Legal Decisions[1]

Income-tax Act

LD/62/7

CIT, Kolkata-III
Vs.
Rajarani Exports Pvt. Ltd.
April 24, 2013 (CAL)

Section 37(1) of the Income-tax Act, 1961 – Business Expenditure – Allowability of

Without calling in question commercial expediency of commission paid by assessee, fact that services was rendered to assessee by a party other than agent to whom commission was paid, was wholly immaterial so far as deductibility of commission in hands of the assessee was concerned.

The assessee had made payment of export commission. The Assessing officer disallowed the commission in view of the *Explanation* to section 37 (1). Against this disallowance the assessee preferred appeal before the Commissioner (Appeals) which was allowed.

The Tribunal dismissed the department's appeal holding *inter alia* as follows:

> *"The assessee had made payment for commission and had been rendered services in consideration of the same. As a matter of fact, it was not even revenue's case that no services had been rendered at all. The fact that services had been rendered by a party other than the agent to whom commission was paid was wholly immaterial so far as deductibility in the hands of the assessee was concerned.*
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> *As for the position that the payment was highly excessive vis-à-vis the local costs, even if that be so, that aspect of the matter did not affect the deductibility in the hands of the assessee either. The assessee was concerned with commercial expediency of the said payment and not with what were the actual costs incurred in rendering the services for which the payment was made. It was absolutely necessary for the assessee to make the impugned payments and, in any event, the commercial expediency of these payments had not even been called into question by the Assessing Officer. The case of the revenue was confined to invoking the Explanation to Section 37(1). Thus, the Tribunal held that the objections to the said commission payments were, therefore, not sustainable in law, so far as deductibility under section 37(1) is concerned."*

The Calcutta High Court upheld the order of the Tribunal taking into the finding of facts recorded by the Tribunal.

Companies Act

LD/62/8

V.L.S. Finance Ltd.
Vs.
Union of India & Ors.
May 10, 2013 (SC)

Section 211 read with Section 621A of the Companies Act, 1956 – Form and Contents of Balance Sheet and Profit and Loss Account

An accused charged with offence under section 211(7), not being an offence punishable with imprisonment only or imprisonment and also with fine, is permissible to be compounded by Company Law Board either before or after institution of any prosecution and prior permission of court is not necessary

The Registrar of Companies, NCT of Delhi and Haryana laid complaint in the Court of Chief Metropolitan Magistrate alleging that during the course of inspection of company 'S' it was noticed in the balance sheet of 1995-96 Schedule of the fixed assets included land worth ₹21 crore. According to the complaint the Company 's' had taken this land from New Delhi Municipal Corporation on licence and the Company only pays the yearly licence fee thereof. Thus, according to the complainant, without any right, land had been shown as land in the Schedule of fixed assets, which is not a true and fair view and punishable under Section 211(7). The Company and its Chairman-cum-Managing Director were arrayed as accused.

However, before the court in seisin of the case could proceed with the complaint, the Company and its Managing Director jointly filed an application before the Company Law Board for compounding the offence. The Company Law Board acceded to the prayer and compounded the offence against the Managing Director on payment of ₹1000/- for each offence each year.

Aggrieved by the same, appellant preferred Company Appeal before the High Court, *inter alia*, contending that the power of compounding could

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.*

be exercised by the criminal court and not by the Company Law Board. Said submission had not found favour and the Company Judge dismissed the appeal.

The Supreme Court held that it is an admitted position that the allegation made exposed the Company and its Managing Director for punishment under Section 211(7) which provides for imprisonment or fine or with both. In the face of the same, no fact needs to be adjudicated and the point being a pure question of law going to the root of the matter, same can be permitted to be raised before the Supreme Court for the first time.

From a plain reading of Section 621A(1) it is evident that any offence punishable under the Act, not being an offence punishable with imprisonment only or with imprisonment and also with fine, may be compounded either before or after the institution of the prosecution by the Company Law Board and in case, the minimum amount of fine which may be imposed for such offence does not exceed ₹5000/-, by the Regional Director on payment of certain fine. The penal provisions of the Act provide for different kinds of punishments for variety of offences and can be categorised as, (i) offences punishable with fine only, (ii) offences punishable with imprisonment only, (ii) offences punishable with fine and imprisonment, (iv) offences punishable with fine or imprisonment, (v) offences punishable with fine or imprisonment or both.

Section 211(7) provides for punishment with imprisonment for a term which may extend to six months or with fine or with both. Therefore, an accused charged with the offence under Section 211(7) has not necessarily to be visited with imprisonment or imprisonment and also fine but can be let off by imposition of fine only. Therefore, the punishment provided under Section 211(7) comes under category (v). Section 621A(1) excludes such offences which are punishable with imprisonment only or with imprisonment and also with fine. The nature of offence for which the accused has been charged necessarily does not invite imprisonment or imprisonment and also fine. Hence, the nature of the offence is such that it was possible to be compounded by the Company Law Board.

Sub-section (1) of Section 621A and sub-section (7) thereof are differently worded but on their close reading it is evident that both cover such offences depending upon the nature of punishment. Sub-section (1) of Section 621A excludes offence punishable with imprisonment only or with imprisonment and also fine and includes the residue offences which will obviously include offence punishable with imprisonment or with fine or with both whereas sub-section (7) specifically include those and excludes, like sub-section(1), offences punishable with imprisonment only or with imprisonment and also fine. Therefore, both cover similar nature of offences. Hence, the power for compounding can be exercised in relation to the same nature of offences by the Company Law Board or the court in seisin of the matter with the difference that the Company Law Board can proceed to compound such offence either before or after the institution of any prosecution. In this connection, it shall be relevant to refer to Section 621A(4)(b) of the Act, which

provides that where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the Company to the Registrar within 7 days from the date on which the offence is compounded. Section 621A(4)(d) mandates that where the composition of any offence is made after the institution of any prosecution, such composition would be brought by the Registrar in writing to the notice of the court in which the prosecution is pending and on such notice of the composition of the offence being given, the accused in relation to whom the offence is so compounded shall be discharged.

It is more than clear that an offence committed by an accused under the Act, not being an offence punishable with imprisonment only or imprisonment and also with fine, is permissible to be compounded by the Company Law Board either before or after the institution of any prosecution. In view of sub-section (7) of Section 621A, the criminal court also possesses similar power to compound an offence after institution of the prosecution.

Both sub-section (1) and sub-section (7) of Section 621A start with a non-obstante clause. As is well known, a non-obstante clause is used as a legislative device to give the enacting part of the section, in case of conflict, an overriding effect over the provisions of the Act mentioned in the *non-obstante* clause.

Ordinarily, the offence is compounded under the provisions of the Code of Criminal Procedure and the power to accord permission is conferred on the court excepting those offences for which the permission is not required. However, in view of the non-obstante clause, the power of composition can be exercised by the court or the Company Law Board. The legislature has conferred the same power to the Company Law Board which can exercise its power either before or after the institution of any prosecution whereas the criminal court has no power to accord permission for composition of an offence before the institution of the proceeding. The legislature in its wisdom has not put the rider of prior permission of the court before compounding the offence by the Company Law Board.

Thus the power under sub-section (1) and sub-section (7) of Section 621A are parallel powers to be exercised by the Company Law Board or the authorities mentioned therein and prior permission of Court is not necessary for compounding the offence, when power of compounding is exercised by the Company Law Board. The order impugned does not require any interference.

Note: Order dated November 5, 2003 of Delhi High Court in Company Appeal (B) No. 1 of 2001, upheld.

SEBI

LD/62/9

N. Narayanan
Vs.
Adjudicating Officer, SEBI
April 26, 2013 (SC)

Section 15HA, read with section 15JA of the SEBI Act, 1992 read with Regulations 3 & 4 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practice Relating to Securities Market) Regulations, 2003 – Penalty for Fraudulent and Unfair Trade Practices

Where company had committed serious irregularities in its books of accounts and showed inflated profits and revenues in the financial statements and lured the general public to invest in the shares of the company based on such false financial statements, it should be held to have violated the provisions of SEBI FUTP Regulations; directors would be penalised therefor

The appellant was the promoter as well as a whole time Director of Pyramid Saimira Theatre Limited (PSTL), a company registered under the Companies Act, 1956. The shares of PSTL were listed on Bombay Stock Exchange Ltd. (BSE) and National Stock Exchange (NSE) at the relevant time. The company was involved in the business of Exhibition (Theatre), Film and Television, Content Production, Distribution, Hospitality, Food & Beverage, Animation and Gaming and Cine Advertising etc. The company had nine Directors, including the appellant herein.

The investigation department of SEBI noticed that the company had committed serious irregularities in its books of accounts and showed inflated profits and revenues in the financial statements and lured the general public to invest in the shares of the company based on such false financial statements thereby violated the provisions of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practice Relating to Securities Market) Regulations, 2003.

The appellant-director's main defence was that, though he was the Whole Time Director as well as Promoter of the company, yet was not involved

in the day-to-day management of the company and that he was looking after the Human Resource Department of the company. Further, the financial statements, accounts etc. were prepared and duly audited by the statutory auditors, verified by the audit committees and reviewed by the managing Director and that, in the company, the role of each Director was confined to his field of operation and there was no justification for holding a Director to be in over-all charge and control of the affairs of the company. Further, it was also pointed out that the auditors were well versed in accounts and f inance, therefore, there was no reason for the Directors who have no expertise or knowledge of the intricacies of the accounts and finance to suspect them or sit in judgment over their decisions. In such circumstances, it was contended, that there is no justification in debarring appellant-directors from buying, selling or dealing in securities or accessing securities market or to impose penalty.

The Supreme Court held as follows:

India's capital market in the recent times has witnessed tremendous growth, characterised particularly by increasing participation of public. Investors' confidence in the capital market can be sustained largely by ensuring investors' protection. Disclosure and transparency are the two pillars on which market integrity rests. Facts of the case disclose how the investors' confidence has been eroded and how the market has been abused for personal gains and attainments.

Companies whose securities are traded on a public market, disclosure of information about the company is crucial for the accurate pricing of the companies' securities and also for the efficient operation of the market.

Corporate Governance and Directors

SEBI Act read with Regulations of the Companies Act would indicate that the obligations of the Directors in listed companies are particularly onerous especially when the Board of Directors makes itself accountable for the performance of the company to share holders and also for the production of its accounts and financial statements especially when the company is a listed company.

The Directors of the company or the person in charge directly or indirectly use or employ, in connection with the issue, purchase or sale of any securities listed in stock exchange, any manipulative or deceptive device or contrivance in contravention of SEBI Act or the Regulations made thereunder have necessarily to be dealt with in accordance with the provisions of the Act and the Regulations which is absolutely necessary for the investor's protection and to avoid market abuse.

The facts clearly indicated that the company had made false corporate announcement stating that it had entered into agreements with 802 theatres and that false corporate announcement gave false figures relating to advance, security deposit and income pertaining to the theatres which were not inexistence. The deposits shown were turned out to be not genuine but mere book entries to hide receivables in the balance sheet.

Responsibility is cast on the Directors to prepare the annual records and reports and those accounts should reflect 'a true and fair view'. The over-riding obligation of the Directors is to approve the accounts only if they are satisfied that they give true and fair view of the profits or loss for the relevant period and the correct financial position of the company.

Company though a legal entity cannot act by itself, it can act only through its Directors. They are expected to exercise their power on behalf of the company with utmost care, skill and diligence. A director is liable for fraud in the conduct of business of the company even though no specific act of dishonesty is provided against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the company even superficially.

The Directors of the company in question had failed in their duty to exercise due care and diligence and allowed the company to fabricate the figures and making false disclosures. Facts indicate that they have overlooked the numerous red flags in the revenues, profits, receivables, deposits etc. which should not have escaped the attention of a prudent person. For instance, profit as on quarter ending June 2007 was three times more than the preceding quarter, it doubled in the quarter ending December 2007 over the preceding quarter. Further, there was disproportionate increase in the security deposits i.e. ₹36.05 crore in September 2007 to ₹270.38 crore in December 2007 as compared to increase in the number of theatres during the same period. They have participated in the board meetings and were privy to those commissions and omissions. Still they took no corrective measures.

Securities Market – Market abuse

The Directors of the company have "created artificiality" by projecting inflated figures of the company's revenue, profits, security deposits and receivables and that the manipulation in the financial results of the company resulted in price rise of the scrip of the company and the promoters of the company then pledged their shares to raise substantial funds from financial institutions. The conduct of the appellant-director and others was, therefore, fraudulent and the practices they had adopted, relating to securities, were unfair, which attracted the penalty provisions contained in Section 15 HA read with 15J of the SEBI Act.

Disclosure and Transparency

The Companies Act casts an obligation on the company registered under the Companies Act to keep the Books of accounts to achieve transparency. Previously, it was thought that the production of the annual accounts and it preparation is that of the Accounting Professional engaged by the company where two groups who were vitally interested were the shareholders and the creditors. But the scenario has drastically changed, especially with regard to the company whose securities are traded in public Market, disclosure of information about the company is crucial for the accurate pricing of the company's securities and for market integrity. Records maintained by the company should show and explain the company's transactions, it should disclose with reasonable accuracy the financial position, at any time, and to enable the Directors to ensure that the balance sheet and profit and loss accounts will comply with the statutory expectations that accounts give a true and fair view. Companies (Amendment) Act, 2000 has added clause (a)(iii) under which SEBI has also been given the power of inspection of listed companies or companies intending to get listed through such officers, as may be authorised by it.

After the declaration of financial results on January 31, 2008, containing inflated profits, revenues for the quarter ended on 31.12.2007, the Managing Directors of the company, his wife and the appellant had together pledged 72,75,455 shares of the company with various banks and financial institutions and raised 97.30 crores as loans. The Directors and the Chief Financial Officers of the company had caused to publish forged and misleading results of the company, various quarterly financial results and the annual results for the year 2007-08, were reported to the stock exchanges containing inflated figures of the company's revenue, profits, security deposits and receivables and those financial statements which were relied upon by investors in making investment decisions, which did not reflect a true and fair view of the state of affairs of the company.

The appellant, admittedly, was a whole time Director of the company, as regards the preparation of the annual accounts, the balance-sheet and financial statement and laying of the same before the company at the Annual General Meeting and filing the same before the Registrar of the Companies as well as before SEBI. The Directors of the company have greater responsibility, especially when the company is a registered company. Directors of the companies, especially of the listed companies, have access to inside knowledge, such as, financial position of the company, dividend rates, annual accounts etc. Directors are expected to exercise the powers for the purposes for which they are conferred. Sometimes they may misuse their powers for their personal gain and makes false representations to the public for unlawful gain.

The subsequent conduct of pledging their shares at artificially inflated prices, based on inflated financial results and raising loan on them would indicate that they had deliberately and with full knowledge committed the illegality and hence the principle of *"acta exteriora indicant interiora secreta"* (meaning external actions reveals inner secrets) applies with all force.

Decision

The SEBI has rightly restrained the appellant for a period of two years from the date of that order from buying, selling or dealing with any securities, in any manner, or accessing the securities market, directly or indirectly and from being Director of any listed company and that the adjudicating officer has rightly imposed a penalty under Section 15HA of the SEBI Act.

A word of caution

SEBI, the market regulator, has to deal sternly with companies and their Directors indulging in manipulative and deceptive devices, insider trading etc. or else they will be failing in their duty to promote orderly and healthy growth of the Securities market. Economic offence, people of this country should know, is a serious crime which, if not properly dealt with, as it should be, will affect not only country's economic growth, but also slow the inflow of foreign investment by genuine investors and also casts a slur on India's securities market. Message should go that our country will not tolerate "market abuse" and that we are governed by the "Rule of Law". Fraud, deceit, artificiality, SEBI should ensure, have no place in the securities market of this country and 'market security' is our motto. People with power and money and in management of the companies, unfortunately often command more respect in our society than the subscribers and investors in their companies. Companies are thriving with investors' contributions but they are a divided lot. SEBI has, therefore, a duty to protect investors, individual and collective, against opportunistic behavior of Directors and Insiders of the listed companies so as to safeguard market's integrity.

Print and Electronic Media have also a solemn duty not to mislead the public, who are present and prospective investors, in their forecast on the securities market. Of course, genuine and honest opinion on market position of a company has to be welcomed. But a media projection on company's position in the security market with a view to derive a benefit from a position in the securities would amount to market abuse, creating artificiality. SEBI has the duty and obligation to protect ordinary genuine investors and the SEBI is empowered to do so under the SEBI Act so as to make security market a secure and safe place to carry on the business in securities.

Note: Order dated 5-10-2012 of Securities Appellate Tribunal (SAT), Mumbai in N. Narayanan Vs. SEBI (Appeal Nos. 28 & 29 of 2012), upheld. ■