

IN THE INCOME TAX APPELLATE TRIBUNAL
AMRITSAR BENCH; AMRITSAR
BEFORE SH. A.D.JAIN, JUDICIAL MEMBER AND
SH. T.S. KAPOOR, ACCOUNTANT MEMBER

I.T.A No.476(Asr)/2008
Assessment Year: 2005-06

Dy. CIT,
Range-III, Jalandhar.

Vs. M/s Sarup Tanneries Ltd.
P.O. Ramdaspora, Jalandhar.
PAN:

(Appellant)

(Respondent)

Appellant by: Sh. Bhawani Shankar (DR.)
Respondent by: Sh. Y.K. Sud. (CA.)

Date of hearing: 30.06.2016
Date of pronouncement: 10.08.2016

ORDER

PER T. S. KAPOOR (AM):

This is an appeal filed by Revenue against the order of learned CIT(A), Jalandhar, dated 24.07.2008 for Asst. Year:2005-06.

2. The Revenue has taken the following grounds of appeal.

“1. That on the facts and in the circumstances of the case the learned Commissioner of Income Tax (Appeals) has erred in deleting the addition of Rs.3,86,63,896/- made by the A.O by disallowing loss claimed as amount written off due from subsidiary company.

2. That on the facts and in the circumstances of the case the learned Commissioner of Income Tax (Appeals) has erred in deleting the disallowance of Rs.86,183/- made out of foreign traveling expenses and Rs.1,00,000/- out of car expenses.

3. That on the facts and in the circumstances of the case the learned Commissioner of Income Tax (Appeals) has erred in allowing the assessee to carry forward a loss of Rs.8,76,277/-.

4. It is prayed that the order of the learned Commissioner of Income Tax (Appeals) be set-aside and that of the Assessing Officer restored.”

3. At the outset, the learned AR submitted that the appeal of Revenue was earlier disposed off by the Hon'ble Tribunal vide order dated 23rd

January, 2009 wherein the Hon'ble Tribunal had partly allowed the appeal of Revenue by reversing the order of learned CIT(A) which the Revenue had raised ground Nos. 1 & 3 of its appeal. The learned AR further submitted that the assessee filed Miscellaneous Application and the Tribunal recalled partially the above order by holding that the Tribunal had omitted to consider the Hon'ble Supreme Court Judgment in the case of *Amalgamations Pvt. Ltd vs. CIT (1969)226 ITR 188(SC)*. It was submitted that in the mean time assessee had approached the Hon'ble Punjab & Haryana High Court and the Hon'ble Punjab & Haryana High Court after noting down the entire facts had restored the issue back to the Office of Tribunal to decide the issues afresh and therefore, parties are before this Tribunal.

4. As regards merits of the case, the learned AR heavily placed his reliance on the order of learned CIT(A) and also relied on the judgments listed in the Paper Book at page 1 to 48.

5. The learned DR, on the other hand, heavily placed his reliance on the order of Assessing Officer.

6. We have heard the rival parties and have gone through the material placed on record. We find that that assessee derives its income from manufacture and sale of leather goods, Shoe upper, soles etc. During the assessment proceedings for the year under consideration the

Assessing Officer observed that assessee had debited in its P&L Account an amount of Rs.3,86,63,836/- on account of loss due to irrecoverability of amount due from its subsidiary company in U.S.A. The assessee had issued standby letter of guarantee on behalf of its subsidiary in U.S.A which the lenders had invoked and assessee company had to pay the guaranteed amount and therefore the amount had become recoverable from its subsidiary but which the subsidiary could not pay and therefore, the assessee had written it off in its P&L Account. The Assessing Officer also observed that assessee had claimed carry forward of capital loss of Rs.8,76,277/- on account of loss of share capital investment in its subsidiary company in U.S.A. The Assessing Officer held that such losses claimed by assessee were not related to the business of assessee and therefore, were not allowable and therefore, he made an addition of amounts represented by such amounts and did not allow carry forward of capital loss. On appeal before learned CIT(A), the learned CIT(A) deleted these additions along with other additions.

7. On further appeal filed by the Revenue before the Hon'ble Tribunal, the Hon'ble Tribunal partly allowed the appeal of Revenue. The assessee filed Miscellaneous Application against the order dated 23.1.2009 passed by the Hon'ble Tribunal and the ITAT in its order in M.A. No.46(Asr)/2009 vide order dated 30th June, 2010 partially recalled its earlier order but did not adjudicate on the issue after the recall. The

Hon'ble Tribunal had recalled the issue of allowability of amount which the assessee had debited in its P&L Account. However, the Hon'ble Tribunal had dismissed the other issue raised in Misc. Application relating to carry forward of capital loss. In the mean time the assessee had approached the Hon'ble Punjab & Haryana High Court and the Hon'ble Punjab & Haryana High Court noting down all the material facts restored the matter back to the office of Tribunal and directed the Tribunal to adjudicate the issues pending before it. The operative part of the Hon'ble Court is reproduced below.

"3. It was pointed out by learned counsel for the parties that an application under Section 254(2) of the Act bearing MA No.46(Asr)2009 was filed by the assessee. The tribunal vide order dated 30.6.2010 corrected the mistake on account of not having noticed the judgment of the Supreme Court in CIT vs. M/s Amalgamations Private Limited (1997) 226 ITR 188. It was observed by the Tribunal that the applicability of the aforesaid decision cannot be adjudicate under the provisions of Section 254(2) of the Act as it is covered under Section 254(1) of the Act. The said application was, thus, partly allowed by recalling its earlier order on this aspect. Thereafter, revenue also filed MA No.12(ASr)/201 under Section 254(2) of the Act against the order dated 30.6.2010 which was dismissed by the Tribunal vide order dated 19.11.2012. The revenue filed appeal bearing ITA No.53 of 2013 assailing the said order which was dismissed by this Court on 9.4.2015 with the following observations:-

"3. The appellant filed M.A. NO.12(Asr)/2011 under Section 254(2) of the Act against the order dated 30.06.2010 which was dismissed by the impugned order and judgment dated 19.11.2012. In view of what we have mentioned earlier, the appellant is in any event not without a remedy. However, this order in an application under Section 254(2) is not appealable.

4. Needless to add that the decision in ITA-472-2009, if decided before the Tribunal decisions the matter under Section 254(1), would have its own effect."

4. Learned counsel for the revenue produced the record of ITA No.54 of 2013 for the perusal of the Court.

5. *It was further submitted by learned counsel for the parties that the Tribunal after partially recalling its order dated 23.1.2009 which has been impugned in this appeal had kept the matter pending regarding admissibility of the deduction.*

6. *It was prayed by learned counsel for the parties that in view of the subsequent developments that have taken place after the filing of the appeal, the present appeal be disposed of by directing the Tribunal to adjudicate the issue pending before it in accordance with law without being influenced by any findings or observation noticed by the Tribunal in its earlier order dated 23.1.2009 in that regard. Order accordingly.*

7. *The appeal stands disposed of in the manner indicated above.”*

Therefore, in view of the above findings of Hon’ble Court, we have again heard the parties on the issue pending before it and have gone through the material placed on record. In view of the Hon’ble Courts order we have to decide on the following issue only.

Whether learned CIT(A) has rightly allowed relief to the assessee by deleting the addition of rs,3,86,63,836/-.

We find that assessee company opened its wholly owned subsidiary in the name of Sarup Footwear Assembly Corporation in USA for manufacturing and sale of footwears which is the main business of the company. It stood guarantee for the working capital of the subsidiary company to the extent of Rs.3,86,63,836/-. The subsidiary company due to the circumstances beyond its control had to close down its business and went sick and therefore, the share capital invested by assessee company got vanished and the guarantee given by the assessee which was invoked was not recoverable from subsidiary company and therefore, assessee wrote off the said amount in P&L Accounts.

8. As regards loss of capital to the tune of Rs.8,76,277/- the assessee claimed it as capital loss and carried forward to next year. The Assessing Officer disallowed the claim of loss claimed in P&L Accounts by holding that loss did not arise from normal course of business of assessee and for the same reason it did not allow carry forward of capital loss. However, on appeal before learned CIT(A), he allowed relief on both issues by holding as under:

"I have carefully considered the submissions of the appellant. I have gone through the findings of the AO as incorporated in the order. I have also seen the report of the AO along with the rejoinder filed by the appellant. As seen from the order, the AO did not allow the claim of Rs.3.86 crores on account of loss due to irrecoverability of direct loan and also loan amount for the execution of stand by letter of credit paid to the WOS [Wholly Owned Subsidiary] Co. in the USA. It was not treated as trading loss as AO held that granting loan to its subsidiary or standing guarantee for any company including its subsidiary is not the business of the appellant company. The AO did not find any merits in the case laws cited by the appellant and AO in turn by placing reliance on certain case laws as mentioned in the order, did not allow the said debit on account of direct loan to subsidiary and also the loan amount paid for execution of stand by letter of credit claimed by the appellant. The case of the appellant on the other hand is as per written submissions there is no dispute about the fact that the amount have been written off by the appellant after closure of the WOS in USA during the relevant year. The appellant company is in the business of exporting shoes to USA after manufacturing in India and in order to expand its business it established a wholly owned subsidiary company under the name and style of Sarup Footwear Assembly Corpn in the year 1999. The appellant representing the holding company, the investment in the shape of share capital and loans and advances became the liability of the holding company. In the return furnished by the appellant to the Registrar of Company in accordance with the provisions of Companies Act, the financial affairs of the subsidiary company were reflected in the balance sheet of the appellant. The AO held that it was not the business of the appellant but while holding so the Id. AO has simply gone by the main objects as appearing in the memorandum of association [MOA Sr. No. III (A)] and in the process ignored the objects incidental of the main objects which cover the

issue .under dispute as enumerated in clause B of the MOA. There is no denial of the fact that factum of existence and incurring of expenditure for the WOS was not in doubt or dispute along with other facts i e. closure of business activities by the WOS by the end of financial year 2001-02 and the actual dates /period of payment made to the WOS or for execution of stand by letter of credit^ These facts, therefore, reveals that the advancing of loan and to stand surety for the WOS is a statutory obligation under the Companies Act. The Id. AO have not allowed the claim of the appellant by mentioning in para 5 that it is not incidental to its business and while holding so no dispute was raised of its being, in the nature of trading loss or a capital loss. It was also not the findings that the funds leant to subsidiary company were used for non business purposes. Therefore, it is to be seen whether the transactions were incidental to the business of the appellant and whether the same had any element of commercial expediency. No doubt in view of the MOA and its relevant clauses 9 and 19. the transactions with the WOS were connected with the business of the appellant and in this regard the findings of the AO can not be sustained. As per the provisions of Companies Act u/s 4 (1) and 4(3) dealing with holding and subsidiary company the Id. AO failed to appreciate that it was a WOS and. therefore, all the investments whether in the equities or by way of loans were to flow from the holding company. In a recent decision the Hon'ble Apex Court in the case of SA Builders Vs. CIT reported at (2007) 288 ITR 1 have held that "loan to a sister company which in this case was a WOS, is one which should be treated as prompted by commercial expediency." While holding so, it was the ruling that the transaction prompted by commercial expediency the claim arising therefrom was even other allowable. The Hon'ble Apex Court- reversed the decision of Hon'ble Bombay High Court in the case of Phaltan Sugar Mills Ltd Vs. CWT 208 ITR 989 and up held the view of the HOn'ble Tribunal in that case wherein it was held that the amount borrowed and utilized by the subsidiary company the amounts in question can be said to have been borrowed by the appellant company for the purposes of its business. It also endorsed the decision of Hon'ble Delhi High Court in the case of CIT Vs. Dalmya Cement Ltd cited as 254 ITR 377. Thus from the relevant decision the special relationship between the holding and subsidiary company was recognized and it was held that the advances made by the holding company to the subsidiary company, being prompted by commercial expediency, fall within the ambit of section 37. I agree with the appellant that existence of the agreement was not material because the holding company stood guarantee for the arrangement of finance for the subsidiary company. The business consideration was in the nature of manufacturing of shoes for the customers of the appellant in the USA. Considering the facts of the case, the decision relied upon by the AO are on distinguishable facts than on the facts existing in the case of the appellant. In the case decided by Hon' ble Madras High court cited as 150

ITR 365 (Mad) which was relied upon by the AO therein it was held that giving of guarantee was neither part of the assessee's line of business nor was it closely inter linked with his business as financier. In that case the assessee was not taken to have given the guarantee in the course of his business and the deduction claimed was held not allowable as bad debt or business loss. But in the case of appellant, the money advanced to its subsidiary was for the purpose of the business and not like the facts in the quoted case wherein the money lent was not related to the business of the assessee. The AO has also placed reliance on the decision of Hon'ble Madras High Court in the case of Janki Ram (KS) Vs. CIT (1962) 45 ITR, 430 (Mad) and the said decision was followed by Hon'ble Madras High Court in the above case cited as 150 ITR 365 (Mad) [supra]. Since the decision in 150 ITR 365 was held not applicable to the facts in the case of appellant, therefore, the earlier decision reported at 45 ITR 430 and followed by the Hon'ble Madras High Court also can not be held applicable to the facts of the case. The AO has also referred to the decision of Hon'ble Calcutta High Court cited as 167 ITR 859 but in that case the decision was based on the facts that the furnishing of guarantee was not in the normal course of business of assessee or for any commercial consideration rather it resulted only in the nature of an accommodation provided to the debtor on extra commercial consideration. Thus the loss incurred in granting loan was held non deductible. It is a decision on its own facts and it does not become relevant to the facts as existing in the case of the appellant. The AO also placed reliance on the decision of Hon'ble Apex Court cited as 77 ITR 754 (SC). It was held therein that there was no material to establish that the managed company was under legal obligation to finance the selling agent or to guarantee of the loan advanced to the selling agent which indirectly facilitated the carrying on of assessee's business. But in the case of appellant the WOS was financed by the holding company for the purpose of business of the appellant. On the facts of the case the decision relied upon by the appellant of the Hon'ble Bombay High court in the case reported at (1980) 125 ITR 4&2 (Bom) becomes relevant wherein it was held that if the object of advancing of money was to provide finance for a company in which the assessee was substantially interested, the debt must be regarded as directly springing from its business activities and the connection could not be considered too remote for the purpose of allowance as a trading debt. It was held that test and the approach to be applied in this case must be that of a businessman. By paying regard to the economic realities which existed behind the legal facade the loss was held deductible as a trading loss in the cited case. In the other case decided by Hon'ble Bombay High Court cited as (1979) 119 ITR 38ff (Bom) the AO held the loan amount being advanced by the appellant company as a capital loss and was held not allowable as trading loss. But it was held therein that the loan-advanced by the assessee to its managing company was incidental to the carrying on of the business by the assessee company as managing agents and the managing company having gone into liquidation and advance

became irrecoverable the loss became trading loss which was eligible as deduction while computation the business income of the assessee company. In the case of appellant also the appellant was managing the affairs of the WOS by having the complete share holding of the WOS and the WOS having gone into loss as in the cited case, the said loss was eligible as trading loss. Therefore, considering the facts in the case of appellant, the claim made by the appellant also gets supported by the decision of Hon'ble Bombay High Court in the case cited as 74 1TR 78[*supra*]. No doubt the subsidiary company closed its business by the end of 2000-01 but the appellant chose to write off the amount as it got permission from the RBI to close down, its subsidiary on 16-6-2004 which is relevant to the year under consideration. The AO has placed reliance on the letter dated 6-10-2003 of the RBI which is mentioned in certain other letters of the RBI filed by the appellant before the AO dated 15-11-2003 and 13-4-2004 wherein the RBI desired from appellant to file various documentary evidence in support of its c 1 aim for approval of closure of WOS in USA. From the said letters which were subsequent to the letter dated 6-10-2003 of the RBI reflected in the order, it becomes clear that the RBI had not given the final approval but the AO while mentioning and relying on the said letter dated 6-10-2003 omitted to consider other letters. In fact the appellant finally got the approval for the closure on 16-6-2004 and the same falling in the relevant asstt year the claim was made. |After considering the decisions of Hon'ble Apex Court in the case cited as 53 1TR 114 rendered in the context of accrual of income and 53 TTR 1J34 (SC) where it was called upon to decide the question of incurring of liability and deduction thereof, the settled position of law which emerges is that in the case of an assessee following mercantile system of accounting a liability is said to be properly incurred when the dispute between the parties is immediately settled or finally adjudicated, where the liability in question is not a statutory liability. In the case of appellant also the^ matter came to be finally settled on receipt of approval of the RBI to close the WPS w.e.f. 16-6-2004. The final adjudication being falling in the relevant year the claim of the appellant thus becomes eligible for allowance. As gathered, it is not a case where the appellant has realized anything as realization amount of the assets of the WOS. The WOS being in losses the appellant had not charged any interest on the amount extended to it as the said amount was advanced towards the working capital requirements of the subsidiary to pay off its liability against expenses. Regarding the standby letter of credit which was given to the foreign bank to provide working capital finance to the WOS the same was revoked by the foreign bank as WOS was unable to pay its debt. The loss of the subsidiary, therefore, appeared in the annual return filed to the Registrar of Companies for the relevant period. Thus the financial affairs of the WOS were part of balance sheet of the appellant company. There were no contrary finding in the earlier year on this issue. Therefore, findings of the AO that the loss suffered does not directly emerge from the carrying on the business or profession of the appellant can not be sustained. .Accordingly, the/findings of the

AO in this regard are vacated and the grounds taken by the appellant are allowed.”

9. We find that Hon’ble Tribunal in its order dated 23.01.2009 reversed the findings of learned CIT(A) with respect to above two additions. However, the Hon’ble Tribunal vide order dated 30.06.2010 recalled the issue of claim of write off of Rs.3,86,63,836/-, whereas the issue of carry forward of capital loss was dismissed. The Hon’ble Tribunal while recalling the order to that extent had held that Tribunal while passing order dated 23.01.2009 omitted to take into account the order of Hon’ble Supreme Court in the case of *Amalgamations Pvt. Ltd vs. CIT (supra)*. The findings of the Tribunal as contained in para 7.4 are reproduced below.

“7.4. In the light of the above two decisions of the Hon’ble Supreme Court relied upon by the assessee, we are of the considered opinion that the latest decision of the Hon’ble Supreme Court, in the case of CIT Vs. Amalgamations Pvt. Ltd. (supra) was not considered by the Bench in the impugned appellate order. Thus, respectfully following the core ratio decidendi laid down by the Hon’ble Supreme Court, in the case of ACIT Vs. Saurashtra Kutch Stock Exchange Ltd. (2008) 305 ITR 227 (SC), we hold that non-consideration of the decision of the Hon’ble Supreme Court, in the case of CIT Vs. Amalgamations Pvt. Ltd. (supra), which deals with the issue of loss sustained, consequent upon standing guarantee to a subsidiary company constitutes mistake apparent from record. Consequently, the specific issue of claim of impugned loss raised in the impugned ‘Misc. Application’ is rectifiable mistake apparent from record, as contemplated u/s 254(2) of the Act., having regard to the decision of the Hon’ble Supreme Court, in the case of Asstt. Commissioner of Income Tax Vs. Saurashtra Kutch Stock Exchange Ltd. (supra). Thus, to this extent alone, the impugned appellate order of the Bench is rectified. It is made clear that the applicability or otherwise of the decision of the Hon’ble Supreme Court, in the case of CIT Vs. Amalgamations Pvt. Ltd.(supra), cannot be adjudicated under provisions of section 254(2) of the Act, as the same is covered under section 254(1) of the Act.”

10. We find that in the case of *Amalgamations Pvt. Ltd vs. CIT (1969) 226 ITR 188 (SC)*, the Hon'ble Apex Court has held that the nature of the business of assessee company included furnishing of guarantee to debts borrowed by subsidiary company and therefore, it was held that assessee company had incurred the loss in carrying on its own business which included furnishing of guarantees to debts borrowed by its subsidiary company. The relevant findings of Hon'ble Supreme Court as contained in para 8 & 9 are reproduced below.

*"The High Court has referred to its earlier judgment in **Amalgamations P. Ltd. vs. CIT (1969) 73 ITR 380 (Mad) : TC 24R.808**, wherein the nature of the business of the assessee-company has been considered and it has been held that the provisions of s. 23A of the 1922 Act were applicable to the assessee-company since the assessee-company's business includes furnishing guarantee to debts borrowed by subsidiary companies. The High Court has held that the said finding given in that case is clearly applicable to the questions under consideration before it and that the assessee-company had incurred the loss in carrying on its own business which includes furnishing guarantees to debts borrowed by its subsidiary companies. According to the High Court; the loss was allowable as a deduction in the year in which it came to be ascertained and in the instant case the High Court held that the assessee-company could have ascertained whether there was loss in the transaction of guarantee only at the stage of final payment by the liquidators which was received in the relevant previous year for the asst. yr. **i 962-63** and that the Tribunal was right in allowing it in that year. The judgment of the High Court does not suffer from any legal infirmity. **CIT vs. Amalgamation (P) Ltd. (1976) 108 ITR 895 (Mad) : TC 14R.884 affirmed."***
(Paras 8 & 9)

11. Now coming to the facts and circumstances of the present case, we find that assessee company set up a wholly owned subsidiary in U.S.A for the purpose of attainment of its main objects. The incidental objects as contained in Clause of memorandum of association states that the company in pursuance and development of its business can incorporate or promote any company or companies whether in India or elsewhere

which in the company or companies could or might directly or otherwise proved advantage to the assessee. Clause 9 of the incidental objects authorizes the assessee to lend as advance money with or without security. For the sake of convenience the objects Clause as contained in Clause 9 & 19 are reproduced below.

“(9) To lend and advance money, either with or without security and give credit to such persons (including Government) and upon such terms and conditions as the company may think fit in connection with its business.

(19) To form incorporate or promote any company or companies whether in India or elsewhere having amongst its or their objects the acquisition of all of the asset of the Company or for any other object' which in the opinion of the Company could or might directly or otherwise prove advantageous to the Company and to pay all or any of the costs and expenses indirectly assist the Company in the control or the development of its business and properties or incurred in connection with any such promotion incorporation and remunerate any person or company in any manner it shall think fit for services rendered or to be rendered to the company in or about the conduct of its business.”

12. Clause 9 of the objects incidental to main objects authorized the company to lend and advance money, either with or without security and give credit to such persons on such terms and conditions as the company may think fit in connection with its business. In the present case the assessee has not lent any money to its subsidiary company but had indirectly lent the money by executing standby letter of guarantee for the debts obtained by subsidiary company in U.S.A. In view of this enabling provision in the memorandum of association of company the assessee being holding company stood guarantee for the arrangement of finance for the subsidiary company. The lender invoked the said letter of

guarantee and assessee had to make payment for the same. The entire sequence of events resulted into indirectly lending to the subsidiary company which become irrecoverable due to losses of the said subsidiary and had to be written off in the P&L Account of assessee. Keeping in view the ratio of Hon'ble Supreme Court in the case of Amalgamations (P) Ltd. (supra) the said unrecovered amount from it's subsidiary is a loss incurred by assessee in carrying on it's own business. Therefore, the issue before us as raised by Revenue in ground No.1 is decided against Revenue and Ground No.1 of appeal is dismissed. None of the other grounds raised by Revenue were pending before the Tribunal as they had already reached their finality and hence cannot be adjudicated again Ground No.2 raised by Revenue has already been adjudicated by Hon'ble Tribunal vide its order dated 23.01.2009 and Hon'ble Tribunal had already dismissed it. Similarly ground No.3 raised by Revenue has already been adjudicated by the Hon'ble Tribunal vide it's order dated 23.01.2009 in favour of Revenue. Though assessee had filed Misc. Application on this issue also but the Hon'ble Tribunal had dismissed the Misc. Application on this account. The assessee though took both issues to Hon'ble Punjab & Haryana High Court but the Hon'ble Punjab & Haryana High Court had directed the Tribunal to dispose off the matters pending before it. As the Hon'ble Tribunal had not recalled it's order on this issue, therefore, the only issue pending before Tribunal was

relating to claim of loss of Rs.3,86,63,896/- which we have already adjudicated.

13. The appeal of the Revenue is thus disposed off as above and the appeal stands partly allowed in terms of the earlier order of Tribunal and the present order.

14. In view of the above, the appeal filed by Revenue is partly allowed.

Order pronounced in the open Court on 10.08.2016.

Sd/-
(A.D. JAIN)
JUDICIAL MEMBER

Sd/-
(T. S. KAPOOR)
ACCOUNTANT MEMBER

Dated:10.08.2016.

/PK/ Ps.

Copy of the order forwarded to:

- (1) The Assessee:
- (2) The
- (3) The CIT(A),
- (4) The CIT,
- (5) The SR DR, I.T.A.T.,

True copy

By Order