



A tax officer does not have the power to recompute the book profit under MAT provisions and has to rely upon the accounts scrutinised and certified by the statutory auditors

Background

Recently, the Karnataka High Court in the case of Sri Hariram Hotels (P.) Ltd.¹ (the taxpayer) held that the Assessing Officer (AO) does not have the power to recompute the book profit under Section 115JB² of the Income-tax Act, 1961 (the Act). The AO has to rely upon the authentic statements of account of the company which are scrutinised and certified by the statutory auditors, approved by the company in a general body meeting and thereafter filed before the Registrar of Companies (ROC).

Facts of the case

- The taxpayer was incorporated on 3 February 1992 with an objective to commence the business of running a hotel. It had purchased land at Mahadevapura through public auction from the appropriate authority of the tax department for INR2.6 million.
- The taxpayer borrowed an unsecured loan of INR2.4 million from its directors for meeting the purchase consideration of the land.

- The taxpayer could not commence the hotel project on the said land, and therefore, sold the land for INR12.25 million on 23 January 2003.
- In the books of account of the taxpayer, the loan was capitalised during the financial year which ended on 31 March 2003. The taxpayer booked a capital gain of INR5.17 million arising out of the sale of the land directly to the capital reserve and not to the profit and loss account.
- The AO held that the capital gains ought to have been included in the profit and loss account, according to the accounting standard referred to by him in the assessment order and hence, arrived at a conclusion that the profit shown in the profit and loss account should be increased by the amount of capital gain of INR5.17 million.
- The Commissioner of Income-tax (Appeals) [CIT(A)], following the decision of the Bombay High Court in the case of Veekaylal Investment Co. (P) Ltd.³ held that even under Clause 3(xii)(b) of Part II of Schedule VI to the Companies Act, 1956 (Companies Act),

¹ Sri Hariram Hotels (P.) Ltd. v. CIT [2016] 66 taxmann.com 233 (Kar)

² Minimum Alternate Tax (MAT) provisions

³ CIT v. Veekaylal Investment Co. (P) Ltd. [2001] 249 ITR 597 (Bom)

profit or losses in respect of transactions of an exceptional or non-recurring nature are to be disclosed. Thus, the CIT(A) held that capital gains should be included for the purpose of computing book profit. The Bangalore Tribunal confirmed the order passed by the CIT(A).

High Court ruling

- The Supreme Court in the case of Apollo Tyres Ltd.⁴ held that the AO while computing the income under Section 115J of the Act has only the power of examining whether the books of account are certified by the authorities under the Companies Act, 1956. The AO thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section.
- Subsequently, the Supreme Court in the case of HCL Comnet Systems & Services Ltd.⁵ held that the adjustment required to be made to the net profit disclosed in the profit and loss account for the purpose of Section 349 of the Companies Act are quite different from the adjustment required to be made under the Section 115JA of the Act. For the purpose of Section 115JA of the Act, the AO can increase the net profit determined as per the profit and loss account prepared as per Parts II and III of Schedule VI to the Companies Act only to the extent permissible under the Explanation to Section 115JA of the Act.
- The Explanation appended to Section 115JB of the Act provides certain items which if debited to the profit and loss account can be added back to the net profit for computing the book profit. Clause (b) of the said Explanation provides for the amount carried to any reserves by whatever name called. In the present case, the capital gains were directly accounted to a capital reserve without taking the said amount to the profit and loss account, therefore, said Explanation to Section 115JB of the Act is not applicable to the facts of the present case.

- In view of above, the AO has no power to recompute the book profit and has to rely upon the authentic statements of account of the company, the accounts being scrutinised and certified by the statutory auditors though with a qualification, approved by the company in a general body meeting and thereafter filed before the ROC, who has a statutory obligation to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act.
- Accordingly, the High Court allowed the appeal in favour of the taxpayer.

Our comments

The Karnataka High Court in the instant case relying on the decisions of the Supreme Court reiterated that the AO does not have the power to recompute the book profit under Section 115JB of the Act when the accounts of the company have been scrutinised and certified by statutory auditors.



⁴ Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC)

⁵ CIT v. HCL Comnet Systems & Services Ltd. [2008] 305 ITR 409 (SC)

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