

No sec. 10B relief if unit had shown artificial profit due to interest-free loan from director; reassessment upheld

Summary – The High Court of Gujarat in a recent case of Nabros Pharma (P.) Ltd., (the Assessee) held that where there was no disclosure of relevant material facts on part of assessee regarding huge interest free borrowings from its directors and, thus, exemption under section 10B was wrongly allowed, reassessment by Assessing Officer beyond a period of four years would be justified

Facts

- The assessee-company was engaged in the business of manufacturing of pharmaceutical drugs and formulations. The company had set up two units for such purpose. It claimed exemption under section 10B.
- The Assessing Officer except for disallowance of certain sum under section 14A, accepted assessee's other declaration. Later, he issued a notice for reopening of assessment on grounds that sizeable amount of loans were advanced to the assessee by two of the directors of the company without charging interest. According to him, the profit of the eligible unit under section 10B was artificially inflated and also, claim of exemption under section 10B was not available to the assessee.
- On petition before the High Court:

Held

- Section 10B pertains to special provisions in respect of newly established 100 per cent export oriented undertakings and briefly put grants exemption to new industrial undertakings established for 100 per cent exports. For consecutive years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture, its income from exports of articles would be 100 per cent exempt from tax. Sub-section (7) of Section 10B provides that the provisions of sub-section (8) and sub-section (10) of section 80-IA shall so far as may be applied in relation to the undertaking referred to in the present section as they apply for the purpose of undertaking referred to in Section 80-IA. Thus, by reference, the provisions of sub-section (8) and sub-section (10) of Section 80-IA are made applicable to Section 10B also.
- Section 80-IA pertains to deductions in respect of profits and gains for industrial undertakings or enterprises engaged in infrastructure development *etc.*
- In terms of this provision, therefore, where it appears to the Assessing Officer that owing to close connection between the assessee carrying on eligible business and any other person, the course of business is so arranged that the business transacted between them produces to the assessee more than the ordinary profits expected to arise in such eligible business, the Assessing Officer while

computing the profits and gains of such eligible business for the purpose of deduction would take the amount of profits as may be reasonably deemed to have been derived therefrom.

- The fact that the petitioner company borrowed sizeable amount from the said two directors is not in dispute. Since the directors were closely connected with the petitioner-company, sub-section (10) of section 80-IA would certainly apply allowing the Assessing Officer to modulate the profit of the company for the purpose of exemption under section 10B appropriately. The contention that the company not having paid the interest and the directors not having charged the interest, the Assessing Officer cannot reduce the profit of the assessee, therefore, cannot be accepted.
- Requirement flowing from the provisions of section 147 would have to be appreciated bearing in mind *Explanation 1* which provides that production before the Assessing Officer of the account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not necessarily amount to disclosure within the meaning of the proviso. There is thus, a thin line between the disclosure which disguises a material fact and, therefore, would be in terms of the proviso read with *Explanation 1* would amount to failure of disclosure and one where it would be the duty of the Assessing Officer on the basis of primary facts disclosed by the assessee to draw further inferences on facts and or in law.
- In the present case, what formed part of the record was that the assessee-company had borrowed huge loans from said two persons. What did not form part of the record was whether on such loans any interest was paid or not, a fact which could not have been evident or visible to the Assessing Officer unless he had made further inquiries. Undoubtedly, the Assessing Officer could have made further inquiries and ascertained for his satisfaction whether on such borrowings any interest was paid or not and had he done so, as is referred to in *Explanation 1* to section 147, he would have discovered a material fact *viz.* of the company not paying interest on sizeable borrowings. In fact, the fact that the said two lenders were the Directors of the Company is not appearing in the audit report where the figures of loans are mentioned. Thus, the Assessing Officer would have to correlate different documents only upon which, if at all, he would learn that the two directors had advanced huge loans to the company. Thus, this case clearly fell within the scope of *Explanation* to section 147. This would not, therefore, prevent the Assessing Officer from reopening the assessment beyond a period of four years from the reign of the assessment year.