

(2007) 09 DEL CK 0192
In the Delhi High Court
Case No : ITA No. 1315 of 2006

Commissioner of Income Tax (Central)-III	APPELLANT
Vs	
J.S. Electronics Pvt. Ltd.	RESPONDENT

Date of Decision : 21-09-2007

Acts Referred:

Companies Act, 1956 — Section 391, 394
Income Tax Act, 1961 — Section 40A(2), 49(2)

Citation : (2007) 213 CTR 138 : (2009) 311 ITR 311 : (2008) 166 TAXMAN 24

Hon'ble Judges : Madan B. Lokur, J; Dr. S. Muralidhar, J

Bench : Division Bench

Advocate : P.L. Bansal, for the Appellant; Ajay Vohra and Kavita Jha, for the Respondent

Final Decision : Dismissed

Judgement

Madan B. Lokur, J.—The Revenue is aggrieved by an order dated 24th August, 2004 passed by the Income Tax Appellate Tribunal, Delhi Bench "F" in ITA No. 1508/Del/1999 relevant for the assessment year 1992-93.

2. The assessed is a private limited company dealing in shares. The assessed came to know that the erstwhile HCL had entered into a joint venture agreement with Hewlett Packard, USA and that in terms thereof, shares of the erstwhile HCL would effectively be transferred to HCL Ltd. and HCL HP Ltd. In fact, a scheme of arrangement to this end was prepared and sanctioned under Sections 391 and 394 of the Companies Act, 1956 by this Court. One of the terms of the scheme of arrangement, with which we are concerned, provided that the shareholders of the erstwhile HCL would receive, for 100 shares held by each shareholder, 68 shares of HCL HP Ltd. and 32 shares of HCL Ltd. The assessed also came to know that Hewlett Packard, USA would buy the shares of HCL HP Ltd. at a predetermined price of Rs. 168.80 per share.

3. Based on this information, the assessed purchased 7,77,100 shares of the erstwhile HCL. Out of these, the assessed sold 1,29,600 shares on various dates

leaving behind a balance of 6,47,500 shares of the erstwhile HCL.

4. In terms of the joint venture agreement, for these 6,47,500 shares the assessed was allotted 4,40,300 shares of HCL HP Ltd. and 2,07,200 shares of HCL Ltd.

5. Out of the 4,40,300 shares of HCL HP Ltd. held by the assessed, it sold to Hewlett Packard, USA 1,14,486 shares at the predetermined price of Rs. 168.80 per share.

6. On these broad facts, two issues arose before the Assessing Officer on the return of income filed by the assessed. The first issue concerned the high price paid by the assessed for the purchase of shares of the erstwhile HCL. The second issue concerned the valuation of the closing stock of shares held by the assessed.

7. With regard to the first issue, the Explanation given by the assessed for purchasing shares of the erstwhile HCL at a high price was that it had purchased a large number of shares in large blocks from the Delhi Stock Exchange. The assessed submitted that necessary brokers' notes were available and the payment made to the brokers was by account payee cheques. In other words, according to the assessed, the transactions were above board. The Assessing Officer did not accept this Explanation and made an addition of Rs. 89,29,635/- to the income of the assessed on account of the high price paid by the assessed for the purchase of shares of the erstwhile HCL.

8. In so far as the second issue regarding valuation of the closing stock of shares is concerned, the assessed worked out the average cost of the shares of HCL HP Ltd. at Rs. 55.82 per share. The Assessing Officer took the view that the market price for the shares of HCL HP Ltd. was Rs. 100/- per share and on this basis he made an addition of Rs. 1,40,94,839/- to the closing stock of shares held by the assessed.

9. The assessed challenged both the conclusions arrived at by the Assessing Officer but the Commissioner of Income Tax (Appeals) [CIT (A)] by his order dated 31st October, 1995 rejected the challenge. The assessed then preferred an appeal before the Tribunal which passed an order on 20th January, 1997. This order is of some importance because the Tribunal remanded the matter to the file of CIT (A) for passing a speaking order and also gave certain directions.

10. The direction given by the Tribunal with regard to the first issue concerning the addition of Rs. 89,29,635/- on account of the high price paid for the shares of the erstwhile HCL was that the CIT (A) should examine the matter in the light of Section 40A(2) of the Income Tax Act, 1961 (the Act) or determine whether the transaction entered into by the assessed with the brokers was a sham or bogus transaction. The Tribunal was also of the view that a mere difference in the purchase price was not enough to sustain an addition and the Explanation given by the assessed needed to be examined.

11. As regards the second issue relating to the valuation of the closing stock of

shares, the Tribunal directed the CIT (A) to examine the matter in the light of Section 49(2) of the Act and also to take into consideration the fact that shares of the erstwhile HCL were split up into shares of HCL HP Ltd. and HCL Ltd.

12. The CIT (A) then heard the matter on remand in terms of the directions given by the Tribunal. In respect of the first issue, the CIT (A) came to the conclusion that the Assessing Officer had taken the price of the shares of the erstwhile HCL as prevalent in the Bombay Stock Exchange while the assessed had actually made purchases from the Delhi Stock Exchange. Moreover, the transaction was confirmed by the brokers and payments were made to the brokers through account payee cheques. The transactions did not appear to be sham transactions and the Assessing Officer had not brought on record any evidence to show to the contrary or that any part of the consideration had come back to the assessed. It was noted that the assessed had some special knowledge about the joint venture and the scheme of arrangement and was, Therefore, willing to pay a higher price to corner the shares. The CIT (A) came to the conclusion that Section 40A(2) of the Act was inapplicable inasmuch as the expenditure was neither excessive nor unreasonable nor was the transaction a sham and, Therefore, the addition of Rs. 89,29,635/- was incorrect and was deleted.

13. With regard to the second issue of the addition of Rs. 1,43,29,635/- being the difference in the valuation of the closing stock of shares on the basis of its market value, the CIT (A) examined the case in the light of the provisions of Section 49(2) of the Act. He noted that the Assessing Officer had completely lost sight of the scheme of arrangement which required the splitting up of the shares of the erstwhile HCL into the shares of HCL HP Ltd. and HCL Ltd. and that the assessed was entitled to value the shares of HCL HP Ltd. at the cost price of Rs. 55.82 per share rather than the undetermined market value of Rs. 100/- per share. It was, accordingly, held by the CIT (A) that the addition was not tenable.

14. Feeling aggrieved by the order passed by the CIT (A), the Revenue preferred an appeal before the Tribunal.

15. On a reading of the order of the Tribunal, we find that the submissions before it really centered around the interpretation of the earlier order dated 20th January, 1997 passed by the Tribunal when it remanded the case to the CIT (A) and whether the directions given by the Tribunal were correctly interpreted and implemented by the CIT (A). In this regard, the Tribunal came to the conclusion that the CIT (A) correctly understood the earlier order passed by the Tribunal on 20th January, 1997 and had fully implemented it.

16. On the merits of the case, the Tribunal held that on the first issue, the CIT (A) had clearly held that no case had been made out for invoking the provisions of Section 40A(2) of the Act or to hold that the transactions entered into by the assessed were sham transactions. The Explanation given by the assessed for purchasing the shares of the erstwhile HCL at a high price was plausible and

since the payments made to the brokers were through account payee cheques, there was enough material to negate all doubts about the transaction being a sham. Moreover, there was nothing to show that any part of the amount came back into the coffers of the assessed.

17. As regards the second issue, the Tribunal noted the contention of the Departmental Representative that Section 49(2) of the Act was not applicable. It, however, held that since the earlier order passed by the Tribunal on 20th January, 1997 was accepted by the Revenue, it was now not possible for the Departmental Representative to contend that Section 49(2) of the Act was not applicable.

18. The question whether the closing stock could be valued at the cost price or the market value was conclusively settled, as noted by the Tribunal, by the decision of the Supreme Court in *Sakthi Trading Co. Vs. Commissioner of Income Tax, Coimbatore*, wherein it is held:

It is an established rule of commercial practice and accountancy that where there is no discontinuation of business, the closing stock is to be valued at cost or market price, whichever is lower.

On these facts, the Tribunal found that there was no error committed by the CIT (A).

19. We are of the view that the scope of enquiry before us is rather limited in view of the order passed by the Tribunal. The only question that really arises before us is whether the CIT (A) correctly understood and implemented the earlier order passed by the Tribunal on 20th January, 1997. The Tribunal has found no error in the view taken by the CIT (A). We do not find any reason to interfere in this regard because this is essentially a matter of understanding the order of the Tribunal which does not lead to any substantial question of law.

20. On merits also, we find that the Explanation given by the assessed with regard to the first issue was a plausible Explanation and could not be termed as perverse. The CIT (A) as well as the Tribunal were quite justified in examining the Explanation and coming to a conclusion thereon which is that the transactions of purchasing shares of the erstwhile HCL at a high price were not sham transactions. This is essentially a question of fact which ought not to be disturbed unless it is perverse which, in our opinion, is not so. Both the CIT (A) and the Tribunal have considered the relevant facts and the submissions of the parties in the right perspective. As regards the second question about valuation of the closing stock, the assessed was well within its rights to value the closing stock at cost price which was lower than the market price. The action of the assessed is fully backed by the decision of the Supreme Court in *Sakthi Trading Co.* and no fault can be found in the stand taken by the assessed in this regard.

21. No substantial question of law arises for our consideration. The appeal is dismissed.