IN THE HIGH COURT OF KARNATAKA, BENGALURU

DATED THIS THE 26TH DAY OF JUNE, 2015

PRESENT

THE HON'BLE MR. JUSTICE MOHAN M SHANTANAGOUDAR

AND

THE HON'BLE MR. JUSTICE ARAVIND KUMAR

ITA NO.700/2009
C/W
ITA NO. 684/2009

ITA NO.700/2009

BETWEEN:

1. THE COMMISSIONER OF
INCOME TAX
C.R. BUILDING
QUEENS ROAD,
BANGALORE.

2. THE DY. COMMISSIONER OF
INCOME TAX,
CIRCLE-11(4)
QUEENS ROAD,
BANGALORE. ...APPELLANTS

(BY SRI. K.V. ARAVIND, STANDING COUNSEL)

AND:

M/S HMA DATA SYSTEMS PVT. LTD.,
G-01, RIO GRANADE,

NO.7/3, BRUNTON ROAD,
BANGALORE-560 001. ..RESPONDENT

(BY SRI A. SHANKAR AND SRI M LAVA, ADVOCATES)

ITA 700/2009 IS FILED UNDER SECTION 260A OF INCOME TAX ACT, 1961, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BANGALORE IN ITA NO.1154/BNG/2009, DATED 29.05.2009 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-11(4), BANGALORE.

ITA NO. 684/2009

BETWEEN:

M/S HMA DATA SYSTEMS P.LTD.,
REP. BY ITS MANAGING DIRECTOR
SRI. HARISH K.MURTHY
G-01, RIO GRANADE,
NO.7/3, BRUNTON ROAD,
BANGALORE-560 001. …APPELLANT

(BY SRI A. SHANKAR AND SRI. M LAVA, ADVOCATES)

AND:

THE DEPUTY COMMISSIONER
OF INCOME TAX,
CIRCLE-11(4)
QUEENS ROAD,
BANGALORE-560 001. ..RESPONDENT

(BY SRI. K.V. ARAVIND, STANDING COUNSEL)

ITA 684/2009 IS FILED UNDER SECTION 260A OF INCOME TAX ACT, 1961, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BANGALORE IN ITA NO.1154/BNG/2009, DATED 29.05.2009.

THESE APPEALS BEING HEARD AND RESERVED, COMING ON FOR PRONOUNCEMENT OF JUDGMENT THIS DAY, **ARAVIND KUMAR J.,** DELIVERED THE FOLLOWING:

JUDGMENT

These two appeals have been preferred by the Revenue and the assessee respectively being aggrieved by the order passed by Income Tax Appellate Tribunal, Bangalore Bench in ITA No.1154/Bang/2009 dated 29.05.2009 whereunder the Tribunal has held:

(i) income earned on the sale of 50,000 equity shares of M/s.Diebold HMA Pvt. Ltd., was liable to be brought to tax under the head "Capital gains" and not as "income from business" as held by the assessing officer;

(ii) travel expenditure, professional charges and other expenses in connection with sale of said shares had nexus to such sale; and

(iii) amount paid towards legal charges in respect of such sale was allowed by the CIT(A) was correct.

2. This Court has admitted both the appeals on 24.09.2010 and 27.10.2009 respectively to consider the following substantial questions of law:

1. **ITA 700/2009:**

(i) "Whether the Appellate Authorities were correct in holding that the income of Rs.21,55,47,800/- earned on the sale of 50,000 equity shares of M/s.Diebold HMA P. Ltd., was liable to be brought to tax under the head "capital gains" and not "income from business" as held by the Assessing Officer despite the assessee increasing the profit and

loss account in respect of the value of the shares for each assessment year from the date of purchase i.e., assessment year 1992-93?

(ii) Whether the Appellate Authorities were correct in not taking into consideration the fact that the assessee had claimed travel expenditure, professional charges and other expenses in connection with sale of M/s.Diebold HMA P. Ltd., shares and especially when the assessee had no other business income during the current assessment year?

(iii) Whether the sum of Rs.24,93,800/- paid to M/s.Amarchand Mangaldas towards legal charges in respect of sale of M/s.Diebold HMA P. Ltd., shares is liable to be deducted from the sale value when computing capital gains tax when the actual payment accrued and was paid in the earlier assessment year 2003-04 and allowing the claim during the current assessment year would distort the profits of the current year?"

2. <u>ITA 684/2009:</u>

(i) "Whether the Tribunal was justified in law in holding that the appellant

is not entitled to the deduction on account of technical support charges on the facts and circumstance of the case?

(ii) Whether the Tribunal was justified in law disallowing the expenditure relating to Travel by the executive for the purpose of business on the facts and circumstance of the case?

(iii) Whether the Tribunal was justified in holding that accrual of income is the precondition for allowing expenditure on the facts and circumstances of the case?"

3. Facts in brief which has led to filing of these appeals are as under:

Assessee is a private limited company engaged in the development of software as well as manufacture and sale of equipments and maintenance. For the assessment year 2004-05 return of income came to be filed declaring its total income at ₹3,70,66,590/-. The assessing officer after issuing notice under section 143(2) after selecting the return for

scrutiny has proceeded to frame the assessment order under Section 143(3) by order dated 22.12.2006, whereunder disallowances to the tune of ₹2,67,85,610/- was made. During the previous year relevant to the assessment year, assessee sold 50,000 shares of M/s.Diebold HMA Pvt. Ltd., said to have been acquired by it during the year 1992-93 for a total consideration of ₹21,55,47,800/- and declared a long term capital gain of ₹20,51,66,634/- in its return of income. However, the assessee was denied the benefit of long term capital gain arising from such sale of shares on the ground that the assessee had been debiting its profit and loss account with decrease or increase in the value of investments and as such it should be treated as `income from business'. It was also noticed by the assessing officer that professional charges of ₹1,19,09,768/- debited to profit and loss account is to be disallowed to an extent of ₹24,93,800/- on the ground that such

professional charges related to sale of shares and the payment relating to this expenditure had been made in the year 2002-03 but accounted to in the assessment year 2004-05. Hence, assessing officer came to a conclusion that payment was made outside the books of accounts and accordingly disallowed the claim for deduction to the extent indicated hereinabove. However, CIT (A) held such payment had been reflected as advance (pre-paid professional-charges) in that year and it cannot be allowed while computing business income, but it has to be allowed in computing the long term capital gains, since assessee had incurred expenditure in sale of Diebold HMA shares and same is to be allowed in computing long term capital gains as claimed by assessee and his finding came to be affirmed by Tribunal. Further, assessing officer also disallowed a sum of ₹ 18,55,756/- claimed by the assessee as expenditure relating to abroad travel by the company's

Managing Director and his wife on the ground that there was no business activity justifying their foreign travel for business purposes. A sum of ₹ 94,74,184/- claimed by the appellant as `technical support charges' paid towards promotion of products and services in North America was also disallowed on the ground that the agreement relating to this activity had not been put into practice which came to be affirmed by CIT (A) and Tribunal.

4. Thus, revenue being aggrieved by the order of the Tribunal which affirmed the finding of CIT(A) insofar as treating the receipt of the amount by the assessee insofar as sale of shares as 'capital asset' and allowance of the legal fee paid by the assessee as professional fee to be allowed while computing the long term capital gains as claimed by the assessee which finding has been affirmed by the Tribunal has been

questioned by the revenue in ITA No.700/2009. The assessee being aggrieved by the finding of the assessing officer who disallowed the expenditure relating to foreign travel by the Managing Director and his wife and disallowing the amount paid by the assessee as 'technical support charges' to professionals on the ground that such activity had not been put into practice came to be affirmed both by the CIT (A) as well as Tribunal and as such, the assessee has preferred ITA No.684/2009.

5. We have heard the learned advocates appearing for the parties and perused the orders passed by the Tribunal, CIT(A) and the assessing officer.

6. It is the contention of Sri K.V.Aravind, learned Advocate appearing for the revenue that the appellate authorities committed an error in holding that income earned by the assessee on sale of 50,000 equity

shares to be brought under the head "Capital Gains" and not "Income from Business" though assessee had increased the profit and loss account in respect of the value of shares for each assessment year from the date of purchase of shares namely, from 1992-93. He would also contend that the amount paid towards legal charges was liable to be deducted from the sale value when computing capital gains tax when the actual payment accrued and was paid in the earlier assessment year 2003-04 and allowing the claim during current assessment year would distort the profits of the current year and contends non-consideration of this aspect by the appellate authorities have resulted in erroneous order being passed. Hence, he prays for answering the substantial questions of law in favour of the revenue.

7. Per contra, Sri A.Shankar, learned Advocate appearing on behalf of assessee would support the order of the Tribunal insofar as it has rejected the claim of the revenue and he would contend that the authorities erred in disallowing the traveling expenses incurred by the assessee and merely because there was no business activity, per se would not indicate that there was no business activity by the assessee. He would also elaborate his submission by contending that professional charges paid to H.M.A.S., an American based company was on the basis of contract entered into by the assessee with the said Firm to render professional services in the form of market input and other issues as detailed in the contract and accordingly, as per the contractual term, a sum of $1,00,000 was to be paid as upfront amount and accordingly, it was paid. Non-consideration of said plea of the assessee in this perspective has resulted in great injustice to the

assessee and hence, he prays for substantial questions of law being answered in favour of the assessee as formulated in ITA No.684/2009 and he would also pray for dismissal of the appeal filed by the revenue.

8. RE: FINDING ON SUBSTANTIAL QUESTION OF LAW NO.(1) FORMULATED IN ITA NO.700/2009.

At the cost of repetition, it is noticed that assessee had purchased 50,000/- shares of M/s.Diebold HMA Private Limited during the year 1992-93 and sold the same during the previous year relevant to the assessment year 2004-05 for a total consideration of ₹21,55,47,800/- and declared a long term capital gain of ₹20,51,66,634/- in its return of income. The assessing Officer denied the benefit of long term capital gains and held that it should be treated as 'income from business'. The CIT(A) has noticed that the balance sheet along with its enclosures of the earlier 2-3 years,

assessee has been showing the value of the shares of Diebold HMA Private Limited at Rs.50,00,000/- and has never claimed diminution. It is also noticed by the CIT (A) that claim for diminution/increase in valuation in respect of other shares had not been allowed by the assessing Officer and the assessee had accepted the same. It has been held that observation made by the assessing Officer to the effect "assessee has been in the business of purchase and sale of investments year after year and has been debiting the P & L A/c with increase or decrease in the value of investments under the head 'revaluation of investments' , is far from the facts. In that view of the matter, we are not inclined to accept the contention of the revenue and we are of the considered view that the finding recorded by the CIT (A) which has since been affirmed is a question of fact. Hence, substantial question of law No.(1) is answered in the affirmative.

9. **RE: SUBSTANTIAL QUESTION OF LAW NO.(2) IN ITA No.700/2009 AND SUBSTANTIAL QUESTIONS OF LAW NOS.(1) AND (2) IN ITA NO.684/2009:**

The assessee had claimed a sum of ₹33,86,284/- as expenditure relating to travel abroad by the company's Managing Director (Sri Harish K Murthy) and his wife (Smt.Asha Murthy). A sum of ₹18,55,756/- came to be disallowed by the assessing Officer on the ground that there was no business activities in these years and no explanation was forthcoming to establish the nexus of travel to that of business purpose. Undisputedly, before the assessing Officer as well as before the CIT(A), assessee could not substantiate the claim by producing cogent evidence with regard to expenditure incurred towards the Director's foreign travel to the extent of disallowance made by the assessing Officer. The assessee had not discharged the burden cast on it by furnishing the details like the

business visa, at whose invitation the business trip was held, proof of any meetings abroad and the details alike. In that view of the matter, the order of assessing Officer as affirmed by the lower appellate authorities cannot be found fault with. In that view of the matter, we are of the considered view that disallowance made by the assessing Officer insofar as foreign travel expenditure is concerned, requires to be affirmed by holding that the appellate authorities were correct in affirming the findings of the assessing Officer.

10. The assessing Officer disallowed a sum of ₹94,74,184/- claimed by the assessee as technical support charges towards promotion of products and services in North America on the ground that there was no business activities and the agreement on which the assessee based its claim was an agreement which was not put into practice. This finding of the assessing

Officer came to be affirmed by CIT(A) as well as by the Tribunal. The assessee made payment of $1,00,000 on 14.07.2003 and $1,06,000 on 02.12.2003 based on an agreement dated 01.07.2003 contending interalia that such payment was made as per Clause (6) of the agreement and the recipient namely, HMAS was required to render professional services in the form of furnishing market input and other issues as detailed in the contract. Undisputedly, assessee did not place any material to show as to the actual implementation of the contract and the report which the consultant HMAS had to furnish to the assessee and as such, in the absence of any commercial expediency of incurring such expenditure, the disallowance was sustained by both the appellate authorities. It cannot be gainsaid by the assessee that even in the absence of any evidence, the claim ought to have been allowed. The mere existence of a technical agreement with HMAS was not sufficient

and there being no business activity in the year under consideration, the burden was on the assessee to prove the business expediency to claim expenditure. Hence, all the authorities were justified in disallowing the claim or holding that the assessee is not entitled to the deduction. Accordingly, the questions of law are answered in the affirmative.

11. **RE: SUBSTANTIAL QUESTION OF LAW NO.(3) IN ITA NO.700/2009 AND ITA NO.684/2009**

The assessee also claimed expenditure of ₹1,19,09,768/- towards professional charges. Out of this, the assessing Officer disallowed the assessee's claim for deduction of payment of ₹24,93,800/- and same was set aside by the CIT(A) on the ground that there was misinterpretation by the assessing Officer in respect of payment of professional fees to the legal advisers and the assessee who had made the payment in financial year 2002-03, it has been reflected as

advance (pre-paid professional charges). Hence, same was ordered to be allowed in its entirety namely, to the extent claimed by the assessee.

12. The Tribunal has rightly noticed that the exercise undertaken by the assessee in the book is to transfer the same from pre-paid professional charges to professional charges account and held that in the year under consideration, expenditure took place and accounted for in the books. Hence, the Tribunal found that the allowance made by the CIT(A) was in connection with the transfer of shares and hence, it is to be computed in the income from the long term capital gains and cannot be allowed while computing the business income. The said finding of fact by the authorities does not give rise to the substantial question of law for being answered in favour of the assessee. As such, the same is answered in the affirmative.

13. For the reasons aforestated, we proceed to pass the following:

ORDER

(I) ITA No.700/2009 and ITA No.684/2009 are hereby dismissed.

(II) Order dated 29.05.2009 passed by Income Tax Appellate Tribunal, Bangalore Bench in ITA No.1154/Bang/2009 is hereby affirmed.

(III) The substantial questions of law are answered as indicated hereinabove.

(IV) No order as to costs.

Sd/-
JUDGE

Sd/-
JUDGE

SBN/sp