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Court : Income Tax Appellate Tribunal ITAT Chennai

Decided On : Feb-14-2005

Reported in : (2006)7SOT317(Chennai)

Appellant : Alacrity Foundations (P.) Ltd.

Respondent : Dy. Cit, Special Range Vii

Judgement :

Both the appeals of the assessee relate to assessment years 1994-95 and 1995-96. We heard both the appeals together -and disposing of the same by this common order.

Let us first take I.T.A. No. 369 (Mad,)/98 for the assessment year 199495. The first issue arises for consideration is regarding disallowance of Rs. 11,87,763 paid towards salary and LTA to service engineers deputed to M/s. Alacrity Electronics Ltd. Mr. S. Renganathan, the learned representative for the assessee submitted that the service engineers were on the pay roll of the assessee-company who were recruited and appointed even before the Housing and the Electronics Division were transferred to the public limited company, namely, Alacrity Housing Ltd. and Alacrity Electronics Ltd. According to the learned representative, the assessee-company entered into manpower transfer agreement to depute experienced service engineers to Alacrity Electronics Ltd. During deputation period, M/s. Alacrity Electronics Ltd. would pay the salary to the service engineers. Therefore, the service engineers, who were not deputed, continued to remain with the assessee-company and the salary and other emoluments were paid by the assessee-company. According to the learned representative, as per the agreement, Alacrity Foundations (P.) Ltd., the assessee-company agreed to train and depute all future manpower required by Alacrity Electronics Ltd. Therefore, according to the learned representative, expenses were incurred by the assessee for payment of salary and LTA to the said service engineers in a long-term perspective from the point of view of the assessee's business. According to the learned representative, there is no justification in disallowing the payment of salary on the ground that the services of all the employees were not fully utilized by the assessee. According to the learned representative, the salary was paid since the employees were appointed by the assessee-company and in case they were discharged from the service, the assessee-company would be forced to incur heavy expenditure towards gratuity and other retirement benefit. Therefore, as a prudent businessman, the assessee-company has incurred the expenditure towards salary and LTA to the service engineers so that they could be profitably utilized by deputing them to Alacrity Electronics Ltd. whenever the manpower is required by Alacrity Electronics Ltd. The learned representative further submitted that since the genuineness of the payment was not doubted, the reasonableness of the expenditure cannot be questioned by the assessing officer. The learned representative placed his reliance on the judgment of the Supreme Court in the case of CIT v. Walchand & Co. (P.) Ltd. (1967) 65 ITR 381 (SC) and submitted that the reasonableness and commercial expediency of the expenditure has to be judged from the businessman's point of view and not of the revenue. The learned representative again placed his reliance on the judgment of the Madras High Court in the case of CIT v. Associated Electrical Agencies (2004) 266 ITR 631 (Mad). Therefore, according to the learned counsel, the assessee has incurred the expenditure due to commercial expediency, therefore, the entire claim of Rs. 11,87,763 has to be allowed.

On the contrary, Dr. I. Vijayakumar, the learned departmental Representative submitted that the assessing officer found that a sum of Rs. 32,78,727 was debited towards payment of salary and another sum of Rs. 3,13,335 was debited towards leave travel allowance. According to the learned Departmental Representative, the only income of the assessee for the assessment year under consideration are income from royalty, consultancy fees, rent, hire charges, corporate fees and technology transfer fees, etc. The assessee admittedly transferred the business of Electronics Division to the newly promoted company M/s.

Alacrity Electronics Ltd. As per the transfer agreement all assets and liabilities and rights were transferred to M/s. Alacrity Electronics Ltd. The learned Departmental Representative further submitted that the new company has confirmed the taking on deputation all the personnel attached to Electronics Division as on 31-10-1992. According to the learned Departmental Representative, since all the assets and liabilities were transferred, the assessee did not have any activity relating to Electronics Division during the year under consideration.

Therefore, according to the learned Departmental Representative any further payment of salary and leave travel allowances to service engineers and other employees after the transfer of Electronics Division to the newly formed company cannot be justified. According to the learned Departmental Representative the payment made by the assessee towards salary in respect of the employees working in General Administration, Finance, Accounts have not been disallowed. Therefore, according to the learned Departmental Representative when the Electronics Division has been completely transferred together with all assets and liabilities and the newly formed company confirmed that it took all the personnel working in Electronics Division on deputation, there is no necessity much less commercial expediency for the assessee to pay the salary and leave travel allowance in respect of employees who are already taken on deputation to M/s. Alacrity Electronics Ltd. According to the learned Departmental Representative, the agreement for transfer of assets and liabilities to M/s. Alacrity Electronics Ltd. stipulates that once the personnel ceases to be on the pay roll of the assessee, he automatically ceases to be an employee of Alacrity Electronics Ltd. Furthermore, Alacrity Electronics Ltd., undertook to pay the salary and other benefits to the personnel who are on deputation. Therefore, it is very clear that the assessee is to train the personnel and keep them on their pay roll and M/s. Alacrity Electronics Ltd. has to pay their salary. In those factual circumstances, the learned Departmental Representative submitted that there is no justification for claiming any expenditure towards salary and leave travel allowances for the personnel who are meant for the benefit of M/s. Alacrity Electronics Ltd. Therefore, according to the learned Departmental Representative, the lower authorities have rightly disallowed the claim of the assessee to the extent of Rs. 11,87,763.

We have considered the rival submissions on either side, and also perused the material available on record. Admittedly, the Electronics Division of assessee-company was transferred to M/s. Alacrity Electronics Ltd. which is a new company promoted by the assessee. As per the transfer agreement, the assessee-company has to recruit the necessary manpower, train them and keep them in their pay roll.

Whenever the necessary personnel were required by M/s. Alacrity Foundations (P.) Ltd., the assessee-company would depute them to M/s.

Alacrity Electronics Ltd. The learned representative for the assessee submitted before this Tribunal that the employees were recruited even before the new company was promoted, therefore, if they are discharged from service, the assessee has to incur a heavy expenditure in payment of retirement benefits. According to the learned representative of the assessee, just to avoid the payment of heavy amount towards retirement benefit, the assessee retained the service engineers and other personnel and they were deputed to M/s. Alacrity Electronics Ltd. whenever they require the manpower. It is also an admitted fact that whenever the personnel were deputed to M/s. Alacrity Electronics Ltd., the payment and other benefits to the personnel on deputation were paid by M/s. Alacrity Electronics Ltd. The learned representative for the assessee has produced a copy of the manpower transfer agreement and business transfer agreement between the assessee-company and M/s.

Alacrity Electronics Ltd. The agreement for transfer of manpower reads as follows : "(1) AFPL agrees to lend & AEL accepts to be taken on Deputation all the personnel of AFPL, engaged in the business of production, marketing, sales, service, accounting, belonging to the Electronics Division, as also the personnel at the various branches taken over, and those manning ancillary services like word processing, delivery of material and the like, numbering in all 130 as on 1-11-1992.

(2) During the currency of this agreement, AFPL agrees to train and depute all future manpower required by AEL, wherefor the latter agrees to given reasonable Notice, and, during said period, AEL agrees, not to recruit/engage any personnel, otherwise than, on deputation from AFPL, and also, not to alter, the terms/ conditions of service of such personnel, directly /indirectly. It is clearly understood that any person ceasing to be an employee of AFPL for any reason whatsoever shall forthwith cease to work for AEL as well.

(3) AEL undertakes to directly pay at its own cost the salaries /benefits/ perquisites of such personnel and treat the same as part of its operational expenditure, and agrees to the solely responsible in meeting all concomitant legal/contractual obligations, payment/s, including contributions to Provident/Superannuation/Gratuity Funds, Income-tax Deduction at Source." Therefore, it is very clear that the new company M/s. Alacrity Electronics Ltd. has taken all the personnel engaged in the Electronics Division of the assessee-company. The assessee-company agrees to train and depute all future manpower. However, when deputed to Alacrity Electronics Ltd., the salary and other benefits would be paid by the new company. We have also carefully gone through the business transfer agreement. The assessee has incurred an expenditure of Rs. 1,58,250 in connection with formation of M/s. Alacrity Electronics Ltd. M/s.

Alacrity Electronics Ltd. has agreed to compensate this expenditure to the assessee. Therefore, it is very clear that the expenditure incurred by the assessee in promotion of the new company, that was reimbursed by the new company. The transfer of manpower agreement and business transfer agreement very clearly say that the expenditure incurred by the assessee in promoting the new company would be compensated by way of reimbursement. As far as the salary and leave travel allowances are concerned, the newly formed company undertook to pay from its own costs and treat the same as part of its operational expenditure. Therefore, we do not find any merit in the submission of the learned representative for the assessee that some of the employees who are not deputed continue to remain with the assessee-company and their emoluments were paid by the assessee-company. In view of the specific agreement between the assessee and the M/s. Alacrity Electronics Ltd., the newly formed company has absorbed all the personnel including the service engineers who were working in the Electronics Division of the assessee-company. Therefore, there is no justification in the contention of the learned representative for the assessee that some of the employees continue to remain with the assessee-company. It is not in dispute that the Electronics Division of the assessee-company was transferred to M/s. Alacrity Electronics Ltd. along with its personnel and the assessee-company has no more requirements of electronic service engineers. Moreover, when the assessee recruits manpower for future requirements of the new company, the expenditure that may be incurred by the assessee-company would be reimbursed by M/s. Alacrity Electronics Ltd. In those circumstances, we do not find any merit in the claim of the assessee towards payment of salary and leave travel allowances in respect of personnel who were meant for M/s. Alacrity Electronics Ltd. We have also carefully gone through the judgment of the Madras High Court in the case of Associated Electrical Agencies (supra). In the case before the Madras High Court, the assessee was agent of television manufacturing company. The assessee agreed to bear a part of the expenditure which was required to be incurred to promote the sale of the product with a view to expand the market and the sale. In those circumstances, the High Court held that the money agreed to be paid by the assessee to the manufacturing company were incurred with a view to enlarge the market and improve the sales. Expenditure incurred by the manufacturing company resulted in benefit to the assessee as they were selling agent of the company. In the case on our hand, the facts are entirely on different footing. Once the Electronics Division was transferred to the newly promoted company, there is no further business relationship except as a promoter of the new company. Though the assessee-company has to recruit the required manpower and train them, M/s. Alacrity Electronics Ltd. has to reimburse the expenditure and it has the responsibility and liability to pay the salary and other benefits to the employees. Therefore, in our considered opinion, this judgment of the Madras High Court is not applicable to the facts of this case.

We have also carefully gone through the judgment of the Supreme Court in the case of Walchand & Co. (P) Ltd. (supra). In the case before the Supreme Court, the assessee- company paid a remuneration of Rs. 2,500 per month to each director. The remuneration was increased retrospectively by Rs. 1,000 per month.

In the year 1953, the remuneration of each of the directors was increased by Rs. 500 per month. The assessing officer disallowed the increase in the remuneration of directors and officers of the assessee. The reason for disallowance is that the increase in remuneration does not result in increase in profit of the assessee. On those factual circumstances, the Supreme Court held that increased remuneration can only be justified if there be corresponding increase in the profits of the employer is erroneous. The work of the assessee has considerably increased, therefore, the strain on the directors and the top executives had increased justifying increase in their remuneration. Therefore, the Supreme Court allowed the claim of the assessee with regard to payment of increased remuneration. The facts in our case are entirely different. It is not the case of payment of increased salary to the executives. Here, the payment was claimed to be made to the employees who are working in another company namely, M/s. Alacrity Electronics Ltd. Since the new company has taken over the entire liability and assets of the Electronics Division including the personnel working in the Electronics Division, in our opinion, no further claim could be allowed in respect of payment of salary to those employees who are deputed to M/s. Alacrity Electronics Ltd. It is not in dispute that the expenditure incurred by the assessee for promoting a new company was reimbursed by the new company. In those factual circumstances we do not find an merit in the assessee's appeal. Therefore, we confirm the order of the lower authorities on this issue.

The next ground of appeal is regarding the claim of depreciation on plant and machinery. Mr. Renganathan, the learned representative for the assessee submitted that in pursuance of an agreement dated 1-7-1992, the assessee allowed M/s. Alacrity Housing Ltd. to use the machinery for their business. According to the learned representative, the lower authorities disallowed the claim of the assessee on the ground that no matching income was shown by the assessee in respect of machinery leased out to M/s. Alacrity Housing Ltd. According to the learned representative for the assessee, as per clause 2 of the agreement, the consideration for lease of machinery was included in the total payment of Rs. 320 lakhs made when the Housing Division was transferred to Alacrity Housing Ltd. This receipt of Rs. 320 lakhs was treated as revenue receipt. Therefore, it is not correct to say that the assessee has not received any rentals for allowing to use the machinery by M/s. Alacrity Housing Ltd. According to the learned representative, the rentals for the machinery was included in the transfer fee which was already received by the assessee. The learned representative further invited our attention section 32 of the Income Tax Act and submitted that for the purpose of grant of depreciation the assessee has to satisfy two conditions- (I) the assessee should be the owner of the machinery; (2) the machinery should be used for the purpose of the business of the assessee. According to the learned representative section 32 does not say anything about matching income.

Therefore, according to the learned representative, the assessee has fulfilled all the ingredients required for grant of depreciation.

Therefore, the assessee is entitled to depreciation as claimed.

On the contrary, Dr. I. Vijayakumar, the learned Departmental Representative submitted that as per business transfer agreement dated 14-12-1992, the entire business of the assessee was transferred for Rs. 320 lakhs. The assets transferred have been mentioned in Schedules A and B of the Agreement. The plant and machinery do not form part of the assets transferred. Therefore, the consideration of Rs. 320 lakhs does riot relate to use of plant and machinery belonging to the assessee.

Therefore, the assessee has allowed M/s. Alacrity Housing Ltd. to use its machinery without payment of any lease rent. Therefore, according to the learned Departmental Representative the assessee is not entitled to any depreciation.

We have considered the rival submissions on either side, and also perused the material available on record. Admittedly, the assessee claimed a sum of Rs. 5,08,628 as depreciation. For the purpose of claiming depreciation, the assessee should be the owners of the machinery and it should be used for the purpose of the assessee's business. The first Appellant authority confirmed the order of the lower authority on the ground that no matching income was shown by the assessee. As rightly, submitted by the learned representative for the assessee, showing matching income may not be a pre-condition for allowing the claim of depreciation. The assessee claimed before us that the receipt of Rs. 320 lakhs was shown as revenue receipt. However, we find from the order of the assessing officer for the assessment year 1993-94 that the assessee claimed the receipt as capital receipt and not chargeable to tax. The first appellate authority, after going through the agreement for business transfer and schedule thereto, found that the consideration of Rs. 320 lakhs was not in respect of the plant and machinery. Therefore, it is not known under what basis the learned representative for the assessee contends before this Tribunal that the receipt of Rs. 320 lakhs was treated as revenue receipt. Therefore, we have to first find out whether the receipt of Rs. 320 lakhs for transfer of business was considered as revenue receipt or capital receipt. The material available on record does not show how the abovesaid receipt was treated by the revenue. The assessing officer though observed that the amount was claimed as capital receipt by the assessee, he has not made any observation how it was treated by the revenue after considering the claim of the assessee. Furthermore, we have to find out how the machinery was allowed to be used by M/s.

Alacrity Housing Ltd. In other words, we have to find out whether leasing out the machinery is a part of the business of the assessee.

Therefore, in our view, the assessing officer has to reconsider the entire material available on record afresh and record a specific finding with regard to classification of receipt of Rs. 320 lakhs (whether capital or revenue) and whether the lease rental for the plant and machinery was included in the abovesaid sum. It is also necessary to find out whether the business of the assessee includes leasing out of plant and machinery.

In view of the above, we set aside the order of the lower authorities and remand back the issue to the file of the assessing officer. The assessing officer shall reconsider the whole issue as indicated above and thereafter decide the issue in accordance with law after giving due opportunity to the assessee.

Now let us take ITA No. 370 (Mad)/98 for the assessment year 1995-96.

The only issue arises for consideration is regarding disallowance of Rs. 13,24,424 while making a prima facie adjustment under section 143(1)(a) towards the value of obsolete inventory and non-recoverable debts returned back by Alacrity Electronics Ltd. Shri Renganathan, the learned representative for the assessee submitted that the assessee has transferred inventory of its Electronics Division to M/s. Alacrity Electronics Ltd. during the financial year 1992-93 for Rs. 64,58,365 and debtors of Rs. 66,64,313. The assessee has also taken these two items as part of its income during the assessment year 1992-93. During the assessment year under consideration, M/s. Alacrity Electronics Ltd. returned back the inventory for a value of Rs. 4,64,183 and also requested the assessee to take back non-recoverable debts of Rs. 8,60,241. Accordingly, the assessee accepted the inventory returned by the Alacrity Electronics Ltd. and the non-recoverable debts and wrote off these inventory and non-recoverable debts in the books of account.

According to the. Learned representative, the inventory taken back by the assessee from M/s. Alacrity Electronics Ltd. was already included in the income of the assessee for the assessment year 1992-93 and the return made by the Alacrity Electronics Ltd. is only in the nature of sales returns. Therefore, it has to be allowed. Likewise, the bad debt of Rs. 8,60,241 was also included in the income of the assessee for the assessment year 1992-93 and the assessee has written off these in the books of account. Therefore, the claim of the assessee to the extent of Rs. 13,24,424 has to be allowed. The learned representative further submitted that even otherwise the claim of the assessee is a debatable one, therefore, it cannot be decided while making a prima facie adjustment without giving an opportunity to the assessee.

On the contrary, Dr. I. Vijayakumar, the learned Departmental Representative submitted that the assessee has filed the return of income for the assessment year under consideration admitting a total income of Rs. 96,31,473. While processing the return, the assessing officer found that the assessee has debited a sum of Rs. 13,24,424 in the profit & loss account towards obsolete inventory and long pending debts written off. This was disallowed by the assessing officer while making a prima facie adjustment since the debt was already transferred to M/s. Alacrity Electronics Ltd. The learned Departmental Representative further submitted that under Schedule 17 of Profit & Loss Account, a sum of Rs. 13,24,424 was debited under administrative expenses. The assessing officer also found that the assets of the assessee were taken over by M/s. Alacrity Electronics Ltd. on 1-11-1992. Therefore, the deduction claimed by the assessee in respect of assets transferred to M/s. Alacrity Electronics Ltd. on 1-11-1992 does not belong to the assessee. Therefore, the assessee is not entitled to any deduction as claimed. Accordingly, the lower authorities rejected the claim of the assessee.

We have considered the rival submissions on either side, and also perused the material available on record. It is not in dispute that the assessee has transferred the entire inventory and the bad debts. In other words, entire assets and liabilities have been transferred to M/s. Alacrity Electronics Ltd. The assessee now claims M/s. Alacrity Electronics Ltd. has re-transferred a part of inventory and non-recoverable debts. The assessee claims that since the inventory of Rs. 4,64,183 and non-recoverable debts of Rs. 8,60,242 were already included in the income of the assessee for the assessment year 1992-93 and it was written off in the books of account for the assessment year under consideration, it has to be allowed while computing the total income. Admittedly, the assessing officer disallowed the claim of the assessee while making a prima facie adjustment. When the assessee claims that the amount which was written off as inventory returned back and non-recoverable debt was included in the total income of the assessee for assessment year 1992-93, in our opinion, the matter requires a detailed investigation. In other words, the issue arises for consideration is a debatable one. Therefore, the assessing officer cannot disallow the same behind the back of the assessee in the guise of making a prima facie adjustment under section 143(1)(a). In our considered opinion, the matter ought to have been taken up for scrutiny under section 143 and an opportunity should have been given to the assessee. In this case, since the prima facie adjustment was made, in our view, it is not permissible under the provisions of section 143(1)(a). The issue arises for consideration requires a detailed investigation. Therefore, it is highly debatable in nature. In view of the above discussion, we set aside the order of the lower authorities and delete the disallowance of Rs. 13,24,424.

In the result, ITA No. 369 (Mad)/98 is partly allowed and ITA No. 370 (Mad)/98 is allowed.