

**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

**ITA No.687 of 2008 (O&M)
Date of decision: 17.2.2016**

The Commissioner of Income Tax, Patiala

.....Appellant

vs.

M/s Groz Beckert Asia Limited

.....Respondent

**CORAM: HON'BLE MR. JUSTICE AJAY KUMAR MITTAL
HON'BLE MRS. JUSTICE RAJ RAHUL GARG**

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not?
3. Whether the judgment should be reported in the Digest?

Present: Mr. Zora Singh Klar, Advocate for the appellant-revenue.

Mr. C.S.Aggarwal, Sr. Advocate with Ms. Rinku Dahiya,
Advocate for the respondent-assessee.

Ajay Kumar Mittal, J.

1. This order shall dispose of ITA Nos.702, 687 of 2008, 610 of 2010, 163 of 2012 and 198 and 18 of 2013 as learned counsel for the parties are agreed that the issues involved in all these appeals are similar. However, the facts are being extracted from ITA No.687 of 2008. This appeal has been preferred by the appellant-revenue under Section 260A of the Income Tax

Act, 1961 (in short, “the Act”) against the order dated 27.3.2008, Annexure A.3 passed by the Income Tax Appellate Tribunal, Chandigarh Bench 'A', Chandigarh in ITA No.808/Chandi/2007 for the assessment year 2004-05, claiming following substantial questions of law:-

“a) Whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹ 19,31,168/- on account of the expenditure incurred on foreign travel and local travelling of family members of MD/director and other employees especially when the assessee failed to prove that the expenditure in question was infact laid out wholly and exclusively for the purpose of business carried out by it?

b) Whether, on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹ 1,27,748/- on account of corporate membership fee paid to Golf Club as a capital expenditure?

c) Whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹ 17,70,003/- on account of lending loan out of business funds at a lower rate of interest i.e. @ 2% (while the assessee had borrowed funds at higher rate) to the President, Vice President and employees?

d) Whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹ 14,32,771/- on account of legal and professional expenses without appreciating that the assessee failed to produce any agreement relating to the assessment year under consideration?

e) Whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹

75,16,894/- on account of Information and Technology Expenses by holding that the expenditure incurred on foreign traveling was a revenue expenditure?

f) whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of ₹ 68,23,481/- on account of scrap sales ignoring the fact that according to the principle of accountancy the expenditure on that account having already been debited in the Trading/Manufacturing account could not be just written off by the assessee as damaged/obsolete stock without accounting for it at its scrap value?

g) Whether on the facts and in the circumstances of the case, the Tribunal was justified in upholding the order of the CIT(A) by following its own orders relating to earlier years ignoring the fact that the same have not yet attained finality as appeals against the followed orders are pending before the Hon'ble Punjab and Haryana High Court?

h) Whether on the facts and in the circumstances of the case, the Tribunal was justified in upholding the order of the CIT(A) ignoring the presumption of law that the AO was bound to take adverse inference for assessee's failure to produce evidence in support of its own claim for certain expenses and that the expenditure were wholly and exclusively laid out for the purpose of the business carried on by it?"

2. A few facts relevant for the decision of the controversy involved as narrated in ITA No.687 of 2008 may be noticed. The assessee, a manufacturer and dealer of hosiery needles filed its return of income on 28.10.2004 declaring loss of ₹ 1,82,10,801/-. The assessment under section 143(3) of the Act was completed on 28.12.2006 inter alia making the

following additions:-

- (i) Addition of ₹ 1,27,748/- on account of corporate membership fee paid to Golf Club. The Assessing Officer treated the same as capital expenditure being the expenses in personal nature of Managing Director and other employees of the company. Accordingly, disallowance of ₹ 1,27,748/- was made.
- (ii) Disallowance of ₹ 17,70,003/- under the provisions of section 36(1)(iii) of the Act. The Assessing Officer noticed that the said amount had been shown as loan and advances given to the President, Vice President and other employees of the company and the company had charged interest at the rate of 2% on these advances whereas the company paid higher rate of interest on borrowed funds. As the company utilized a part of borrowed funds for investment at lesser rate of interest, so the Assessing Officer disallowed notional interest on the amount of advances and made addition of ₹ 17,70,003/- under Section 36(1)(iii) of the Act.
- (iii) Disallowance of ₹ 19,31,168/- out of travelling expenses. The Assessing Officer found that the assessee company had claimed travelling expenses of ₹ 57,93,504/- which also included expenses in respect of foreign as well as local travel. The Assessing Officer made total disallowance of ₹ 19,31,168/- being 1/3rd of the total expenses claimed. The disallowance out of foreign travel expenses had been made by the Assessing Officer on the plea that the assessee company had provided liquor and food etc. to the directors/employees who had not attended any conference on the dates mentioned in the vouchers whereas out of local travel expenses, the expenses which were not incidental to the business and could not be said to be expenditure incurred wholly and exclusively for

business purpose were disallowed.

(iv) The assessee claimed expenses under the head “Legal and Professional expenses” amounting to ₹ 14,32,771/- as against the expenses claimed in the immediate preceding year at ₹ 20,54,519/-. The assessee claimed that the expenses had been incurred in connection with hiring of professional services relating to SAP software and duty drawback scheme and claimed as revenue. The Assessing Officer treated these expenses as capital expenditure and made disallowance of ₹ 14,32,771/-. The Assessee claimed expenses under the head “Information Technology expenses” amounting to ₹ 75,16,894/- as revenue expenses. The Assessing Officer disallowed the claim by treating the expenses as capital expenditure on the plea that the expenses were not covered under section 37(1) of the Act.

(v) The assessee in its manufacturing and trading account for the assessment year 2004-05 debited an amount of ₹ 17,89,31,799/- under the head “Stores and Spare parts” as per details given under Schedule 17 of the Audit report. The assessee explained that the items of stores and spares which had become obsolete were identified on the basis of evaluation by the technical staff of the assessee and accordingly written off in the books of account. The Assessing Officer was not satisfied with the explanation and made an addition of ₹ 68,23,481/-.

3. Aggrieved by the order, the assessee filed appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. The CIT(A) partly allowed the appeal in the following terms:-

I) The addition of ₹ 1,27,748/- on account of corporate membership fee paid to Golf club was deleted treating it as revenue expenditure for the promotion of business.

II) Disallowance of ₹ 17,70,003/- under Section 36(1) (iii) of the Act was deleted on the plea that the advances had been made in the prior years and in those years, there was no finding that such advances were made out of borrowed funds and hence in the instant year, no such disallowance was permissible to be made.

III) Out of total disallowance of ₹ 19,31,168/- on account of travelling expenses, the CIT(A) sustained the disallowance equal to 25% of the total disallowance and allowed relief of ₹ 14,48,376/-.

IV) Disallowance on account of Legal and professional expenses amounting to ₹ 14,32,771/- was deleted by the CIT(A) following its own order in the previous assessment year in the assessee's own case.

V) Disallowance on account of Information Technology expenses amounting to ₹ 75,16,894/- was deleted by the CIT(A) following its own order in the previous assessment year in the assessee's own case.

VI) Addition/disallowance of ₹ 68,23,468/- on account of scrap sales was reduced by the CIT(A) to ₹ 37,33,282/- with the observation that the obsolete items of stock could at best be valued at 50% of their book value of ₹ 74,66,564/-. The CIT(A) also directed the Assessing Officer that he should have taken it as value of closing stock of stores and spares and not under the head scrap.

4. Not satisfied with the order, the revenue as well as the assessee preferred appeals before the Tribunal. The Tribunal vide order dated

27.3.2008, Annexure A.3 allowed the appeal of the assessee in respect of

the issues relating to disallowance out of travelling expenses and on account of scrap sales whereas dismissed the appeal of the revenue in toto in respect of all the issues. Hence the instant appeals by the revenue.

5. We have heard learned counsel for the parties.

6. After considering the entire material on record, findings have been recorded by the authorities below on each issue which are as under:-

(i) Disallowance of ₹14,32,771/- incurred on Legal and Professional expenses

The Assessing Officer made ad hoc disallowance of ₹ 14,32,771/- out of the expenses under the head “legal and professional charges” treating the same to be capital in nature. Similar disallowance was made by the Assessing Officer during the assessment year 2003-04 but was deleted by the CIT(A). It was observed by the Assessing Officer that since the appeal of the department against the order of the CIT(A) was pending in the Tribunal, the impugned disallowance was made. The relevant observations of the Tribunal read thus:-

“11. We find that the Tribunal in the assessment year 2003-04 (supra) has affirmed the decision of the CIT(A) by making the following discussion:-

“16. It is observed from the assessment order that Assessing Officer has made a disallowance on the ground that the expenditure incurred by the assessee with reference to SAP Software expenses as well as professional charges are in the nature of capital expenditure. The Commissioner of Income Tax (A) on perusal of the account of legal and professional expenses found that the expenditure related to the payment of professional charges for various services rendered. The Commissioner of Income Tax (A) has recorded a finding of

fact that expenses incurred by the assessee are on recurring basis and do not result in any benefit of enduring nature. The Commissioner of Income Tax (A) has further recorded that such expenses have been allowed in full in earlier years. The Commissioner of Income Tax (A) has further pointed out that the payments made to professionals for running of SAP software were not for acquisition of any hardware or software and therefore, the expenditure was of revenue nature and rightly allowed by CIT(A).

17. We have also gone through the details of legal and professional charges and find that no expenditure is relating to acquisition of any capital assets. We therefore, find no justification to interfere with the order of the Commissioner of Income Tax (A) in having deleted the disallowance.”

Respectfully following the above decision of the Tribunal in the assessee's own case for the assessment year 2003-04 (supra), we dismiss this ground of the appeal of the revenue.”

Learned counsel for the revenue could not demonstrate that the conclusion of the Tribunal was erroneous or perverse in any manner.

(ii) Disallowance of ₹ 75,16,894/- incurred on Information Technology expenses

7. The assessee claimed expenses under the head Information technology expenses as revenue expenses. The Assessing Officer disallowed the claim by treating the expenses as capital expenditure on the plea that the expenses were not covered under Section 37(1) of the Act. The Tribunal deleted the addition following its decision in the previous assessment year 2003-04 with the discussion as follows:-

“19. The facts relating to this ground of appeal are that the Assessing Officer had noticed information technology expenses of ₹ 1,10,12,932/- having been debited by the assessee as against a sum of ₹ 1,99,89,273/- in the preceding year. The

assessee had been asked to give the explanation about the nature of the expenditure. It was explained that the expenditure had been incurred on Annual Maintenance contracts for computer hardware/software, internet connectivity, purchase of software, consumable such as ink cartridges etc. The Assessing Officer made the disallowance on the ground that the entire expenditure incurred by the assessee was of enduring value which increases the efficiency of the business of the assessee and there, is of capital nature. He accordingly made the disallowance. The Commissioner of Income tax (A) has deleted the addition.

20. We find that similar disallowance was made for assessment year 2001-02 and the Tribunal vide para No.18 of its order (supra) upheld the order of the Commissioner of Income Tax (A) in deleting the disallowance.

21. It is found from the evidence on record that the expenditure relating to AMC of computer, hardware/software etc. has been incurred by the assessee for the running and maintenance of capital assets. Such an expenditure qualifies for deduction as a revenue expenditure. No expenditure has been incurred by the assessee for acquisition of any capital assets, nor is any expenditure incurred in connection with the acquisition of capital assets. We are, therefore, in agreement with the Commissioner of Income Tax (A) that the disallowance made by the Assessing Officer is not justified in so far as the entire expenditure is of revenue nature. We therefore, decline to interfere with the order of CIT(A). The ground of appeal raised by the revenue is accordingly dismissed.

Respectfully following the above decision of the Tribunal in the assessee's own case for the assessment year 2003-04 (supra), we dismiss this ground of appeal of the revenue.”

The approach of the Tribunal was not shown to be against the record warranting interference by this Court.

iii) disallowance of ₹ 68,23,481/- on account of scrap sales made by the Assessing Officer which was reduced to ₹ 37,33,282/- by CIT(A) on account of write down of stock of store and spares.

8. Disallowance of ₹ 68,23,468/-on account of scrap sales was reduced by the CIT(A) to ₹ 37,33,282/- with the observation that the obsolete items of stock could at best be valued at 50% of their book value of ₹ 74,66,564/-. The Assessing Officer was also directed that he should have taken it as value of closing stock of stores and spares and not under the head scrap. The Tribunal accepted the claim of the assessee on this issue. The relevant findings recorded by the Tribunal read thus:-

“15. Since the cross grounds relate to the same issue, the two are considered and disposed off together. The factual background is that the assessee had written off a sum of ₹ 74,66,564/- representing obsolete stock of stores and spares. On being asked to justify, the assessee explained before the Assessing Officer that the items of store and spares which had become obsolete, were identified on the basis of an evaluation by the technical staff of the assessee and accordingly written off in the books of account. The assessee further explained that it has a system of reviewing its inventory of stores and spares and other items from time to time and writing off the obsolete/damaged items. Particularly, it was pointed out by the assessee that similar query was made by the Assessing authority during the course of the assessment proceedings for the assessment years 2001-02, 2001-02 and 2003-04 and the then Assessing Officers were satisfied in as much no addition on this count has been made in the past. It was therefore submitted that the impugned write off does not call for any disallowance. The Assessing Officer however was not satisfied with the explanation offered and made an addition of ₹ 68,23,481/- by adopting a basis which can be understood as follows:-

scrap value of stock of stores and spares written off as obsolete at 50% of the value written off	₹ 37,33,282/-
0.5% of value of raw material consumed	₹ 9,33,847/-
2% of value of stores and spares consumed	₹ 27,88,762/-
2% of expenditure on repairs and maintenance	₹ 3,30,404/-
Less value of scrap sales booked by the Assessing company (as per Schedule 15 of the audited accounts)	₹ 9,62,814/-
Addition made by the learned Assessing Officer	₹ 68,23,481/-

16. The addition has since been scaled down by the CIT(A) to ₹ 37,33,382/-. According to the CIT(A) the obsolete items of stock can at best be valued at 50% of their book values and therefore, he has estimated the value of obsolete stock at ₹ 37,33,282/-, thus resulting in an addition of said amount to the total income of the assessee. The revenue is in appeal against the relief allowed by the CIT(A) whereas the assessee is in appeal against the part sustenance of the addition by the CIT(A).

17. Before us, the counsel of the assessee submitted that the addition partly sustained by the CIT(Appeals) also deserves to be deleted. Learned counsel pointed out that in the past, there was no such disallowance made by the Assessing Officer although the assessee has been following the consistent policy of identifying its obsolete/damaged stock of stores and spares on the basis of technical evaluations by the company personnel. That in any case, no infirmity has been found by either of the lower authorities with the claim of the assessee, in principle. It was pointed out that the CIT(Appeals) has merely substituted his own estimation in preference to the stand of the assessee that the obsolete stocks do not have any value. Learned counsel pointed out that in case the assessee recovers any amount subsequently with respect to such items of stores and spares, the same would be includible in the income of the assessee and therefore there is no justification for the adhoc disallowance made by the lower

authorities.

18. On the other hand, the learned DR has defended the order of the Assessing Officer. According to the learned DR, the Assessing Officer has pointed out that the amount written off by the assessee as damaged/obsolete stocks was not accounted for by the assessee in the scrap account and therefore the policy of the assessee was wrong. The learned DR therefore submitted that the claim of the assessee was unjustified.

19. We have considered the rival submissions carefully. At the outset, we may observe that the assessee pleaded before the Assessing Officer as well as before the CIT(Appeals) that the claim in question was not peculiar to the year under consideration. Infact the assessee pointed out that it has a policy of identifying obsolete/damaged items of the stock of stores and spares. Such identification was done by the technical staff of the assessee company. Such items of stores and spares are written off in the accounts from time to time. It was further pointed out, as evident from para 7 of the assessment order that similar queries were raised by the Assessing Officer for the earlier assessment years. No such disallowance has been made in the past. To these pleadings of the assessee there is no negation at any stage. Even before us it is not the stand of the revenue that the claim of the assessee in this year is not in line with the claims made in the earlier years. Therefore, on the rule of consistency itself, we do not find any justification in the stand of the revenue to make any disallowance in this year. More so, when no factual difference or change in law has been brought on record by the income tax authorities. Although each assessment year is an independent year, yet an issue of principle which permeates during the different assessment years has been decided one way or the other and the parties have allowed that position to be sustained then it would be unjustified for the revenue to turn around and take a different view subsequently and that too without bringing on record any material difference. The aforesaid proposition is well

supported by the judgment of the Hon'ble Supreme Court in the case of *Radhasoami Satsang Vs. CIT*, 193 ITR 321. On this count itself, in our considered opinion, the said addition made by the Assessing Officer deserves to be deleted. In any case, if the claim of the assessee is examined, it reveals that the write off of the stocks have been carried out on account of obsolescence/damage. The CIT(Appeals) in the course of proceedings before him made further verification and examined the claims of the assessee made in the earlier assessment years. We find that without pointing out any infirmity in the decision of the assessee to write off the impugned stocks, the CIT(Appeals) on the other hand, had made a subjective decision by estimating value of the stock at 50%. We find no reasons attributed by the CIT(Appeals) for such proposition. In the scenario of the assessee having followed a consistent policy and which was accepted by the revenue in the past, the onus was clearly on the revenue to establish that the system followed by the assessee did not result in showing of true and proper income. We find that such onus has not been discharged by the revenue in the present issue. Therefore, no addition is warranted on this count. In the result, we allow the ground of appeal of the assessee and dismiss the ground preferred by the revenue in relation to the relief allowed by the CIT(Appeals).”

The findings recorded by the Tribunal are in conformity with the record and are thus upheld.

(iv) Addition of ₹ 1,27,748/- on account of Corporate membership fee of Golf Club, Chandigarh

9. The assessee paid an amount of ₹ 1,27,748/- in respect of corporate membership fee to Golf Club. The Assessing Officer treated the same as capital expenditure being the expenses in personal nature of Managing Director and other employees of the company. Accordingly

disallowance of ₹ 1,27,748/- was made. The CIT(A) deleted the disallowance treating it as revenue expenditure for the promotion of business, which was upheld by the Tribunal. The issue is covered by the decision of this Court in the case of the assessee in this case itself where the matter was referred to the Full Bench on this issue in *The Commissioner of Income tax, Patiala vs. M/s Groz Bockert Asia Limited*, (2013) 351 ITR 196 (FB), wherein after considering the relevant case law, it was held as under:-

“16. In the present case, the nature of the expenditure incurred by the assessee cannot be said to be a capital expenditure. The second test culled down in Assam Bengal Cement Co. Ltd.'s case (supra) is that expenditure should bring into existence an asset or an advantage for the enduring benefit of a trade. In the present case, the corporate membership of Rs.6 lacs was for a limited period of 5 years. The corporate membership was obtained for running the business with a view to produce profit. Such membership does not bring into existence an asset or an advantage for the enduring benefit of the business. It is an expenditure incurred for the period of membership and is not long lasting. By subscribing to the membership of a club, no capital asset is created or comes into existence. By such membership, a privilege to use facilities of a club alone, are conferred on the assessee and that too for a limited period. Such expenses are for running the business with a view to produce the benefits to the assessee. Consequently, it cannot be treated as capital asset. Therefore, the reasoning given by Delhi, Bombay and Gujarat High Courts in respect of members of Clubs is based upon correct enunciations of the principles of law as delineated above in the judgments of the Supreme Court.

17. In view of the above, we find that the judgment of this Court in M/s Majestic Auto Limited's case (supra) is not a

correct interpretation of expression "capital expenditure".
Consequently, the said judgment is overruled.”

(v) Disallowance of ₹ 17,70,003/- under section 36(1)(iii) of the Act on account of notional interest on the loans given to its employees/directors.

10. The assessee had advanced loans to its employees at a concessional rate of interest which was lower than the rate at which the assessee was borrowing funds from the banks. The Assessing Officer made disallowance of ₹ 17,70,003/- on the ground that part of the interest bearing funds borrowed by the assessee was not utilized by the assessee for the purpose of its business since advances made to the employees were at nil/concessional rate of interest. Similar disallowance was made in the assessment year 2001-02 which was deleted by the CIT(A) and upheld by the Tribunal. The Tribunal adopted the same view in respect of the assessment year in question. The operative portion of the order of the Tribunal for the assessment year 2001-02 is reproduced as under:-

“On this issue we have considered the rival submissions. Section 36(1)(iii) permits deduction for interest expenditure if the borrowed funds are utilized for the purpose of business. In the instant case the assessee has raised borrowings from bank on which it was paying interest. On the other hand the assessee had advanced loans to its executives and employees which carried interest lower than the interest charged by the Bank on the amounts lent to the assessee. According to the Assessing Officer, the assessee had diverted its interest bearing funds for purposes other than business. In our view the practice of advancing loans to the employees cannot be construed as diversion of funds for non business purpose. The grant of such facilities to the employees is part and parcel of the carrying on of business

operations of an assessee. The business activities of an organization cannot be viewed as confined to its activity of selling the final product. A host of activities which go to supplement the main activity of an organization are also activities which are construed as incidental to the carrying on of business. For instance, activity of accounting, recording of transactions etc. are not the front line activities of an organization but are certainly activities carried out in furtherance of main business objectives. It cannot be said that expenditure incurred on such activities are for non business purposes in the instant case the impugned expenditure, though notional, has been incurred by the assessee to retain and motivate its executives and employees who are engaged in various activities of the assessee company. The expenditure is liable to be viewed as having been incurred in the course of activities which are incidental to the carrying on of business by the assessee. The purpose of the expenditure therefore cannot be construed as non business. In the result, in our view, the expenditure can be said to have been incurred wholly and exclusively for the purposes of business. Under such circumstances invoking of section 36(1) (iii) by the Assessing Officer was misplaced. Therefore, we sustain the conclusion of the CIT(Appeals) in deleting the addition albeit on a different ground. We also find that the reasoning which prevailed with the CIT(Appeals) to delete the addition is supported by the judgment of the Hon'ble Karnataka High Court in the case of *Sridev Enterprises* (supra). On this basis too, the order of the CIT(Appeals) deserves to be upheld. We hold so. On this ground, thus, the revenue fails.”

The findings recorded could not be shown to be result of any misreading or mis-appreciation of material on record on the basis of which it could be urged that the same were unsustainable.

(vi) Addition of ₹ 19,31,168/- on account of travelling expenses etc.

11. The assessee had claimed travelling expenses of ₹ 57,93,504/- which included directors' traveling expenses of ₹ 7,95,774/- as against ₹ 48.70 of the last year. On verification it was found that there was no supporting evidence that the directors/employees had attended conferences abroad. The Assessing Officer held that in the absence of complete detail of the expenditure of the family members and also for want of supporting evidence from the respective quarters, disallowance of ₹ 19,31,168/- being 1/3rd of ₹ 57,93,504/- under this head was made to the returned income of the assessee. The CIT(A) sustained an addition of ₹ 4,82,792/- on ad hoc basis out of traveling expenses of ₹ 19,31,168/- disallowed by the Assessing Officer on ad hoc basis. The Tribunal following its decision in the earlier assessment years i.e. 2001-02 and 2003-04 in the assessee's own case deleted the entire addition.

12. The findings recorded by the Tribunal are based on appreciation of entire material and evidence on record. Learned counsel for the revenue has not been able to show any error in the said findings. The substantial questions of law are, thus, answered accordingly. The appeals stand dismissed.

(Ajay Kumar Mittal)
Judge

February 17, 2016
'gs'

(Raj Rahul Garg)
Judge