

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 26TH DAY OF AUGUST 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE H.T.NARENDRA PRASAD

I.T.A. NO.191 OF 2011

C/W

I.T.A. NO.32 OF 2012

I.T.A. NO.191 OF 2011

BETWEEN:

M/S. BEST TRADING AND AGENCIES LTD.,
REP. BY ITS DIRECTOR B.R. GOPALA KRISHNA
C/O. KIRLOSKAR ELECTRIC CO. LTD.,
P.B. NO.5555, MALLESWARAM (WEST)
BANGALORE-560055.

... APPELLANT

(BY SRI. A. SHANKAR, SR. COUNSEL A/W
SRI. M. LAVA, ADV.,)

AND:

THE DEPUTY COMMISSIONER OF INCOME-TAX
CIRCLE-11(2), 5TH FLOOR
NO.14/3, R.P. BHAVAN
OPP. RBI, NRUPATHUNGA ROAD
BANGALORE-560001.

... RESPONDENT

(BY SRI. K.V. ARAVIND, ADV.)

THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT,
1961 ARISING OUT OF ORDER DATED 08.02.2011 PASSED IN ITA

NO.36/BANG/2010 FOR THE ASSESSMENT YEAR 2005-06,
PRAYING THAT THIS HON'BLE COURT MAY BE PLEASSED TO:

(I) FORMULATE THE SUBSTANTIAL QUESTION OF LAW
STATED THEREIN.

(I) ALLOW THE APPEAL AND SET ASIDE THE FINDINGS TO
THE EXTENT AGAINST THE APPELLANT IN THE ORDER PASSED BY
THE TRIBUNAL IN ITA NO.36/(BANG)/2010 DATED 08-02-2011, IN
THE INTEREST OF JUSTICE AND EQUITY.

I.T.A. NO.32 OF 2012

BETWEEN:

M/S. BEST TRADING AND AGENCIES LTD.,
REP. BY ITS DIRECTOR B.R. GOPALA KRISHNA
C/O. KIRLOSKAR ELECTRIC CO. LTD.,
P.B. NO.5555, MALLESWARAM (WEST)
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CIRCLE-11(2), 5TH FLOOR
NO.14/3, R.P. BHAVAN
OPP. RBI, NRUPATHUNGA ROAD
BANGALORE-560001.

... RESPONDENT

(BY SRI. K.V. ARAVIND, ADV.)

THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT,
1961 ARISING OUT OF ORDER DATED 27.09.2011 PASSED IN ITA
NO.1216/BANG/2010 FOR THE ASSESSMENT YEAR 2006-07,
PRAYING THAT THIS HON'BLE COURT MAY BE PLEASSED TO:

(I) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW
STATED THEREIN.

(I) ALLOW THE APPEAL AND SET ASIDE THE FINDINGS TO
THE EXTENT AGAINST THE APPELLANT IN THE ORDER PASSED BY
THE TRIBUNAL IN ITA NO.1216/(BANG)/2010 DATED 27-09-2011,
IN THE INTEREST OF JUSTICE AND EQUITY.

THESE ITAs COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.**, DELIVERED THE FOLLOWING:

JUDGMENT

These appeals under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act' for short) have been preferred by the assessee. I.T.A.No.191/2011 pertains to Assessment year 2005-06, whereas, I.T.A.No.32/2012 pertains to Assessment year 2006-07. Since, the substantial questions of law which arise for consideration in these appeals are similar, therefore, they were heard analogously and are being decided by this common judgment.

2. I.T.A.No.191/2011 was admitted by a bench of this court vide order dated 10.04.2012 on following substantial questions of law:

(i) Whether the Tribunal as justified in law in holding that there is no nexus between the interest earned on fixed deposits and the interest paid to the creditors where the deposit is made out of surplus from restructuring

process on the facts and circumstances of the case?

(ii) Whether the interest paid to the creditors to the extent of Rs.12,80,461/- is not an allowable expenditure on the facts and circumstances of the case?

(iii) Whether the Tribunal was justified in law in holding that the provisions of Minimum Alternative Tax under the provisions of Section 115JB of the Act are applicable to the company on the facts and circumstance of the case?

(iv) Whether the Tribunal was justified in law in holding that indexed cost of acquisition cannot be reduced for the purpose of computing book profits under Section 115JB of the Act on the facts and circumstances of the case?

(v) Whether the Tribunal was justified in law in not following the decision of the coordinate Bench in respect of applicability of provisions of Alternative Minimum Tax on Companies on the facts and circumstances of the case?

3. I.T.A.No.32/2012 was admitted by a bench of this court by order dated 28.05.2012 on following substantial questions of law:

(i) Whether the Tribunal was justified in law in holding that there is no nexus between the interest earned on fixed deposits and interest paid to the creditors, when the said deposit is made out of surplus from restructuring process on the facts and circumstances of the case?

(ii) Whether the interest paid to the creditors to the extent of Rs.49,84,256/- is not an allowable expenditure on the facts and circumstances of the case?

4. Facts leading to filing of these appeals briefly stated are that the assessee is a company and was utilized as a special purpose vehicle for restructuring of Kirloskar Electric Company Ltd. Under an arrangement, approved by this court, the surplus on non

manufacturing and liquid assets including real estate at Bangalore, Pune etc. have been transferred to Special purpose vehicle for disbursement of the liabilities. The assessee for the Assessment year 2005-06 filed the return of income declaring a loss of Rs.11,51,59,138/- and subsequently, filed a revised return of income on 30.11.2006 declaring a long term capital loss of Rs.11,67,36,836/- and total income of Rs.2,97,239/- being income from other sources. The return of income was selected for scrutiny and a notice under Section 143(2) of the Act was issued to the assessee.

5. The Assessing Officer passed an order of assessment on 30.11.2007 under Section 143(3) of the Act and disallowed the claim of interest paid to the financial institutions, which was claimed as deduction under Section 57 of the Act to the tune of Rs.12,80,461/- as capital expenditure. The Assessing Officer determined the total income of the assessee as Rs.15,77,700/-. The Assessing Officer also invoked the

provisions of Section 115JB of the Act and assessed the assessee on book profits at Rs.8,16,66,340/- without giving the benefit of indexation on the cost of capital asset sold during the year. Being aggrieved, the assessee filed an appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) by an order dated 05.10.2009 inter alia held that there is a close nexus between the interest earned on the fixed deposits and the interest paid to the lenders and the creditors. It was further held that interest received on fixed deposits is not taxable as income from other sources on the principles of diversion by overriding title. Accordingly, the Commissioner of Income Tax (Appeals) allowed the appeal of the assessee with regard to claim of deduction under Section 57 of the Act for an amount of Rs.12,80,461/-. The revenue preferred an appeal before the Income Tax Appellate Tribunal. The Tribunal vide order dated 08.02.2011 inter alia held that there is no nexus

between the interest, income and expenses and the appeal preferred by the revenue was allowed.

6. I.T.A.No.32/2012 pertains to Assessment year 2006-07. The assessee filed the return of income for the assessment year 2006-07 by declaring total income of Rs.10,38,360/-. The Assessing Officer by an order dated 31.12.2008 determined the total income of the assessee at Rs.60,22,614/- by making a disallowance of expenses against interest income of Rs.49,84,256/- being interest paid to the financial institutions. The Commissioner of Income Tax (Appeals) by an order dated 26.08.2010 allowed the appeal preferred by the assessee. However, the Tribunal by an order dated 27.09.2011 by following its earlier order in case of the assessee for the Assessment year 2005-06 allowed the appeal filed by the revenue. In the aforesaid factual background, the assessee has filed these appeals.

7. Learned Senior counsel for the assessee submitted that the assessee acted as a conduit and was formed with the sole purpose of restructuring the Kirloskar Electric Company under a scheme approved by this court and the interest of Rs.12,80,461/- was paid to the term lenders and creditors. It is argued that Assessing Officer erred in disallowing interest on the ground that interest payments had not been debited to the profit and loss account and there is no direct nexus between the interest paid to term lenders and the interest earned from other sources. It is further submitted that the interest income accrued from the monies kept in the fixed deposits and nexus between the deposit, interest earned and interest paid was directly established as company did not have any other activity in the previous year. It is further submitted that the Tribunal erred in not discussing the finding recorded by the Commissioner of Income Tax (Appeals) that, the interest is not taxable on the principles of diversion of

overriding title. In this connection, our attention has been invited to Section 57(iii) of the Act and it is submitted that interest of Rs.12,80,461/- paid to term lenders and creditors is an allowable expenditure as per Section 57 of the Act.

8. It is urged that difference between sale consideration and the indexed cost of acquisition represents the actual income of the assessee, which is taxable under Section 45 of the Act as provided under Section 112 of the Act and there is no provision of the Act which prevents the assessee from claiming the indexed cost of acquisition on sale of asset in a case where the assessee is subjected to provisions of Section 115JB of the Act. It is argued that in view of Section 115JB(5) of the Act, the indexed cost of acquisition has to be considered for the purpose of computation of book profit under Section 115JB of the Act as all other provisions of the Act apply. It is also argued that Section 115JB of the Act is not applicable in the fact situation of

the case as the assessee does not have book profits and has also not declared any dividends. Our attention has also been invited to Circular No.762 dated 11.02.1998 issued by Central Board of Direct Taxes and it is pointed out that Circular issued by the Central Board of Direct Taxes is binding on the authorities. It is also urged that the Tribunal ought to have followed the precedents including its own order and has failed to appreciate the decision of coordinate bench of this court in **'MSR & SONS INVESTMENT LTD.** in I.T.A.No.769/2000 decided on 14.09.2011. In support of aforesaid submissions, reliance has been placed on decisions in **'COMMISSIONER OF INCOME TAX VS. SHOORJI VALLABH DAS AND CO.'**, (1962) 46 ITR 144 (SC), **'SETH R. DALMIA VS. COMMISSIONER OF INCOME TAX'**, (1977) 110 ITR 644 (SC), **'COMMISSIONER OF INCOME TAX VS. RAJENDRA PRASAD MOODY'**, (1978) 115 ITR 519, order of the Income Tax Appellate Tribunal dated 20.05.2005 passed in **'MSR &**

SONS INVESTMENTS LTD. VS. DEPUTY COMMISSIONER OF INCOME TAX', 'COMMISSIONER OF INCOME TAX VS. LAKSHMI MACHINE WORKS', (2007) 290 ITR 667 (SC), 'Togars COOPERATIVE SALE SOCIETY LTD. VS. INCOME TAX OFFICER', (2015) 231 TAXMANN 794 (KARNATAKA), 'VODAFONE SOUTH LTD. VS. COMMISSIONER OF INCOME TAX', (2015) 378 ITR 410, 'KARNATAKA INSTRADE CORPORATION LTD., VS. ASSISTANT COMMISSIONER OF INCOME TAX', (2015) 235 TAXMANN 374 (KARNATAKA), 'RAJESHWARI COTTON AND GINNING AND PRESSING INDUSTRIES VS. ASSISTANT COMMISSIONER OF INCOME TAX', (2016) 284 CTR 300 (KARNATAKA) 'SRI.HARI RAM HOTELS (P) LTD. VS. COMMISSIONER OF INCOME TAX-III', (2016) 237 TAXMANN 564 (KARNATAKA), 'KARNATAKA STATE INDUSTRY INFRASTRUCTURE DEVELOPMENT CORPORATION LTD., VS. DEPUTY

COMMISSIONER OF INCOME TAX', (2017) 54 ITR (T) 425, 'MICRO INKS LTD. VS. PRINCIPAL COMMISSIONER OF INCOME TAX', (2018) 407 ITR 681, and 'COMMISSIONER OF INCOME TAX-III CHENNAI VS. METAL AND CHROMIUM PLATER (P) LTD.', (2019) 415 ITR 123.

9. Learned counsel for the revenue On the other hand, submitted that there is no whisper in the orders passed by the authorities as to how the scheme was framed. It is further submitted that in the absence of the scheme, it cannot be held that the assessee was holding funds as conduit. Therefore, the matter deserves to be remitted to the Income Tax Appellate Tribunal for decision afresh. It is fairly submitted by learned counsel for the revenue that the principles with regard to Section 57(iii) laid down in various decisions are not disputed. However, the assessee is not entitled to benefit of Section 57(iii) of the Act in the facts of the case and the assessee has rightly been taxed under Section 56 of the

Act. It is also submitted that there is no finding that the source of deposits in the hands of assessee is the scheme framed by this court and no nexus has been proved between the funds deposited in the fixed deposits and the amount payable to the lenders and the creditors. While referring to object of introduction of Section 115J, it is submitted that since the assessee is not excluded from the ambit of Section 115J(1), therefore, the submission of the assessee that Section 115JB is not applicable to the fact situation of the case cannot be accepted. It is further submitted that Section 115JA(4) and Section 115JB(5) deals with post determination of the profit under the Companies Act. It is further submitted that if the contention of the assessee that Section 115JB does not apply to the fact situation of the case is accepted, it will amount to rewriting the provision. In support of aforesaid submissions, reliance has been placed on decisions of Supreme Court in '**TUTICORIN ALKALI CHEMICALS &**

FERTILIZERS LTD. VS. COMMISSIONER OF INCOME-TAX', (1997) 93 TAXMAN 502 (SC), 'APOLLO TYRES LTD. VS. COMMISSIONER OF INCOME-TAX', (2002) 122 TAXMAN 562 (SC), 'JOINT COMMISSIONER OF INCOME-TAX VS. ROLTA INDIA LTD.,', (2011) 330 ITR 470 (SC) and decision of this court in 'M/S YOKOGAWA INDIA LTD. VS. THE DEPUTY COMMISSIONER OF INCOME-TAX, ITA NO.87/2012 DATED 04.06.2020.

10. We have considered the submissions made by learned counsel on both the sides and have perused the record. The Supreme Court in **SHOORJI VALLABH DAS AND CO.** supra held that income tax is a levy on income and a mere book keeping entry cannot be income unless income has actually resulted. In **LAKSHMI MACHINE WORKS** supra, it was held that tax under the Act is on the income, profits and gains and it is not a tax on gross

receipts. It has further been held that where a deduction is necessary in order to ascertain the profits and gains, such deductions should be allowed and profits should be computed after deducting the expenses incurred for business though such expenses may not be admissible expressly under the Act, unless such expenses are expressly disallowed by the Act. In **SETH M DALMIA** supra, the Supreme Court referred to with approval the decision of the Bombay High Court in '**COMMISSIONER OF INCOME TAX VS. H.H.MAHARANI VIJAYKUNVERBA SAHEB OF MORVI**', (1975) 100 ITR 67, wherein the Bombay High Court while dealing with Section 12(2) of the Act, held that deduction permissible under the aforesaid provision is an expenditure incurred solely for the purpose of making or earning the income, which has been subjected to tax and dominant

purpose of expenditure incurred must be to earn income. It was further held that expenditure and earning of income need not be direct and indirect connection could prove the nexus between the expenditure incurred and the income. It is pertinent to note that Section 57(iii) of the Act is paramateria provision. The Supreme Court in **RAJENDRA PRASAD MOODI** supra dealt with the scope of Section 57(iii) of the Act and held that Section 57(iii) requires that the expenditure must be made out or expended wholly and exclusively for the purpose of making or earning income and does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It was further held Section 57(iii) does not mandate that expenditure shall be deductible only if income is made or earned. In **METAL & CHROMIUM PLATER (P) LTD.** supra, High Court of Madras held

that decision of the Supreme Court in **APOLLO TYRES LTD.** supra was rendered in the context of Section 115J, which does not contain a provision analogous Sub-Section (4) of Section 115JA or (5) of Section 115JB of the Act. It was further held that provisions of Sub-Section 5 of Section 115JB opens the assessment of the application to all other provisions of the Act, except if specifically barred by that Section itself. The Income Tax Appellate Tribunal, Bangalore Bench in **KARNATAKA STATE INDUSTRIAL INFRASTRUCTURE DEVELOPMENT CORPORATION LTD.** supra took note of decision of the coordinate Bench in '**MSR & SONS INVESTMENT LTD. VS. DY. CIT**' wherein it was held that while computing capital gains the benefit of indexed cost of acquisition is to be considered for the purpose of computing tax liability under Section 115JB of the Act. It was further held that the

revenue challenged the aforesaid decision in an appeal before this Court and a division bench of this court vide order dated 14.09.2011 passed in ITA No.3189/2005 upheld the order of the Tribunal and followed the decision rendered in the case of MSR & Sons Investment Ltd.

11. In the backdrop of aforesaid well settled legal principles, we may advert to the factual matrix of the case. The Assessing Officer in its order dated 30.11.2007 has taken note of the fact that under a scheme of arrangement approved by this court, the assessee was utilized as a special purpose vehicle for the purpose of restructuring Kirloskar Electric Supply Company whereby surplus of non manufacturing and liquid asset including real estate at Bangalore, Pune etc. together with certain liabilities was transferred to the assessee. It has

further been noticed that lenders and banks are shareholders of the assessee and hold 88% of the equity. It was also held that assessee has taken over the loans of erstwhile company and the interest payable to the term lenders is part and parcel of the loan, which is outstanding. From perusal of paragraph 3 & 5 of the order passed by the Commissioner of Income Tax (Appeals), it is evident that the Commissioner of Income Tax (Appeals) has taken note of the scheme and has held that the assessee was utilized as a special purpose vehicle for the purposes of distribution of surplus, if any, after clearance of debts of Kirloskar Electric Company. It has further been held that since the process of settlement was continuing, the surplus was deposited as fixed deposit in the banks which earned interest of Rs.12,80,461/- and therefore, there is close nexus between the interest earned

and the fixed deposit, which is the amount representing the surplus of restructuring processes adopted as per the scheme of arrangement approved by this court. The aforesaid finding has not been set aside by the Tribunal.

12. Before proceeding further, it is apposite to take note of Section 57(iii) of the Act, which reads as under:

57. The income chargeable under the head "Income from other sources" shall be computed after making the following deductions namely:-

.....

(iii) 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."

Thus, from perusal of aforesaid provision, it is evident that the purpose of expenditure is relevant in determining the applicability of Section 57(iii) and the purpose must be making or earning of income. The assessee in order to cover the cost of interest payable to the creditors for the unpaid period, invested the surplus in fixed deposits and earned interest. The amount earned by way of interest was paid to the lenders and creditors. Thus, there is a nexus between the interest paid to the creditors on the unpaid balance and interest earned on the deposits. The interest expenditure was incurred wholly and exclusively for the purpose of earning the interest income and therefore, the assessee is entitled to deduction of the interest income under Section 57(iii) of the Act.

13. Section 115JB(5) of the Act reads as under:

“(5) Save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee being a company, mentioned in this Section.”

Thus, by virtue of sub-Section (5) of Section 115JB, the application of other provisions of the Act are open, except if specifically barred by the Section itself. The indexed cost of acquisition is a claim allowed by Section 48 of the Act to arrive at the income taxable under the income from capital gains. The difference between the sale consideration and indexed cost of acquisition represents the actual cost of the assessee, which is taxable as per Section 45 of the Act at the rates provided under Section 112 of the Act. There is no provision in the Act to prevent the assessee from claiming indexed cost of

acquisition on the sale of asset in case, where the assessee is subjected to Section 115JB of the Act. In any case, since, the indexed cost of acquisition is subjected to tax under a specific provision viz., Section 112 of the Act, therefore, the provisions of Section 115JB of the Act, which is a general provision cannot be made applicable to the case of the assessee. For yet another reason, the assessee has to be given the benefit of indexed cost of acquisition as considering the profits on sale of land without giving the benefit of indexed cost of acquisition results in taxing the income other than actual / real income. In other words, a mere book keeping entry cannot be treated as income.

14. It is pertinent to mention here that Central Board of Direct Taxes has issued a Circular

No.762 dated 11.02.1998, the relevant extract of which reads as under:

46.1 In recent times, the number of zero-tax companies and companies paying marginal tax has grown. Studies have shown that inspite of the fact companies have earned substantial book profits and have paid handsome dividends, no tax has been paid by them to the exchequer.

46.2 The Finance Act has inserted a new Section 115JA of the Income Tax Act, so as to levy a minimum tax on companies who are having book profits and paying dividends but are not paying any taxes.

15. It is pertinent to note that provisions of Section 115JB of the Act are not applicable as the assessee has not declared any dividend. It is also noteworthy that the Tribunal has failed to appreciate the decision of this court in case of MSR & Sons

Investment Ltd. supra where the order of the Tribunal was upheld by which the Tribunal has held that if dividends are not paid by the company the provisions of book profit are not attracted. The assessee had not paid the dividends. The profit itself was not attracted and the question of applicability of Section 115JB did not arise. However, the Tribunal failed to consider the decision of this court while passing the impugned order.

16. The submission made by learned counsel for the revenue in the light of decision rendered in the case of Apollo Tyres supra does not deserve acceptance as Section 115J with which the aforesaid decision deals does not contain a provision like Sub-Section (4) of Section 115JA or Sub-Section (5) of Section 115JB. Similarly, the submission made on behalf of the revenue that in the absence of the

scheme, it cannot be held that the assessee was holding the funds as conduit and therefore, the matter deserves to be remitted to the Income Tax Appellate Tribunal for decision afresh also does not deserve acceptance as in paragraph 10 of this order, this court has noticed that the Assessing Officer as well as the Commissioner of Income Tax (Appeals) has taken note of the scheme and has held that assessee was utilized as a special purpose vehicle for purposes of distribution of surplus, if any, after clearance of debts of Kirloskar Electric Company.

In view of preceding analysis, the substantial questions of law framed in both the appeals are answered in favour of the assessee and against the revenue. In the result, the orders passed by the Income Tax Appellate Tribunal to the extent it is

against the assessee are hereby quashed. In the result, the appeals are disposed of.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

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