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

\+ **ITA No.445 of 2008**
ITA No.444 of 2008
ITA No.448 of 2008

Reserved On: March 28, 2011
% *Pronounced On: May 11, 2011.*

1) ITA No.445 of 2008

COMMISSIONER OF INCOME TAX . . . APPELLANT

through : Ms. Suruchi Aggarwal, Sr. Standing Counsel with Ms. Shawana Bari, Advocate.

VERSUS

TULIP STAR HOTELS LTD. . . .RESPONDENT

through: Mr. O.S. Bajpai, Sr. Advocate with Mr. V.N. Jha, Advocate.

2) ITA No.444 of 2008

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CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

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.

For orders, see ITA No.445 of 2008.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

MAY 11, 2011
pmc

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A.K. SIKRI, J.

1. All these three appeals are between the same parties and the Assessment Years involved are 1998-99, 1999-2000 and 2003-04. Some of the questions raised are common to these appeals. Therefore, we feel it appropriate to take up the appeal relating to the Assessment Year 1998-99, which will take care of common questions arising in other appeals as well.

ITA No.445 of 2008: (Assessment Year 1998-99)

2. In this appeal, the following three substantial questions of law are proposed for adjudication:

> "a) Whether the I.T.A.T. was correct in deleting the disallowance of ₹122.47/- lacs made by the Assessing Officer by holding that the alleged debt had not been incurred in the normal course of business and is not allowable as deduction?

b) Whether the I.T.A.T. was correct in law in allowing the deduction of ₹85 lacs claimed by the assessee on account of bad debt written off when the said debt had not become bad and requirements of Section 36 are not satisfied in this case?

c) Whether the I.T.A.T. was correct in law in holding that the provisions of Section 35D are application in the present case although the assessee is not an industrial undertaking nor an extension of industrial undertaking?"

3. Facts leading to the aforesaid questions of law may succinctly be stated as under:

Question (a):

4. This question has arisen under the following circumstances:

₹100 lacs was placed by the assessee with Citibank as fixed deposit in the year 1994-95. The assessee agreed with Citibank for a lien on the said deposit in consideration of the said bank disbursing a credit line to Fairmark, a company in respect of which the assessee company was a co-promoter. The assessee earned interest income on the said deposit from Citibank and also earned interest income on the said deposit from Fairmark. On Fairmark's defaulting in payment of the dues to Citibank, the amount of fixed deposit of ₹109.06 lacs (including interest accrued on the fixed deposit) was appropriated by the said bank against the dues of Fairmark in August, 1997. The business operations of Fairmark were controlled by three Non-Resident Indian Directors who have

since abandoned the business affairs of Fairmark. The assessee had entered into an agreement with the said non-resident Directors on 11.12.1996 whereby the said Directors had undertaken to cause Fairmark to repay the dues of Citibank and pay to the company:

(a) By way of refund of share application money of ₹12.50 lacs;

(b) Arrears of interest on the deposit of ₹100 lacs; and

(c) Share of profit from Fairmark

The assessee has initiated legal proceedings in India against the Dass Brothers for their failure/misconduct in the discharge of their fiduciary responsibilities, as Directors are responsible for the operations of Fairmark and also in U.K. for break of agreement dated December 11, 1996. Notwithstanding a partly favourable judicial ruling by the Courts in U.K., the assessee is not hopeful of recoveries and hence, the amount of fixed deposit of ₹100 lacs with Citibank, the interest accrued thereon which was appropriated by Citibank and the share application money of ₹12.50 lacs, all aggregating to ₹122.47 lacs has been written off as business loss.

5. It was found by the Assessing Officer (AO) that the assessee company had entered into a deal with M/s. Fairmark as a co-

promoter and pledged their fixed deposit receipts with the Citibank, as a security for loan to be given by Citibank to Fairmark. It was further seen by the AO that in order to promote its business, certain advances were also given. After the borrower failed to offer the money in the Citibank and security of FDR given by the assessee company was adjusted by the Citibank against the dues to Fairmark. On perusal of the documents, it was seen by the AO that Sh. Paul Dass who was a non-resident has confirmed the valuation and settlement in U.K. and in India and, therefore, it does not appear to be clear cut case where the money advanced by the assessee company could be said to be money advanced in the normal course of business of money lending. The AO further observed that the assessee company had advanced this money to Fairmark as a co-promoter and definitely advancing money to promote the assessee company is not a part of the business of the assessee. Once the money was advanced to a company, the recovery proceedings from the company are to be carried out with under the provisions of the Companies Act and no such details regarding the steps being taken for recovery of money are moved liquidation of that company have been furnished. Therefore, the AO opined that the necessary conditions that the debt should have been incurred in the

normal course of business and that it should have become bad is not fulfilled and therefore, cannot be claimed as deduction by the assessee.

6. The CIT (A) confirmed the action of the AO, but the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') reversed the order of the AO as well as CIT (A) with direction to allow the same as deduction. The Tribunal, in this behalf, analyzed the facts in the following manner:

> "15. We have seen the correspondences and the factual aspects of the case and found that the assessee had discharged its onus to prove that the money had become bad in fact. The objections of the lower authorities that the assessee is not indulging any money lending activities is not correct because the assessee was incorporated in 1987 and money lending activities have been done by doing non-banking financial business. Huge amounts earned on account of interest was offered for taxation and the same has taxed in earlier year as well as in the under-consideration also. We have seen the objects clauses of the assessee company and found that there are clauses of objects to run the business of non-banking finance business and to advance money as inter-corporate deposits and also business of leasing business."

7. The Tribunal further held that provisions of Section 36(1)(vii) read with Section 36(2) of the Income Tax Act ('the Act' for brevity) were satisfied. It was of the opinion that the business of a Non-Banking Finance Company (NBFC) apart from leasing definitely involves lending of money. The assessee had deposited ₹100 lacs with the Citibank and stood guarantor for the money given to Fairmark by Citibank. This act of the

assessee in giving guarantee is a facet of money lending business, because on the guarantee money of ₹100 lacs, the assessee earned interest from bank as well as from Fairmark @9.125%. This interest earned from Fairmark and from bank was offered for taxation by the assessee.

8. Learned counsel for the Revenue has argued that there was no obligation on the part of the assessee to furnish such a guarantee and in these circumstances, conditions stipulated in Section 36(1)(vii) read with Section 36(2) of the Act were not satisfied as held in the case of ***Commissioner of Income-tax (Central), Calcutta Vs. Birla Bros. P. Ltd.*** [77 ITR 751]. Following discussion from the said judgment was specifically referred to:

> ".....Now a bad debt means a debt which would have gone into the balance sheet as a trading debt in the business or trade. It must arise in the course of and as a result of the assessee's business. The deduction claimed should not be too remote from the business carried on by the assessee. In *Madan Gopal Bagla* v. *Commissioner of Income tax West Bengali* [1956]30ITR174(SC) the principle which was accepted was that the debt in order to fall within Section 10(2)(xi) must be one which can properly be called a trading debt i.e. debt of the trade the profits of which are being computed. It was observed that the assessee in that case was not a person carrying on business of standing" surety for other persons nor was he a money-lender. He was simply a timber merchant. There was some evidence that he had from time to time obtained finances for his business by procuring loans on the joint security of himself and some other person. But it was not established that he was in the habit of standing surety for other persons along with them for the purpose of securing loans for their use and benefit. Even if such had been the case any loss suffered by reason of having to pay a debt borrowed

for the benefit of another would have been a capital loss to him and not a business loss at all. A businessman may have to stand surety for someone in order to get monies for his own business. There may be a custom of the business by which that may be the only method whereby he could get money for the purpose of his own business. If he is to discharge a surety debt and if any such custom is established it would be a business debt. If the assessee has made a payment not voluntarily but to discharge a legal obligation which arises from his business he would be entitled to have the amount deducted as a bad debt under Section 10(2)(xi); see *Commissioner of Income tax Bombay* v. *Abdullabhai Abdulkadar* [1957]31ITR72(Bom) ....."

9. Further reliance was placed on the judgment of the Karnataka High Court in the case of ***Commissioner of Income Tax and Anr. Vs. United Breweries Ltd.*** **[231 CTR 28]** wherein it was held that the amount advanced simply for holding a business associate cannot constitute debt. That was a case where advances were made to business associates for issue of shares in future. The High Court held that such amount advanced could not constitute a debt when the assessee had not placed any material to indicate that the business associate had a legal obligation for repayment of the amount and advance given for the issue of share in future was capital expenditure, which did not qualify for deduction under Section 36(1)(vii) of the Act or Section 36 of the Act. Explaining this provision in the light of aforesaid facts before it, the Court observed that even on the accepted legal principles, a 'debt' is an expression well-known in legal parlance and is an amount

which is a legal obligation which if not discharged will give rise to a claim in favour of the creditor. As the phrase and word of technical and legal content and meaning and an amount which is said to be simply advanced for helping a business associate definitely cannot constitute a debt when the assessee had not placed any material to indicate that the business associate or any associate of the subsidiary of the assessee had a legal obligation for repayment of the amount. Even here, the amount advanced are more towards the issue of shares in future if a company is to be brought into existence and in the hope of getting shares allotted in the company. An expenditure incurred for securing shares per se is a 'capital expenditure' and never 'revenue expenditure' and therefore the amount never qualifies for deduction either under Section 36 or Section 37 of the Act.

10. The aforesaid two judgments would not be applicable to the facts and circumstances of the present case. In ***Birla Bros. P. Ltd. (supra)***, it was a recorded fact that expenditure was not incurred in the course and as a result of the assessee's business. He stood surety, though it was not a part of his normal business. Likewise in ***United Breweries Ltd. (supra)***, the advances were made to business associate for issue of shares in future and this expenditure incurred for

securing shares was treated per se a capital expenditure and not revenue expenditure. On this premise, it was held that the amount did not qualify for deduction either under Section 36 or Section 37 of the Act. In contrast, in the present case, findings of fact have been established on record and found by the Tribunal on the following:

(i) The assessee is in the a non-banking financial company and thus, its business activity is not limited to leasing, but involves lending of money as a whole.

(ii) Act of the assessee in giving guarantee on behalf of M/s Fairmark was a part of money lending business.

(iii) The assessee had, in fact, earned by giving the aforesaid bank guarantee earning in terms of interest, not only from the said bank, but also from M/s Fairmark for whom it stood guaranteed.

(iv) The interest earned was offered for taxation. Such transaction of the assessee which is an NBFC would clearly be a business transaction and this guarantee amount would be treated as debt. When it became irrecoverable, it would qualify as bad debt entitling the assessee to claim as such.

11. Thus, the order of the Tribunal on this score is without any blemish.

Question No. (b):

12. The assessee company had deposited a sum of ₹500 lacs for allotment of preference shares of Piem Hotels Ltd. (hereinafter referred to as 'Piem'). Shares were not allotted. Until allotment of those preference shares by Piem, the above advance was to earn income by way of interest. Piem decided against issue of preference capital and the assessee vide letter dated 26.07.1997 to Piem asked for refund of the above advance with interest. Piem expressed inability to make immediate repayment in view of liquidity constraints. Instead, it offered to instruct M/s. Makan Investment and Trading Co. Ltd. (hereinafter referred to as 'Mekan'), which company during the relevant time owned inter-corporate deposits to Piem. Piem issued instructions in this behalf to Makan vide letter dated 29.07.1997 to make payment to the assesses on its behalf. Acting upon the above instruction, Makan issued post dated cheques aggregating to ₹500 lacs to the assessee along with covering letter of even date. It was also requested by Makan to the assessee to deposit these cheques only when advised to do so. After receiving these cheques, the assessee agreed to discharge Piem against the liability to repay the said

amount of ₹500 lacs. Two cheques of ₹50 lacs and ₹25 lacs issued by Makan were encashed on 19.09.1997 and 31.10.1997 respectively. Thus, a payment of ₹75 lacs was received by the assessee in this manner. However, thereafter Makan requested the assessee not to produce remaining cheques for clearing, as Makan refused its indebtedness to the assessee. Thereafter, discussions took place between the assessee and Makan, whereby it was mutually agreed by the assessee to reduce a sum of ₹85 lacs of principal amount with the hope that the assessee would receive the balance amount. In these circumstances, a sum of ₹85 lacs was claimed as bad debt during this year.

13. We may point out at this stage that the assessee could not receive the balance amount of ₹340 lacs as well and for this reason, it claimed that amount as bad debt in the Assessment Year 1999-2000.

14. The AO, however, refused the treat the same as bad debt on the ground that the assessee was not in the business of money lending. Further, according to the AO, the principal debtor of the assessee was still Piem and therefore, the assessee should have furnished the details and steps taken by it for recovery of the application money for Piem, which was still carrying on its business. No such details were furnished and therefore, the

AO formed the view that the amount could not be treated as bad debt, as the same shown to be irrecoverable from Makan was still recoverable from Piem.

15. The CIT (A) affirmed this view of the AO holding that the amount of ₹500 lacs given by the assessee to Piem was for allotment of preference shares, which were never allotted and the amount was not advanced in ordinary course of business as financier. According to the CIT (A), agreement with Makan did not make any change in the nature and therefore, provisions of Section 36 were not satisfied.

16. The Tribunal has, however, allowed the claim of the assessee for both years. It accepted the contention of the assessee that Makan belonged to a reputed Global Tele System Ltd. and the assessee in good faith discharged Piem on receipt of payment through cheque from Makan. As per the Tribunal, though money was initially given to Piem for allotment of shares, but the shares were not allotted and the assessee had asked Piem to refund the amount with interest. Piem had accepted this request and in these circumstances, instructed Makan to pay the amount on behalf of Piem. On receiving the cheques from Makan, the assessee had discharged Piem from liability and had shown this amount on 31.03.1998 as inter-corporate deposit with Makan and had also show interest thereupon. The

same was taxed also for the year under consideration. Therefore, the amount could be treated as inter-corporate deposit by the assessee to Makan. Since the assessee was doing non-banking finance business, this inter-corporate deposit had to be treated as deposit for the purpose of earning interest, which was equal to money lending business. Giving this hue to the transaction in question, the Tribunal held that the conditions stipulated under Section 36(2) of the Act were satisfied and hence, the amount had become irrecoverable, it could be treated as bad debt.

17. Insofar as interest of transaction is concerned as explained by the Tribunal, there was no plausible ground for the Revenue to dispute the same. Thus, we have to proceed on the premise that the assessee is a non-banking finance company and it had given inter-corporate deposit to Makan for earning interest. Thus, the same had to be treated as advancing the amount under money lending activities.

18. Section 36(1)(vii), as it existed at the relevant time, aloowed deduction in respect of the amount for "any debt, or the part thereof, which is established become a bad debt in the previous year". It is subject to the provisions of Sub-Section (2) of Section 36. Relevant portion thereof reads as follows:

> "(36) (2) In making any deduction for a bad debt or part thereof, the following provisions shall apply –
>
> (i) No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lend in the ordinary course of the business of banking or money-lending which is carried on by the assessee;"

19. As noted above, against the cheques of ₹500 lacs given to the assessee by Makan, cheque worth of ₹75/- lacs had been cleared. However thereafter, Makan started raising dispute about its indebtedness. At that stage, there was a mutual understanding vide which the assessee agreed to forego a sum of ₹85 lacs. It is clear that in these circumstances, the said sum of ₹85 lacs had become bad debt. Since it was a part of inter-corporate deposit, it could clearly be treated as debt. Such debt becoming bad would clearly qualify for deduction under Section 36(1)(vii) of the Act. The embargo put by Clause (1) of Sub-section (2) of Section 36 could not have come in the way of the assessee in view of the findings of the Tribunal that money was lent in the ordinary course of business of money lending which is carried on by the assessee.

20. The entire thrust of the learned counsel for the Revenue was on the transaction between the assessee and Piem on the basis of which it was submitted that since the amount was given for allotment of shares, it was not a transaction of money lending and in support of this, the learned counsel relied upon the judgment of the Karnataka High Court in the case of ***United Breweries Ltd. (supra)***.

21. However, that became history. When Piem decided not to issue any shares and agreed to refund the money thereupon, an arrangement was arrived at between the parties as per the said money was payable by Makan on behalf of Piem, which arrangement was accepted by the assessee discharging Piem and treating the money payable by Makan to assessee as inter corporate deposit. When a sum of ₹85 lacs was treated as bad debt, it was in the hands of Makan and it is the transaction between the assessee and Makan, which is to be looked into for this purpose and not the original transaction between the assessee and the Piem, which no longer survived. Therefore, the judgment of Karnataka High Court in ***United Breweries Ltd. (supra)*** would not be applicable to the facts of the present case.

22. It is held by the Madras High Court in the case of ***Commissioner of Income Tax Vs. V. Ramakrishna and***

Sons Ltd.* 326 ITR 315** that the question as to whether the debt has become bad or not is a pure question of fact. Moreover, the amount payable by Makan to the assessee has to be treated as debt (which had become bad) as is clear from the meaning of 'debt' explained by the Karnataka High Court in the case of ***United Breweries Ltd. (supra).

23. This question is accordingly answered in favour of the assessee and against the Revenue.

Question No. (c):

24. Insofar as this question is concerned, we may note that in the Financial Year 1995-96, the assessee company issued 9,10,000 equity shares in a public issue and incurred certain expenditure. The Assessing Officer did not allow the deduction of the said expenditure under Section 35D of the Act. The disallowance was made on the ground that the provisions of Section 35D of the Act are applicable to the case of industrial undertaking and the assessee is not an industrial undertaking, nor it is a case of extension of an industrial undertaking. Accordingly the provisions of Section 35D were not applicable. The CIT (A) also confirmed the action of the AO.

25. The Tribunal had simply remitted the case back to the AO to decide the same afresh in the light of the decision of the Mumbai Tribunal Bench in the case of ***HSBC Securities India***

Holding Ltd., as can be discerned from the following discussion:

> "43. The learned counsel for the assessee, who appeared before the Tribunal stated that the matter should be sent back to the file of the Assessing Officer to decide the same in light of the decision of the H Bench of the Mumbai Tribunal in the case of HSBC Securities India Holding Ltd. decided in 1394/Mum/2000 for A.Y. 96-97 vide order dated 20.09.2004, as the facts in the case in hand and the facts in the case of HSBC are similar. On the other hand, the Ld. Departmental Representative placed reliance on the orders of the authorities below.
>
> 44. After considering the submissions and perusing the material on record, we restore this issue to the file of the Assessing Officer to decide the same afresh in the light of the decision of the Tribunal in the case of HSBC Securities India Holdings Ltd. (supra) and in view of the provisions of law after affording reasonable opportunity of being heard to the assessee. We order accordingly."

26. Since the matter is to be examined afresh and no prejudice is caused to the Revenue in any manner, no question of law arises. The question of law as proposed, is clearly misconceived, as the Tribunal has not given any finding holding that provisions of Section 35D of the Act are applicable. This aspect is left to be examined by the AO.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

MAY 11, 2011
pmc