is to make increases and deductions as provided in the explanation to Section 115JB of the Act. Assessing Officer has no power to embark upon a fresh enquiry in regard to the entries made in the books of accounts of the company. In the light of the judgment of **Apollo Types** (supra), we are of the opinion that the Assessing Officer has no power to recompute the book profit and has to rely upon the authentic statements of accounts of the company, the accounts being scrutinized and certified by the statutory auditors

though with a qualification, approved by the company in general body meeting and thereafter filed before the Registrar of Companies, who has a statutory obligation to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act.

17. Accordingly, we answer the substantial question of law in favour of the assessee and against the revenue. For the foregoing reasons, appeal is allowed.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

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