Reportable

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.56 OF 2009**

Judgment Reserved on: 18th August, 2010.
% Judgment Pronounced on: 14th September, 2010.

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Advocate

VERSUS

TRIVENI ENGINEERING & INDUSTRIES LTD. . . .Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha and Ms. Akansha Aggarwal, Advocates.

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal pertains to the Assessment Year 2000-01. The respondent-assessee, for that year, filed the return declaring loss at ₹12.58 Crores. The Assessing Officer (AO) while making the assessment took note of the fact that the assessee had claimed a sum of ₹8.65 Crores as unrealizable assets written off and adjusted against the reserves in computation of income. The

figure of unrealized assets written off included the following tw
sums:

(i) ₹15,34,951 representing security deposit, which was written off by the assessee as unrealizable; and

(ii) ₹5,18,380 which was the amount of advance given to various employees and the assessee had written off this as well on the ground that the same had become unrealizable.

2. The AO disallowed these two amounts. The nature of these deposit/advances under which these were disallowed by the AO are as under:

The assessee company was amalgamated with Gangeshwar Ltd. By virtue of this amalgamation, all the assets and liabilities of the amalgamating company became the assets and liabilities of the amalgamated company (i.e. the assessee company). Thus, the assets of the amalgamated company included certain security deposits, which were given to landlords for obtaining lease of premises for purposes of business as well as certain advances, which were given to the employees. Such security deposits as well as advances given to the employees were not recoverable. It was accordingly provided in Para 3.3 in the Scheme of Amalgamation, which was submitted to the High Court of Allahabad under Section 391-394 of the Companies Act, 1956, as under:

"3.3 Treatment of Reserves:

> Upon this Scheme coming into effect, the reserves of the Transferor Company in the same form as those appeared in the financial statements of the Transferor Company as on the Appointed Date. Subject to any other treatment as deemed appropriate by the Board of the Transferee company, it is further provided that Amalgamation Reserve as appearing in the financial statements of the Transferor Company, may be adjusted to the extent of difference, if any, between nominal issue price and carrying cost of any securities between the Transferor Company and the Transferee Company and may be further adjusted with the difference, if any, in the valuation of assets and liabilities of the Transferor Company as determined by the Transferee Company in accordance to Clause 2.15. In the event of Amalgamation Reserve being not sufficient to meet such adjustments as aforesaid, the balance adjustments may be carried out in Share Premium Account."

3. In accordance with the approved scheme, the respondent-assessee wrote off unrecoverable security deposits given to landlords for lease of premises, and unrecoverable employee advances given by the amalgamating company in the earlier years, by debit to the amalgamation reserve account and claimed deduction as pointed out above.

4. The reason for denying these deductions given by the AO was that security deposits and employees balance written off did not spring directly from carrying on of the business and were not incidental thereto, though it was admitted that the same may have some connection with the business.

5. Aggrieved by the disallowance, the assessee-company preferred appeal before the CIT (A). Before CIT (A), the assessee-company submitted that the security deposits were given for obtaining premises on rent and that the advances were given to employees in the course of carrying on of the business. The assessee triumphed in this appeal, as CIT (A) accepted the plea of the

assessee that it had not advanced the amounts for securi capital assets, non-recovery of which could have resulted in capital loss. The CIT (A) was further of the opinion that non-recovery of security deposits and employees advances were directly linked with the business of the appellant and, therefore, the loss suffered as a result of writing off of the same was in the nature of business loss allowable under Section 28 of the Income Tax Act (hereinafter referred to as 'the Act'). In this behalf, the CIT (A) observed:

> "The security deposits were made for obtaining contracts. The same were not advanced for securing of capital asset, non-recovery of which would have resulted into capital loss. Similarly, non-recovery of employee's advance was directly linked with the business of the assessee and therefore, it was in the nature of business loss allowance under Section 28 of the Act."

6. The Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') vide its impugned order dated 08.08.2008 has accorded its approval to the order of the CIT (A), which order is under challenge in this appeal.

7. The present appeal was admitted on the following substantial question of law:

> "Whether the amount of ₹15,34,951 and ₹5,18,380 were a Revenue loss to the assessee so as to allow the same under Section 28 of the Act?"

8. The plea of Ms. P.L. Bansal, learned counsel appearing for the Revenue, is that the assessee had claimed deduction of the aforesaid amount as bad debts under Section 37 (1) (vii) of the Act. She submitted that the AO rejected the same holding that:

(i) The same had not been written off by debiting t Profit and Loss Accounts but had been written off by debiting amalgamation reserve account;

(ii) Section 37(1)(vii) is not applicable as the said amount had not been taken into consideration as income in the previous year or the earlier years; and

(iii) It was not allowable even under Section 28 of the Act, as the said amount did not spring directly from carrying on of the business, the same is not an incident to the business of the assessee, though may have some connection with the business and therefore, in view of the principle laid down by the Apex Court in the case of ***Badri Dass Daga*** Vs. ***The Commissioner of Income Tax*** [(1958) 34 ITR 10 (SC)], the same was not allowable as trading loss.

9. Her submission was that the assessee had not debited the amount as written off in the Profit & Loss Accounts, but had charged as amalgamation reserve. According to Ms. Bansal, reliance placed by the assessee upon Clause 3.3 of the Scheme of Amalgamation was not appropriate. This Clause was subject to Clause 2.15, which lays down that the assets and liabilities of the transferor company as on the appointed date, as per its audited date, shall be taken over by the transferee company at the values stated therein "subject to determination of their realistic value by the Board of Transferee Company in view of any developments that might have taken place, subsequent to the appointed date". Ms.

Bansal argued that this circumstance had not been established by the assessee and in these circumstances, Section 37(1) (vii) read with Section 36(2) is not applicable to the present case. She also argued that the security deposits were given by the assessee for obtaining the premises on rent. Thus, by making refundable security deposit, the assessee had obtained a right to use the property (tenancy right), which is a capital asset. Even otherwise, tenancy right is held to be a capital asset under the Income Tax Act, which is evident from Section 55(2) of the Act. Therefore, the CIT (A) and the Tribunal have erred in holding that the security deposits had been advanced for obtaining contracts. In fact, earnest money was deposited for obtaining contracts, which had already been allowed by the AO. In support of her aforesaid contentions, she referred to various judgments. The first case is the decision of the Supreme Court in the case of ***Badri Dass Daga*** (supra), wherein it has been held that mere connection with the business is not sufficient. The items in the present case had no connection with the trading activities of the assessee and therefore, the same could not have been allowed as trading loss. Advances to employees are in the nature of loan, which was repayable. Loan cannot be the expenditure by any stretch of imagination. Further, in the case of ***Commissioner of Income Tax*** Vs. ***Abdullahbhai Abdulkadar*** [41 ITR 545], the Supreme Court has held that a debt was allowable only when it was a debt and arose out of and as an incident to the trade. Except in money lending trade, debts could only be so described if they were due from customers for goods supplied or loans to constituents or

transactions of a similar kind. In every case, the test is: Is t debt due as an incident to the business? If it was not of that character, it would be a capital loss. She also referred to the judgment of Jurisdictional High Court in the case of ***Iron Traders P. Ltd.*** Vs. ***Commissioner of Income-tax*** 97 ITR 606 wherein it is held that unless the sum represented the price of stock-in-trade of the assessee or it represented expenditure incurred for preserving the assessee's business, it could not be said that the amount was in the nature of revenue expenditure.

10. Mr. Ajay Vohra, learned counsel appeared on behalf of the respondent-assessee and supported the decision rendered by the CIT (A) as affirmed by the Tribunal. His submission was that under Section 28/37(1) of the Act, deduction is admissible for trading loss/loss incidental to business. The only test to be satisfied is that the loss must arise from/spring directly from the carrying on of business. In other words, the loss must be incidental to the trade itself; there must be some nexus between the trade and loss which should have been incurred by the assessee in the course of trade. In order that loss occasioned from non-realization of advances can be allowed, the loss should have been incurred by one in the character of trader and the same should fall on the assessee in that character. He relied upon the decision of the Supreme Court in the celebrated case of ***Badri Dass Daga*** (supra), wherein the Court while allowing the claim for loss on account of embezzlement by an employee, observed as under:

> "7. The result is that when a claim is made for a deduction for which there is no specific provision in section 10(2), whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it. If that is established, then the deduction must be allowed, provided of course there is no prohibition against it, express or implied, in the Act."

11. He also relied upon the judgment in the case of ***Abdullahbhai Abdulkadar*** (supra) wherein the Apex Court held that in case of loss arising out of advance made in a business or profession, the deciding point is whether advances are made for the purpose of business or profession or whether they are related to business or profession or result from it. While dealing with similar issue in the case of ***Commissioner of Income Tax*** Vs. ***Mysore Sugar Company Limited*** [46 ITR 649 (SC)], it was held by the Apex Court as follows:

> "8. To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss capital. But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for that was the money laid out ? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business ? If money be lost in the first circumstances, it is a loss of capital, but if lost in the second circumstances, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses."

12. Mr. Vohra's plea was that the security deposits written off were given by the amalgamating company in the course of carrying on business in order to secure use of premises for purposes of business. Similarly, advances were given to employees employed

with the amalgamating company, in the course of carrying on the business. The same were written off due to non-recoverability thereof on account of disputes with the landlords/vacation of premises, termination of employees, etc. The security deposit/advances given to the employees were not for securing any capital assets or obtaining any enduring advantage in the capital field. The payment of security deposit to landlords was for obtaining use of premises for purposes of business against payment of rent, which payment is clearly in the revenue field, for facilitating carrying on of business more profitably and efficiently while leaving the fixed capital untouched. Advances to employees were given in the ordinary course of business by way of temporary financial accommodation to be recovered out of the salary paid to the employees. The giving of such advances was necessitated in order to share up the personal finances of the employees, to meet any emergency/financial commitment and keep the employees motivated, contended and happy.

13. Insofar as deduction of advances given to the employees are concerned, which had become unrecoverable, that may not pose much of a problem. Advances were given to the persons who had been employed by the assessee-company and if they became unrecoverable, it would clearly be treated as business loss. Law on this aspect stands crystallized by the judgment of the Bombay High Court in the case of ***CIT, Panaji, Goa vs. Maina Ore Transport (P) Ltd**.,* [(2008)218CTR(Bom)653].

14. Thus, the AO was not correct in holding that this was not allowal even under Section 28 of the Act, as it does not spring directly from carrying on of the business and is not incidental thereto.

15. Coming to the security deposit written off by the assessee, the moot question is as to whether the advances were given for securing the capital assets. It is not disputed by the Department that the payment of security deposit to landlords was for obtaining use of premises for the purposes of business against the payment of rent. The contention of the assessee, in this backdrop, is that this payment was clearly in the revenue field, viz., for facilitating carrying on of business more profitably and efficiently while leaving the fixed capital untouched. Learned counsel for the Revenue, however, argues that the security deposits were given for obtaining the premises on rent and thus, the assessee had obtained a right to use the property, i.e., tenancy right, which is a capital asset.

16. In order to appreciate the controversy, we may first state the true nature of this deposit. When the premises were taken on rent by the company, the payments in the form of security deposits were given to the land lords. Since the Rent Agreement entered into with the said landlords has not been produced, which could have shown the purpose for which security deposits were made, in the absence thereof, we presume that normal practice which is followed in giving such security deposits existed here also. On that premise, it can be inferred that these were refundable

security deposits, which were to be given back by the landlords the company on the conclusion of tenancy period and surrendering of the leased premises by the company to the landlords. Therefore, these security deposits were not in the form of rent. The question would be when such a security deposit has become non-recoverable for some reasons whether it can be allowable as deduction under Section 28 of the Act. The deposits were not given in the ordinary course of business either. These were given for securing the premises on rent; *albeit* for the purpose of carrying on business therein. Once we keep in mind this true nature of deposits, we find force in the submission of Ms. Bansal, learned counsel for the Revenue.

17. We may point out that the assessee had relied upon the judgment of the Supreme Court in the case of ***Commissioner of Income Tax*** Vs. ***Madras Auto Service (P) Ltd.*** [233 ITR 468]**.** However, that judgment would not be applicable to the facts of the present case. The expenditure incurred on the construction of building on a leased property was treated as revenue expenditure by the Supreme Court, as the assessee was getting business advantage and was acquiring the business asset in the context of specific Clause in the lease deed. Therefore, the property was not treated as that of the lessor. Further, the Supreme Court found that by incurring the expenditure of this nature, the assessee had taken the advantage in the form of reduced rent for a much longer period. This judgment is, thus, not applicable in the present context.

18. In view of the above, this appeal is partly allowed, holding th the amount of ₹15,34,951/- was not a revenue loss, and therefore not allowable as deduction.

No costs.

(A.K. SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

SEPTEMBER 14, 2010.
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