



## Capital gain credited to capital reserve account instead of profit and loss account cannot be considered while computing book profit under the provisions of MAT

### Background

Recently, the Bombay High Court in the case of Bhagwan Industries Ltd<sup>1</sup> (the taxpayer) while upholding the order of the Tribunal held that capital gain directly credited to capital reserve account instead of Profit and Loss Account cannot be considered while computing book profit under Section 115JB of the Income-tax Act, 1961 (the Act).

### Facts of the case

- During the Assessment Year (AY) 2004-05, the taxpayer earned a capital gain of INR28.48 million which was directly credited to a capital reserve account in the balance sheet rather than routing it through Profit and Loss Account in the manner provided as per Part II and Part III of Schedule VI to the Companies Act, 1956.
- During the course of assessment proceedings, the AO reworked the book profits under the provisions of Section 115JB of the Act. While computing book profit under Section 115JB of the Act, the AO added the sum of INR28.48 million in the book profit.
- The Commissioner of Income-tax (Appeals) [CIT(A)] and the Tribunal deleted the addition made by the AO.

### High Court decision

- The Tribunal referring to the decision of the Supreme Court in a case of Apollo Tyres Ltd.<sup>2</sup> and the decision of the Bombay High Court in the case of Akshay Textiles Trading and Agencies Pvt.Ltd.<sup>3</sup> did not find any infirmity in the order of the CIT(A) for deleting the addition made under Section 115JB of the Act.

- The High Court while upholding the order of the Tribunal observed that the Tribunal had not committed any error while deleting the addition made by the AO under Section 115JB of the Act. Accordingly, the appeal filed by the tax department is liable to be dismissed.

### Our comments

The issue with respect to computation of book profit under the provisions of MAT vis-à-vis routing of capital receipts through profit and loss account has been a subject matter of debate before the Courts/Tribunal.

On one hand, some of the Courts/Tribunal<sup>4</sup> have held that the AO has no powers to go behind accounts of a company to see as to whether same have been prepared in accordance with requirements of Parts II and III of Schedule VI of Companies Act. He has no power to embark upon a fresh enquiry in regard to the entries made in the books of account of the company. The only power vested with the AO is to make increases and deductions as provided in the Explanation to Section 115JB. Therefore, the capital gain should not be included for the purpose of computing book profit under Section 115JB of the Act.

<sup>1</sup> Pr.CIT v. Bhagwan Industries Ltd (ITA No. 436 of 2015, 18 July 2017) – itatonline.com

<sup>2</sup> Apollo Tyres Ltd v. CIT [2002] 255 ITR 273 (SC)

<sup>3</sup> CIT v. Akshay Textiles Trading and Agencies Pvt. Ltd. [2008] 304 ITR 401 (Bom)

<sup>4</sup> Sri Hariram Hotels (P.) Ltd. v. CIT [2016] 66 taxmann.com 233 (Kar), New Oriental Trawlers (P.) Ltd. v. DCIT [2011] 10 taxmann.com 252 (Hyd), Sutlej Cotton Mills Ltd v ACIT [1993] 45 ITD 22 (Cal) (SB)

However, on the other hand, the Courts/Tribunal<sup>5</sup> have held that while computing the book profits under the Companies Act, the taxpayer has to include capital gains for computing the book profits. Even under clause 3(xii)(b) of Part II of Schedule VI to the Companies Act, 1956, profits or losses in respect of transactions or transactions of an exceptional or non-recurring nature are to be disclosed.

It would be interesting to see MAT implications on such transactions when it would be disclosed under Ind AS regime.

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<sup>5</sup> Indo-Marine Agencies Pvt. Ltd. v. ACIT [1995] 51 TTJ 18 (Coch), CIT v. Veekaylal Investment Co. P. Ltd. [2001] 249 ITR 597 (Bom), Sumer Builders (P.) Ltd. v. DCIT [2012] 19 taxmann.com 43 (Mum), Kopran Pharmaceuticals Ltd. v. DCIT [2009] 119 ITD 355 (Mum)



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