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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Mar-31-2008

Reported in : (2008)304ITR114(Delhi)

Judge : N Karhail, R Singh

Appellant : Bagpet Industries Ltd.

Respondent : Dcit

Judgement :

1. This appeal by the assessee is directed against the order dated 19.7.2006 of CIT(A) for the A.Y. 2003-04. The assessee in this appeal has raised disputes on two different grounds, which have been dealt with in the succeeding paras.

2. The dispute raised in ground No. 1 is regarding disallowance of deduction of Rs. 2114000/- claimed by the assessee on account of compensation paid to Ex-shareholders as per the direction of the Company Law Board. Briefly stated, the facts of the case are that minority shareholders who held 56100 equity shares of face value of Rs. 5.61 lacs had filed petition under Section 397/398 of the Companies Act alleging oppression and mismanagement by the majority shareholders. The Company Law Board vide order dated 31.1.2001 held that in case the minority shareholders were interested in selling the shares and the company decided to purchase the shares and would paid interest @ 21% from the date money was remitted into the shares of the company till date of purchase. In view of this order, the Company Law Board, the company had purchased 56100

shares of the minority shareholders and paid additional compensation of Rs. 2114000/- in addition to the face value of Rs. 5.61 lacs. The company as per the direction of the Company Law Board had reduced the authorised share capital by Rs. 5.61 lacs and the additional compensation of Rs. 2114000/- was claimed as deduction in the profit and loss account. To the query raised by the assessing officer, the assessee explained that the compensation had been paid to get rid off minority shareholders who were creating obstacles in the smooth functioning of the company and the compensation paid was thus to facilitate the management and conduct of the business more efficiently and profitably and therefore, it was allowable as deduction. The assessing officer was not satisfied. It was held by him that the amount paid by the assessee for purchase of its own equity shares couldn't be allowed as revenue expenditure and accordingly, he disallowed the claim, which was disputed by the assessee.

3. In appeal, the assessee submitted before CIT(A) that by paying the compensation, no tangible or intangible asset had come into existence nor any enduring advantage had accrued to the assessee. The compensation had been paid not for acquiring any asset but for protecting the company's asset and for improving the profitability of the company by ousting the erring group of shareholders. The compensation was, therefore, operational expenditure allowable as deduction. CIT(A) however was not satisfied and it was observed by him that the payment had been made for purchase of shares and therefore, any expenditure incurred for purchase of share, would be capital expenditure.

4. He referred to the judgement of Hon'ble Supreme Court in case of Brook Bond India Ltd. 225 ITR 798 in which it was held that fee paid to Registrar of Companies for expansion of capital base of the company was capital expenditure. CIT(A) accordingly upheld the order of the assessing officer that the compensation was of the nature of capital expenditure and thus upheld the disallowance against which the assessee is in appeal before the tribunal.

5. Before us, the Ld. A.R. for the assessee reiterated the submissions made before the lower authorities. It was emphasized that the expenditure had been incurred only to remove the obstacles caused to the business and did not result

into creation of any asset of any enduring advantage. The compensation had been paid as per the direction of the Company Law Board and expenditure was therefore, allowable as revenue expenditure. Reliance was placed on the judgement of Hon'ble Supreme Court in case of Bikaner Gypsum Ltd. (187 ITR 39) and on the judgement of Hon'ble High Court of Allahabad in case of Muir Mills Ltd. (148 ITR 418). It was pointed out that the judgement of Hon'ble Supreme Court in case of Brook Bond India Ltd. relied upon by the Ld. CIT(A) was distinguishable as the same related to the expenditure incurred to increase authorised capital. In this case, there was no increase in share capital, which in fact had been reduced.

6. The expenses had been incurred to run the company more efficiently and therefore, it was allowable as revenue expenditure. The Ld. Sr.

Departmental Representative on the other hand strongly supported the order of authorities below. It was submitted that by making the purchases of shares, holding of the majority group had substantially increased and therefore expenditure incurred was capital expenditure.

The expenditure had also resulted into some enduring advantage to the company.

7. It was also argued that the decision of the company law board was not binding on the Income Tax Authorities because the said decision could not overrule the provisions of Income Tax Act. The expenditure incurred was in relation to capital structure of the company and, therefore, it was capital in nature. She placed reliance on the judgements of Hon'ble Supreme Court in case of L H Sugar Factory & Oil Mills Ltd. (125 ITR 293) and in case of ABC Co. Ltd. (27 ITR 34).

8. We have perused the records and considered the rival contentions carefully. The dispute raised is regarding allowability of expenditure incurred by the assessee company towards compensation for purchase of shares held by the minority shareholders. The minority shareholders held 56100 shares in the company with face value of Rs. 5.61 lacs. They had also advanced certain loans to the company, which were not converted into shares by the company and had been returned without paying any interest.

9. The minority shareholders therefore, filed petition Under Section 397/398 before the Company Law Board in which it was alleged that the affairs of the company were being conducted in a manner prejudicial to public interest/interest of the company and were oppressive to the minority shareholders.

10. The Company Law Board after detailed hearing found that the affairs of the company were not being conducted in a manner prejudicial to the company or to the public interest as the company had put a up new plant and had also started earning substantial profits over the years and had made substantial contribution to public exchequer. The company Law Board also observed that denial of issue of further shares to the minority shareholders by which the present shareholding was reduced to minority could be considered oppressive to the minority shareholders but in this case, admitted position was that even in the beginning the minority shareholders had only 43.7% shareholding and thus never had any majority.

11. The company law board further observed that though the objective of the management in issue of further shares was for the benefit of the company, the company should have offered minority shareholders the option to convert their outstanding amount into equity capital particularly when the company was issuing shares at the time when the outstanding amounts were being refunded to the minority group. The Board, therefore, attempted to find an amicable settlement and decided that in case the minority shareholders wanted to sell the shares, the company would be bound to accept the same. The Board determined the markets value of shares by adding interest @ 21% from the date of investment to the face value of shares and also directed to pay interest on the loan amounts already refunded without interest by the management.

12. The Board also directed that in case the company decided to purchase the shares, it would reduce the share capital to that extent.

It was in pursuance of the said direction of the Company Law Board that the company purchased 56100 shares of the minority shareholders towards which in addition to the face value of the shares i.e. 5.61 lacs, compensation of Rs. 21,14,000/- had been paid which also included interest of Rs. 382476/- on the loans refunded by the company earlier without paying interest.

13. The dispute is whether the sum of Rs. 21,14,000/- could be allowed as revenue expenditure. The authorities below held that the expenditure was capital expenditure as the same related to the capital structure of the company. Reliance had been placed on the judgement of Hon'ble Supreme Court in case of Brook Bond India Ltd. 225 ITR 798 in which it was held that fees paid to Registrar of the Companies for expansion of capital base of the company was capital expenditure. The case of the assessee is that the payment for purchase of shares had been made to the minority shareholders to remove the obstructions/obstacles caused by them to the business and it was therefore, allowable as revenue expenditure as the same had not resulted into creation of any assets of enduring advantage. Reliance has been placed on the judgement of Hon'ble Supreme Court in case of Bikaner Gypsum Ltd. (supra) and the judgement of Hon'ble High Court of Allahabad in case of Muir Mills Ltd. (supra).

14. We have carefully gone through the judgements cited by the Ld. A.R. for the assessee. In case of Bikaner Gypsum Ltd. (supra), Hon'ble Supreme Court held that expenditure incurred for removal of any restriction/obstruction or disability would be on revenue account provided the expenditure did not acquire any capital asset. In that case, the assessee was in the business of mining of Gypsum. The assessee had taken certain mining area on lease, which included railway station and staff quarters.

15. There was restriction in the lease agreement for mining operation near the area occupied by the railway. The assessee, therefore, shifted the railway station, yard and quarters to another area and the expenditure incurred was claimed as revenue expenditure on the ground that the same had been incurred for the purpose of removal of a disability. The Hon'ble Supreme Court upheld the claim of the assessee.

The said judgement, in our view, is not applicable in case of the assessee as no material has been placed on record to show that the minority shareholders were causing obstruction to the business of the assessee. In fact, we fail to understand as to how the minority shareholders whose share holding was less than 3% could obstruct the working of the business. On the contrary, the minority shareholders

had filed a petition before Company Law Board complains of being oppressed by the management.

16. The management of the company with shareholding of about 97% had full control and say in the management of the company and there is no way the minority shareholders with such insignificant shareholding could cause obstruction to the working. The minority shareholders had filed a petition before the Company Law Board and to fight the case, if the assessee company incurs expenditure which is essential for maintaining its position and identity, this could always be claimed as revenue expenditure and the judgement of Hon'ble High Court of Allahabad in case of Muir Mills Ltd. (supra) relied upon by the assessee would have supported the case of the assessee. In the said case, the Hon'ble High Court had held that expenditure incurred on defending attack on the company or in connection with passing of resolution for changing the articles of association and for appointing managing agents would be allowable as revenue expenditure. But the case of the assessee is different Admittedly, the amount had been paid for purchase of shares from the minority shareholders.

17. Though the company law board had used the word compensation, but in essence, it was consideration towards purchase of shares. A perusal of the order of Company Law Board shows that the board in the said order had clearly observed that normally the fair market value of shares is required to be valued by a valuer but considering the peculiar facts of this case where payments had been made periodically over a period of time, the Board decided that in addition to the face value, interest @ 21% from the date of investment will be required to be paid towards the consideration for purchase of shares.

18. It is thus clear that the amount paid by the assessee though termed as compensation is in fact the price paid for purchase of shares held by the minority shareholders. Therefore the question basically is whether the payment made for purchase of shares from the shareholders can be considered as revenue expenditure. The payment obviously is in relation to change in the capital structure of the company and this aspect has already been considered by the Hon'ble Supreme Court in case of Brook Bond India Ltd. 225 ITR 798 in which it was held

that expenditure incurred in connection with expansion of capital base of the company was capital expenditure.

19. If the expenditure incurred for expanding the capital base is a capital expenditure, then any expenditure incurred to reduce the capital base cannot in our view, in any sense, be termed as revenue expenditure because by reducing the capital, funds to that extent have gone out of the company and therefore, such expenditure on reducing the capital cannot be considered as expenditure incurred for working of the company more efficiently or more profitably. The expenditure incurred for increasing the capital base could to some extent be related to the better working of the company because of more funds mobilized by the company but even in that case, Hon'ble Supreme Court held that expenditure was capital in nature even if it may have helped indirectly in the more profitable working of the company.

20. Expenditure incurred for removing obstruction or obstacles in the working of the company, can no doubt be considered as an allowable expenditure. But in this case, as we have pointed out earlier, no material is on record to show as to how the minority shareholders with shareholding less than 3% could obstruct the working of the company. In fact the minority shareholders themselves in their petition to the Company Law Board had made allegation of being oppressed by the management of the company. Moreover, we also note that out of the total amount paid for purchase of shares, part of the payment to the extent of face value of shares, has been treated by the assessee itself as capital expenditure and deducted from the capital of the company and the balance part in excess of above the face value has been claimed as revenue expenditure though the nature of both the payments remained the same i.e. consideration towards purchase of shares.

21. The part of the same expenditure cannot be treated as capital and the remaining revenue, nature payment remaining the same. We, therefore, hold that payment made by the assessee towards the purchase of shares, is a capital expenditure and cannot be allowed as a deduction while computing the profit of the company. However, we also note that out of total payment of Rs. 2114000/-, a

sum of Rs. 383476/- is compensation towards refund of loans made by the company earlier without paying any interest. The loans given by the minority shareholders to the company were not converted into shares and had been returned interest free and this compensation had been paid on the direction of the Company Law Board towards use of funds. This is an interest on money taken from the shareholders and used by the company for the purpose of business. Since the interest liability accrued only on the direction of the Company Law Board, this liability in our view, will be allowable as revenue expenditure for the relevant year. The A.O. will, therefore, verify the claim and allow the interest payment relating to the loans taken by the assessee from the shareholders, on direction of the Company Law Board. The claim of the assessee is thus partly allowed.

22. The ground No. 2 is regarding addition of Rs. 317724/- on account of employees' contribution towards PF and not deposited in time under Section 36(1)(va). The assessing officer had made the disallowance on the ground that the same had not been deposited within time limit prescribed under the relevant statute. CIT(A) confirmed the disallowance.

23. Before us, the Ld. A.R. for the assessee pointed out that most of the payments had been made within the grace period of 5 days after the due date, which is allowable as deduction following the judgement of Hon'ble jurisdictional High Court of Delhi in case of Modi spinning & Weaving mills Co. Ltd. (292 ITR 479). The Ld. DR on the other hand placed reliance on the order of authorities below.

24. We have perused the records and considered the matter carefully.

Employees' contribution to PF can be allowed as deduction if the same is deposited by 15th day of the following month under the relevant statute. A further grace period of 5 days has been allowed under the internal instructions of the statutory authorities.

25. Therefore, the deposits made within the grace period are allowable as deduction. This view is supported by the judgement of Hon'ble jurisdictional High Court in case of Modi spinning & Weaving Mills Co.

Ltd. (supra). We, therefore, restore this issue to the file of the assessing officer for passing a fresh order after necessary examination in the light of observations made above and after allowing opportunity of hearing to the assessee.

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