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TAX FLASH NEWS

8 March 2022

Loss on account of permanent diminution in the value of an investment in US subsidiary company is allowed as business expenditure

Recently, the Rajasthan High Court in the case of Vaibhav Global Ltd.[1] (the taxpayer) dealt with the issue of allowability of business loss on account of permanent diminution in the value of the investment made in the equity shares in one of the subsidiaries under Section 37 of the Income-tax Act, 1961 (the Act). The High Court observed that the taxpayer had made an investment in its subsidiary company in order to expand its business with a view to earn higher profit. The investment was thus driven by business expediency. Accordingly, the High Court allowed the taxpayer's claim of business expenditure.

Facts of the case

The taxpayer had claimed business loss on account of permanent diminution in the value of the investment made in the equity shares in one of the subsidiaries in the USA. The Assessing Officer (AO) disallowed the loss under Section 37 since the expenditure could not be considered as revenue expenditure. Further, it was not a case of bad debt which could be allowed under Section 36.

The Tribunal reversed the decision of the AO, relying on an earlier decision of the taxpayer for the assessment year 2012-13. In that case, the Tribunal relying on the decisions of the Supreme Court and various High Courts observed that the expenditure incurred by the taxpayer was allowable. The taxpayer, in order to expand its business worldwide, had setup subsidiaries in other countries. The investment made in such companies was seen as revenue expenditure since the purpose behind making the investment was only for the expansion of the business. The Tribunal held that such investment being in the nature of revenue expenditure was allowed under Section 37.

[1] PCIT v. Vaibhav Global Ltd. (ITA No. 53/2021) – Tax India International Note – The tax department had also raised the issue of Arm's Length Price determination. The High Court did not entertain the same.

High Court's decision

The High Court did not find any error in the Tribunal's order. The High Court observed that the taxpayer had made the investment in its subsidiary company in order to expand its business with a view to earn higher profit. The investment was thus driven by business expediency. Thus, the High Court upheld the order passed by the Tribunal.

Our comments

A large number of Indian companies have set up their subsidiaries outside India to expand their business in the international market. The deductibility of loss/expenditure incurred in connection with such subsidiaries has been a subject matter of litigation before the Courts.

The Karnataka High Court in the case of ACE Designers Ltd.[2] held that write-off of investment made in wholly-owned subsidiary (for the purpose of extension of business activity/business purpose) is a business loss. However, the Ahmedabad bench of the Tribunal in the case of APS Stare Industries Limited[3] held that investment made by the taxpayer in the acquisition of shares with the ultimate purpose of merging another entity with itself constitutes capital investment and any loss arising from writing off of the investments in its books could not be construed as either business loss or revenue expenditure.

The Rajasthan High Court, in the present case, has observed that the taxpayer had made the investment in its subsidiary company in order to expand its business with a view to earn higher profits. The investment was thus driven by business expediency. Accordingly, the High Court allowed the taxpayer's claim of business expenditure.

[2] ACE Designers Ltd. v. ACIT [2020] 120 Taxmann.com 321 (Kar)
[3] APS Stare Industries Limited v. DCIT [2003] 86 ITD 182 (Ahd)

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