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

INCOME TAX APPEAL NO.567 OF 2010

The Commissioner of Income Tax-6,
Aayakar Bhawan, M.K.Road,
Mumbai-20. ...Appellant.

Vs.

M/s.Modern Terry Towels Ltd.,
68/69, Godavari Pochkhanwala Road,
Worli, Mumbai-400030,
Pan No.AABCM0825F. ..Respondent.

Mr. Suresh Kumar for the Appellant.
Ms. Vasanti Patel for the Respondent.

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

DATE : 13th August, 2012

JUDGMENT (Per M.S. SANKLECHA, J.)

This appeal by the revenue under Section 260A of the Income Tax Act, 1961 ("the Act") challenges an order dated 21/7/2008 of the Income Tax Appellate Tribunal ("the Tribunal") relating to assessment year 1997-98 arising out of Income Tax Appeals Nos.6919/Mum/2003 and 7261/Mum/2003.

2) Being aggrieved the revenue has formulated the following question of law for consideration by this Court.

a) Whether on the facts and in the circumstances of the case, the Tribunal is justified in law in allowing deduction u/s. 80M in respect of gross dividend without deducting estimated expenses there from even though the assessee has maintained a common profit and loss account in respect of dividend income, profits of business and other income and common establishment and administrative expenses have been debited in the P & L account and therefore in terms of Section 80AA read with Section 80M deduction u/s. 80M is allowable only on the net dividend income and in the circumstances of the case, the A.O. had no other option but only to estimate the expenditure incurred on earning of dividend income?

b) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in allowing the expenditure of Rs.49,17,790/- made on account of making up charges, without appreciating the fact that the assessee failed to furnish the confirmations of parties to establish the genuineness of the expenses?

c) Whether on the facts and in circumstances of the case the Tribunal was justified in law in accepting the change in the method of valuation of stock in trade,

without appreciating the fact that change in accounting method of stock in trade from net realizable value to lower of cost or market price was undertaken without bringing on record any evidence warranting the change in methodology and was carried out to reduce the incidence of tax liability?

Re Question (a) :

3) The respondent-assessee claimed deduction of Rs.4.16 crores for the assessment year 1997-98 being dividend income under Section 80M of the Act. The Assessing officer by his order dated 30/3/2000 held that in view of Section 80AA of the Act the deduction under Section 80M of the Act is to be allowed only on net dividend i.e. after deducting expenses incurred for earning dividend income. However, as the respondent-assessee had not claimed any expenses towards the earning of dividend income, the Assessing Officer estimated 10% of its gross dividend income as expenditure incurred for earning the same. He thus, restricted the deduction under Section-80M of the Act to only Rs.3.74 crores.

4) The Commissioner of Income Tax (Appeals) by an order dated 30/7/2003 allowed the respondent-assessee's appeal. It was held that as no expenditure had been incurred to earn the dividend income, the Assessing officer was not justified in estimating 10% of the dividend income as the

expenditure incurred for earning the same. Therefore Assessing Officer was directed to allow deduction of dividend income to the extent of Rs.4.16Crores.

5) Being aggrieved the revenue carried the matter in appeal to the Tribunal. The Tribunal by its order dated 21/7/2008 upheld the order dated 30/07/2003 of the Commissioner of Income Tax (Appeals). It held that only the expenditure solely and exclusively incurred for earning dividend income has to be reduced and that there was no justification to reduce the dividend income entitled to deduction under Section 80M of the Act by estimating the expenditure.

6) Mr. Suresh Kumar, Counsel for the revenue submits that in terms of Section 80AA of the Act the deduction available under Section 80M of the Act for dividend income would only be the net dividend income earned after reducing the expenses incurred for earning the dividend income. In support of the aforesaid submission, he relies upon a decision of the Kerala High Court in the matter of **Commissioner of Income Tax Vs. South Indian Bank question Limited reported in 194 Taxman Page 73**. Ms. Vasanti Patel, learned Counsel appearing for the respondent relying upon the Judgment of a Division bench of this court in **Commissioner of Income Tax Vs. Central Bank of India reported in 264 ITR Page 522** submitted that even though the deduction under Section 80M of the Act is allowable on

net dividend basis, the same has to be arrived at after taking into account only the actual expenses incurred for the purpose of earning such dividend and not on estimated basis. She also placed reliance upon another order of this court in the matter of **Commissioner of Income Tax Vs. City Finance India Ltd. In Income Tax Appeal No.6780 of 2010 dated 1/12/2011** wherein on a similar question being raised, this Court held that only expenses directly incurred to earn dividend income are to be reduced while computing deduction under Section 80M.

7) We find that question (a) is covered by the decision of this Court in the matter of **Central Bank of India (Supra) and the City Finance Limited (supra)**. The aforesaid decisions are binding upon us.

8) Ms. Vasanti Patel's reliance upon the judgment of a Division Bench of this Court in ***Commissioner of Income Tax v. Central Bank of India (2003) 264 ITR 522***, is well founded. It is pertinent to note that in the case before us, the Assessing Officer adopted the figure of 10% drawing an analogy from section 80HHC. In *Commissioner of Income Tax v. Central Bank of India*, the respondent had claimed relief under section 80M in the sum of Rs.15,58,646/-. The Income-tax Officer, however, deducted Rs.15,04,220/-, leaving an amount of only Rs.54,426/- as eligible for deduction under Section 80M

holding that the major income of the bank fell under the head "income from securities" under sections 18, 19 and 20 of the Act as it stood at the relevant time. The Income-tax Officer held that section 20 contemplated deduction from interest on securities in the case of a banking company; that the respondent had earned income under the head "Interest on securities" which fell under section 18 and since section 20 contemplated the rule of proportionality of expenses and interest, the Income-tax Officer broadly lifted that rule and imported the same for computing the net eligible relief under section 80M. In that case, there was no dispute that the deduction under section 80M is to be based on the net dividend received. Even before us, there is no dispute in this regard. The Division Bench proceeded to answer the following question :

> *"Whether the Department was entitled to import the rule of proportionate expenditure and interest contemplated by section 20 of the Act as it then stood into section 80M of the Act?"*
>
> *Our answer to the latter question is in favour of the assessee-bank and against the Department. The reasons are as follows:*
>
> *Section 18 of the Act, as it stood at the relevant time, refers to computation of income by way of interest on securities. Section 19, inter alia, states that subject to provisions of section 21, the income chargeable under section 18 shall be computed after making deductions which are enumerated int hat section. Section 20 refers to deduction from interest on securities in the case of banking company. Section 20(2) states, inter alia,*

that expenses deducted under Section 20(1) shall not form part of the deductions admissible under Section 30 to section 37 for the purposes of computing business profits. Section 80M, on the other hand, comes under Chapter VI-A of the Income Tax Act. Chapter VI-A refers to special deduction. As held in numerous cases by this court, Chapter VI-A constitutes a separate code dealing with deductions to be made in computing total income. Section 80M refers to special deduction in respect of inter corporate dividends. As held by the Bombay High court in the case of Maganlal Chhaganlal (P) Ltd. [1999) 236 ITR 456, in order to compute deduction under section 80M, one has to compute the amount of dividend in accordance with the Act after deducting interest on monies borrowed for earning such income. The point to be noted is that deductions contemplated by section 80M referred to actual expenditure whereas, deductions contemplated by section 20(1) are estimated proportionate expenses and interest. Therefore, one cannot import deductions from interest on securities in the case of a banking company under section 20(1) into the deductions contemplated by section 80M. In the case of CIT Vs. United Collieries ltd. [1993] 203 ITR 857 the Calcutta High Court has held that the special deduction under section 80M is allowable on the net dividend which is arrived at after taking into account actual expenditure incurred by the assessee in earning the dividend income and that there was no scope for any estimate of expenditure being made and there was no scope for allocation of notional expenditure unless the facts of a particular case so warranted. In our view, section 20(1) contains a rule of proportionality of expenses and interest and that rule is based on estimation of expenditure whereas, section 80M is allowable on net dividend arrived at after taking into account actual expenditure incurred for the purposes of earning such dividend unless the facts of a particular case warrant otherwise. Therefore, we

answer the latter question in favour of the assessee-bank and against the Department."

The provisions of Section 80HHC are entirely different from those of Section 80M and 80AA. There is no basis for importing the provisions of Section 80HHC with Section 80M. The same does not lead to a satisfactory computation of the net dividend under Section 80M.

Therefore, question (a) as formulated is dismissed as it raises no substantial question of law.

Re Question (b) :-

9) During the assessment year 1997-98 the respondent- assessee had claimed an amount of Rs.1.16 crores as expenses under the head making up charges. During the assessment proceeding the respondent assessee was asked to furnish confirmation letters from the persons to whom the payment was made for making up charges. The respondent-assessee could not furnish the confirmatory letters to the extent of Rs.88.97 lacs. Consequently, the Assessing officer disallowed the expenditure to the extent of Rs.88.97 lacs and added it to the income of the respondent-assessee.

10) On appeal before the Commissioner of Income Tax (Appeals) the respondent-assessee produced further confirmatory letters to the extent of Rs.28.96 lacs from persons to whom payment was made for making up charges. Thus, the dis-allowance was reduced by a further Rs.28.86lacs. Thus the dis-allowance of Rs.88.97 lacs made by the Assessing officer was

restricted only to Rs.49.76 lacs.

11) The Tribunal by its order dated 21/7/2008 allowed the appeal of the respondent-assessee and held that the expenditure of Rs.49.17 lacs on account of making up charges has to be allowed. This was on the basis of a finding that payments were made by account payee cheque on bills raised by the contractor/job workers. Further, tax at source had also been deducted in respect of the aforesaid payments made for making up charges to the contractor/job workers. The Tribunal held that it is not necessary that in every case expenses are to be allowed only upon confirmation letters being filed from the recipients of the amounts. This is particularly so, when the expenditure is backed by considerable evidence, including the registers maintained as per the requirement of the Central Excise Authorities. In view of the above, the Tribunal allowed the respondent-assessee's appeal and held that it is entitled to deduction in respect of the payments made for making up charges.

12) We find that the aforesaid finding of the Tribunal with regard to making up charges is a pure finding of fact. The Tribunal on the basis of the evidence before it has come to the conclusion that the amounts paid towards making up charges were genuine and allowed the expenses. It is not suggested by the revenue that the finding of the Tribunal is perverse or arbitrary.

In the circumstances, the appeal with regard to question (b) is dismissed as it raises no substantial question of law.

Re Question (c) :-

13) The respondent-assessee has been regularly following a method of valuing its closing stock on the basis of net realizable value. However, during the period relevant to the assessment year 1997-98 the respondent changed the method of valuation of its closing stock from net realizable value to cost or market price whichever is lower. As a consequence of change in method of valuing the closing stock the valuation of closing stock went down by Rs.6.17crores. The Assessing officer did not accept the explanation offered by the respondent-assessee for change in the method of valuing closing stock viz. accounting standard AS-2 required the closing stock to be valued at costs or market value whichever is lower. However, the Assessing officer held that change in method of valuation has been effected with an intent to evade tax and approximately Rs.6.17crores was added back to the declared income of the respondent-assessee.

14) The Commissioner of Income Tax (Appeals) allowed the respondent-assessee's appeal. It was held that the change in the method of valuing closing stock was not done to undervalue profit and there was no mala-fide intention on the part of the respondent-assessee. Consequently, the Assessing officer was directed to delete the addition of Rs.6.17 crores on

account of valuation of closing stock.

15) The Tribunal upheld the finding of the Commissioner (Appeals). The Tribunal held that in view of the provisions of the Companies Act the respondent-assesseee is obliged to comply with the Accounting standard issued by the Institution of Chartered Accountants of India. The Accounting standard issued by the Institution of Chartered Accountants of India made it mandatory that the inventories should be valued at the lower of costs or the net realizable value. The Tribunal also recorded the fact that for the earlier assessment year 1996-97 the Auditors had mentioned the fact that the respondent-assesee had not followed the Accounting standards AS-2. In the circumstances, the change in method of valuation of stock was because of a statutory requirement and could not be branded as mala-fide. The contention of the revenue that the change in method of valuation of closing stock would result in distortion of the profit earned as the opening stock has not been disturbed was also negatived by the Tribunal in view of the fact that there was a bona-fide reason for change in the valuation of closing stock.

16) This High Court in **Melmould Corporation v. CIT 202 ITR 789** relied upon the booklet titled “Valuation of Stock and work-in-Progress-Normally Accepted Accounting Principles” brought out by Indian Merchants” Chamber Economic Research and Training foundation, which may usefully be extracted here too:

"2. Where a change from one valid basis to another valid basis is accepted, certain consequences normally follow. The opening stock of the base year of change is valued on the same basis as the closing stock. Whether the change is to a higher level or to a lower level, the Revenue normally does not seek to revise the valuation of earlier years. It neither seeks to raise additional assessments, nor does it admit relief under the "error or mistake" provisions.

3. it is not possible to define with precision what amounts to a change of basis. It is a convenience, both to the tax payer and to the Revenue, not to regard every change in the method of valuation as a change of basis. In particular, the Revenue encourages the view that change which involves no more than a greater degree of accuracy, or a refinement, should not be treated as a change of basis, whether the change results in a higher or a lower valuation. In such cases the new change valuation is applied at the end of the year without amendment of the opening valuation" (underlining ours)".

This court while holding that there is no need to change the valuation of the opening stock for the year when there is change in value of the closing stock due to a change in the method. The Court observed as under:

> *"Whenever there is a change in the method of valuation, there is bound to be some distortion in calculating the profit in the year in which change takes place. But if change is bona-fide and in accordance with the normally accepted accounting practice, there is no reason why it should not be permitted".*

17) In the circumstances, the valuation of closing stock on the basis of cost or net realizable value which is lower, done by the respondent-assessee which is mandatory requirement of law cannot be faulted. In view of the above, question (c) above does not raise a substantial question of law.

18) The appeal is dismissed. No order as to costs.

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