IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 1286 OF 2009

The Commissioner of Income Tax]
Central-I, Old C.G.O. Building, 10th Floor,]
M.K. Road, Mumbai – 400 020.] ... Appellant

Versus

Shri M.P. Ramchandran,]
Prop. of Ms. Jyothy Laboratories,]
344, Shivashakthi Industrial Estate,]
Andheri-Kurla Road, Mumbai-400 053.] ... Respondent

Mr. Tejveer Singh for the Appellant.

Mr. S.E. Dastur, senior counsel with Mr. Sanjiv M. Shah for the Respondent.

CORAM : S.J. VAZIFDAR, &
M.S. SANKLECHA, JJ.

TUESDAY, 28TH AUGUST, 2012

JUDGMENT : [Per S.J. Vazifdar, J.]

1. This is an appeal under section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal dated 17th December, 2007, dismissing the appellant's appeal IT(SS)A No.581/Mum/2003 pertaining to block period 1st April 1990 to 1st

November, 2000. The Commissioner of Income Tax deleted an addition of Rs.6,58,52,694/- and Rs.39,39,00,000/- made by the Assessing Officer on account of royalty and on account of reimbursement of advertisement expenses.

2. The appellant has sought to raise the following questions of law :-

(a) Whether, on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in deleting the addition of Rs.6,58,52,694/- on account royalty and Rs.39.39 crores on account of reimbursement of advertisement expenses as not assessable under Chapter XIV B of the Income Tax Act, 1961 ?

(b) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in holding that the provisions of Chapter XIV B cannot be invoked in respect of additions made on account of royalty and of advertisement expenses inspite of the fact that seized documents recovered during search clearly establish consideration of such income under Chapter XIV B of Income Tax Act, 1961 ?

(c) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in holding that royalty income and income on account of advertisement expenses does not fall within the definition of "undisclosed income" u/s. 158(b) by relying upon the decisions quoted in 64 ITD 396 (ITAT, Pune), 194 ITR 32 (Delhi) and 83 ITD 111 (ITAT, Kolkata) [TM] inspite of the fact that the ratio given in the Tribunal decisions are no longer applicable on account of the amendment made to the definition of "undisclosed income" retrospectively w.e.f. 01.07.95 by the Finance Act, 02 and that the Delhi

High Court decision was delivered with reference to Sec. 132(1)(c) while specific definition of undisclosed income given in Section 158B(b) is applicable to Chapter XIV B in view of the opening words of Section 158B ?

(d) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in holding that royalty income is not taxable as undisclosed income as the papers by themselves do not suggest receipt of it by the assessee inspite of the fact that undisclosed income u/s. 158BB is not restricted to the amount "received" but has its application on the "income accrued" as well when the assessee is following mercantile system of accounting, because of applicability of provisions of Section 145 [Sec. 158B BC(b) refers] ?

(e) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in interpreting explanation to Section 158BA to affirm its conclusion inspite of the fact that neither royalty income nor reimbursement of advertisement expenses had ever been assessed earlier in any regular assessment as income of the assessee ?

(f) Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT erred in ignoring the writings submitted by the Assessing Officer during several hearings and relying on old judgments rendered useless by amendment in Section 158BB vide Finance Act, 2002 ?

(g) Whether on the facts and in the circumstances of the case and in law, the addition on account of royalty in question can be made being undisclosed income under section 158B(b) of the Income Tax Act, 1961 ?

3. Both the parties proceeded on the basis that the above questions, in effect, involved two issues arising on account of the addition of the two sums mentioned above by the Assessing Officer.

4. On 3rd November, 2000, a search and seizure action under section 132 was carried out at the respondent's residential premises and at the premises of Jyothy Laboratories. The Deputy Commissioner of Income Tax passed an order under section 158BC(c) read with section 143(3)(iii) of the Act. He determined the undisclosed income at Rs.46,22,52,694/- i.e. the aggregate of the above sums towards royalty and advertisement expenses. It is the addition of these two sums that the respondent challenged before the Commissioner of Income Tax (Appeals).

5(A). Since about 1983, the respondent carried on business as the sole proprietor of M/s. Jyothy Laboratories of manufacturing and selling fabric liquid whitener under the mark "*UJALA*".

(B) In the year 1992, Jyothy Laboratories Limited was incorporated. The company carried on the same business. The respondent was the promoter, Managing Director and, alongwith the members of his family, the majority share-holder of this company.

(C) The respondent entered into an agreement dated 23rd December, 1994, with Jyothy Laboratories Limited under which the respondent permitted the company to use the said mark. The agreement was to remain in force for ten years. Clause 16 thereof reads as under :

> "*<u>Clause 16(i)</u>*
>
> *"The users shall pay to the proprietor in respect of this Agreement, Technical-know-how / Royalty of 25 paise per bottle of UJALA 75 ml. And proportionally higher or lower sum for various volumes of the product sold during each financial year commencing from the date of this Agreement."*
>
> *<u>Clause 16(ii)</u>*
>
> *"The users shall pay to the proprietor such advance as and when demanded by the latter which, in any*

case, shall not exceed 3 times of the technical-know-how / royalty fee paid during the previous financial year in which the demand for advance has been made."

Clause 16(iii)

"The users shall reimburse the proprietor on demand the following expenses which have been specifically spent with reference to the market covered by the users.

i. Local advertisement like TV / Radio / Printing Cost of POP material etc.

ii. Marketing staff expenses.

iii. Any other direct marketing expenses."

6. The respondent declared royalty from the assessment years 1996-97 onwards. For the assessment years 1996-97 to 1999-2000, the respondent declared royalty amounting to Rs.25,81,625/-, Rs.69,00,229/-, Rs.1,52,05,664/- and Rs.2,64,04,267/-.

7. In respect of the assessment year 2000-01, the respondent showed royalty income upto September, 1999 of Rs.1,67,12,840/-. The respondent annexed Note No.1, which formed a part of Form No.3CD, which mentioned that the payment of royalty had discontinued and that all the business activities had stopped during the

assessment year 2001-02. Thus, though the agreement dated 23rd December, 1994, was to remain in force for ten years with effect from the assessment year 2000-01, the payment of royalty had ceased, the reason is this. As stated earlier, the respondent is the sole proprietor of Jyothy Laboratories. He was also the promoter, Managing Director and alongwith the members of his family, the majority share-holder of Jyothy Laboratories Limited.

8. On 17th November, 1999, the respondent entered into an agreement titled "Shareholders Agreement" with Baring India Investment Limited (BIIL), a company incorporated in Mauritius. The agreement recorded that the respondent was desirous that BIIL invest in Jyothy Laboratories Limited and that BIIL intended investing upto Rs.15 crores in the paid up capital of the company. The relevant provisions of the agreement read as under :-

> *"NOW THEREFORE, in consideration of the purchase price of the said equity shares and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties do hereby agree as follows:*
>
> *1.0. THE INVESTMENT*
>
> *1.1. That the Investor shall subscribe to 500,000*

(five lac) equity shares of face value of Rs.10/- each at a premium of Rs.275/- in not more than three tranches on or before 31 Dec. 2000.
…...........

2.6 All brands developed or to be developed will be exclusively the property of the company. Formal, goal setting and performance appraisal systems and training programs to be initiated in the company."

9. The respondent agreed that by virtue of this clause, the mark stood assigned to Jyothy Laboratories Limited. Accordingly, with effect from 17th November, 1999, the company Jyothy Laboratories Limited stopped paying the respondent royalty.

10. The Tribunal has considered and analyzed the documents on record as well as the respondent's responses to the authorities during the course of search in considerable detail. The same indicates that the respondent had, in fact, not received any royalty with effect from October, 1999. Indeed, the appellant has not been able to indicate any evidence to the contrary. There is, however, nothing to indicate that the share-holder's agreement dated 17th November, 1999, between the respondent and BIIL was sham and bogus. Nor is there anything to indicate that the agreement was not implemented. As the trademark

stood transferred to Jyothy Laboratories Limited, there would be no question of it continuing to pay royalty to the respondent. He contended even in his response to the authorities that he wanted to raise funds for the company and was of the view that by increasing the volume of business, the profits accruing to the company would be more than the royalty earned by him. It must be remembered that the respondent, alongwith the members of his family, were the majority share-holders of Jyothy Laboratories Limited. He further stated that BIIL had, as a condition of its investment, insisted that royalty ought not to be paid to the respondent and that the respondent, therefore, agreed not to receive the same. This was a business decision that the respondent took.

11. Admittedly, in the return filed on 31st October, 2000, i.e. prior to the search, the respondent had attached Schedule VIII in Saral Return of Form No.2D for the assessment year 2000-01. Note No.1, which formed part of Form No.3CD, mentioned that the company had discontinued the payment of royalty during the assessment year 2001-02.

12. Mr. Dastur, the learned senior counsel appearing on behalf of the respondent, relied upon a judgment of this Court in *Commissioner of Income Tax v. Dr. M.K.E. Memon (2001) 168 CTR (Bom.) 184 = 248 ITR 310*. The Division Bench held as under :-

> *"8. In conclusion, we would also like to mention that Chapter XIV-B lays down a special procedure for the assessment of search cases and provides for assessment of undisclosed income as a result of the search. Under s. 158BB, r/w s. 158BC of the Act, what is assessed is the undisclosed income of the block period and not the total income or loss of the previous year required to be assessed under the regular assessment vide s. 143(3). This exercise under s. 143(3) of the Act for regular assessment stands on a different footing in contrast to the exercise undertaken by the AO under Chapter XIV-B where the AO has to assess only the undisclosed income. Therefore, scope of regular assessment is quite different from the scope of assessment under Chapter XIV-B. The regular assessment is to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner whereas what is assessed under Chapter XIV-B is only the undisclosed income from the block period and not the income or loss of the previous year which is only done in the normal regular assessment under s. 143(3). In large number of cases we find that the above distinction is not kept in mind by the AO. It is for this reason that we have spelt out the difference between the regular assessment and the*

block assessment under Chapter XIV-B of the IT Act."

13. Mr. Dastur's submission that the present exercise by the Assessing Officer is not in conformity with the provisions of Section 132 and 158B, is not without force. We are, however, of the view that in the facts and circumstances of the present case, it is not even necessary for the respondent to go that far. Even if it was an assessment under section 143, it would make no difference. The above facts indicate that there was no undisclosed income. The respondent was entitled to enter into the arrangements with the company i.e. Jyothy Laboratories Limited as also with BILL. At the cost of repetition, it is not even contended that these agreements were sham or bogus. Nor is it suggested that they were a device to launder money through BILL. Most important is the fact that the Assessing Officer, during the regular assessment, was aware of the fact that income by way of royalty was not paid with effect from September/October, 1999. The first issue, therefore, does not raise a substantial question of law.

14. The next question is whether as contended by the respondent, the Tribunal erred in deleting the addition of Rs.39.39 crores on account of reimbursement of advertisement expenses. It was submitted that under clause 16(iii), the company was bound to reimburse the respondent, *inter-alia*, marketing expenses in respect of the products sold under the said mark "*UJALA*". It was submitted that the respondent had, in fact, incurred such expenses.

15. There, admittedly, is no material evidencing a reimbursement of the expenses to the respondent. The respondent's case is that he has not even demanded the reimbursement. Whether in normal circumstances, this would be unusual or not is not relevant. This is a case where the respondent himself owns a large majority of the equity capital of the company. It would not, therefore, be unnatural for him not to have demanded the payment. Under clause 16(iii), the company was bound to reimburse the respondent only "on demand" from the respondent. The fact, therefore, that the respondent's accounts are maintained on a mercantile basis would make no difference. Even assuming that he is entitled to reimbursement of the marketing

expenses, the liability of the company to pay him the said would arise only in the event of his having demanded the same. Moreover, this agreement was admittedly with the Department. It is not even the Department's case that it lost sight of the same. Even if it had, the remedy would have been under section 147 r/w section 148 or section 154. The remedy was not under section 132 read with section 158B.

16. The Assessing Officer had stated that there were certain messages for the transfer of advertisement expenses for the financial year 1999-2000 from the Jyothy Laboratories Limited to the respondent's proprietary firm. It was contended that by transferring the amounts from the company to the respondent, the company availed of higher benefits under section 80IA. In other words, it was contended that by reducing the profits of the respondent's sole proprietary firm and increasing the profits of the company, the respondent had evaded taxes. Even assuming that the contention was well founded, the evasion of tax would be by the company and not by the respondent. It is not established that the respondent was, in fact, reimbursed the said expenses. The question of undisclosed income,

therefore, does not arise.

17. The Tribunal rightly declined to interfere with the finding of the Commissioner of Income Tax (Appeals) deleting the addition of Rs.39.39 crores on account of reimbursement of advertisement expenses on the ground that the same were not assessable under Chapter XIV-B of the Act. The Tribunal observed that the Assessing Officer had worked out the apportionment of the advertisement expenses debited in the books of accounts of the company on the basis of the sales and the right of the respondent to be reimbursed the advertisement expenses. As observed by the Tribunal, the advertisement expenses were disclosed in the return of income. The agreement dated 23rd December, 1994, for payment of royalty, which included clause 16, was also with the Department during the regular assessments. It was not contended before the Appellate Authority or before us that the advertisement expenses were false. The Tribunal, therefore, rightly held that the primary facts were also disclosed in the books of accounts of the respondent as well as the company and that the Assessing Officer was, therefore, not justified in making an

addition in the block assessment. It is useful to refer to the following concluding observations of the Tribunal.

> *"To sum up the factual and legal background, as discussed above, the addition on account of reimbursement of advertisement expenses have been also been the subject-matter of consideration in the assessment of the earlier years. The total sum on advertisement expenses is also not in dispute and also not false. The basis of computation of royalty as well as reimbursement of advertisement expenses was available with the Department. Under this situation, it cannot be said that search and seizure action resulted in unearthing evidence of alleged undisclosed income. Even the basis of calculation of royalty and of receipt of reimbursement of advertisement expenses were already available on record. Therefore, both the issues would not fall under the purview of Chapter-XIV B of the Act as no evidence was found during the course of search which would warrant their consideration only in the block assessment order. This proposition is fortified by the ratio of Jurisdictional High Court in the case of Dr. M.K.E. Menon (supra). Under the facts and circumstances, we are not inclined to interfere in the finding of the CIT(A), who has also deleted the addition of Rs.39.39 crores on account of reimbursement of advertisement expenses as not assessable under Chapter XIV-B of the Income-tax Act. We uphold the same."*

18. The appeal, therefore, does not raise a substantial question of law. It is, accordingly, dismissed.

M.S. SANKLECHA, J. ***S.J. VAZIFDAR, J.***