$~3 & 4

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

Date of Decision: September 29, 2014

\+ ITA 603/2014 &ITA No.604/2014

COMMISSIONER OF INCOME TAX-III

..... Appellant

Through: Mr. Kamal Sawhney, Sr.Standing Counsel with Mr. Sanjay Kumar, Jr. Standing Counsel

versus

SBI CARDS & PAYMENT SERVICES PVT. LTD.

..... Respondent

Through: Mr. Sanjeev Sabharwal, Sr. Advocate with Mr. Tushar Jarwal, Advocate

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J (ORAL)

These two appeals by the Revenue pertain to the same assessment year i.e. 2006-07 and arise out of the common order of the Income Tax Appellate Tribunal ('Tribunal', for short) dated 31.01.2014. Revenue has preferred two appeals under Section 260A of the Income Tax Act, 1961 ('Act', for short), as two cross appeals one each by the Revenue and the assessee had been preferred before the Tribunal, relating to the said assessment year.

2. For the sake of convenience, we first take up ITA No.603/2014. The

first issue raised in the said appeal pertains to treatment of Rs.7,54,17,603/- incurred on account of credit investigation to verify information and data provided by prospective customers. The amount claimed was treated as expenditure in the Profit & Loss Accounts by the respondent assessee, but in the assessment order the expenditure was held to be substantially capital in nature. The exact reasoning given by the Assessing Officer reads:-

> "Assessee has submitted its reply vide letter dated 18.12.2009 stating that-"in this regard, it is submitted that the assessee receives applications from various prospective customers for issuance of credit and it needs to verify information and data provided by these customers to establish their bonafide and credit worthiness. For this purpose, the assessee engages the services for credit verification agencies/firms of chartered Accountants, who carry out residence verification/business verification and report on the bonafide of the data provided by the prospective cardholders. This is essential in order to reduce/curtail the high level of delinquencies and resultant credit losses which are widely prevalent in the credit card industry." I have gone through the submission of the assessee and other details filed by the assessee. It is clear that the need of the credit investigation arise for prospective customers for issuance of credit card. This includes the verification of information and data provided by these customers and also to minimize the risk of the assessee company against incurring future bad debts. As a matter of fact, this kind of investigation is a one time verification of credit worthiness and credit history of the prospective customers which leads to creation of data base which is not only used by Assessee Company but also shared by other such credit card companies and banks.
>
> Once the investigation is completed in respect of a prospective customer, there is no need for further investigation and if okayed, such customers keeps on enjoying the services rendered by assessee company. The

> assessee has mentioned that such kind of expenditure is essential in order to reduce the high level of delinquencies and credit losses. I agree with the contention of the assessee regarding the necessity of the expenditure but at the same time such kind of expenditure cannot be justified as recurring expenditure. even if, Assessee Company denies a card to a prospective customer after investigating his credit withness even then no further expenditure is required on such prospective customer. Therefore, it can be safely held that the credit investigation expenses are predominantly one time expense for both kinds of decisions viz. providing card to a prospective customer or denying the same.
>
> The information so gathered about risk profile/credit of a prospective customer can be used for other occasion and by the other agencies also. Therefore, it is a data base/know-how which provides enduring benefit to the assessee company regarding credit worthiness of its prospective customers.
>
> In view of above discussion, the expenditure incurred on credit investigation is held as capital and disallowed as revenue expenditure. However, the assessee is allowed 25% of such expenditure for the assessment year 2006-07 resulting in addition of Rs. 5,65,63,127/- Since, **I** am satisfied that assessee has filed inaccurate particulars about its income therefore, penalty proceedings u/s 271(1)(c) are initiated separately."

3. Thus, the Assessing Officer treated 25% of the expenditure of Rs.7,54,17,503/- as revenue in nature and disallowed Rs.5,65,63,127/- as expenditure of capital nature. The Assessing Officer did not state whether Rs.5,65,63,127/- would be allowed in the assessment years to follow or could be capitalized for depreciation. The intention, it appears was that the aforesaid expenditure would be treated as capital and not allow the same as revenue expenditure in future or even capitalize the same.

4. We are entirely in agreement with the findings of the Commissioner of Income Tax (Appeals) and the Tribunal treating the said expenditure as revenue in nature. In fact, the reasoning given by the Assessing Officer is erroneous and contrary to law. The main business of the assessee, as noted in the assessment order, was receiving applications from prospective clients for issue of credit cards, consequent verification and issuance of credit cards. Information and details furnished by the prospective clients had to be verified, details checked and creditworthiness ascertained. Credit card business involved risks as the person to whom credit card was issued was entitled to make purchases and subsequently make payment. The aforesaid exercise to verify and check the truthfulness and correctness of the details/data and creditworthiness was a part and parcel of the day to day conduct of business. The expenditure, in fact, was similar to and like other revenue expenditure incurred in the normal course of business. The aforesaid exercise had to be taken periodically and routinely as and when new applications were received from the prospective customer. It was an ongoing, continuous and perpetual exercise, directly connected with the line of business.

5. Observation of the Assessing Officer that a database was created on

the basis of verification and thus could be used in future, is farfetched. Creditworthiness of applicants was dynamic and could tend to vary and change from time to time. It was not permanent or even long lasting. Creation of database was an incidental by-product and not the primary reason and cause for carrying out investigation and verification. The expenditure incurred to carry out verification was a part of the running cost incurred to earn profit. The business of the assessee was not to create and sell the database or provide the said information to third parties for consideration. It was not an expenditure incurred to create an asset or an asset of enduring nature. It is not the case of the Revenue or the Assessing Officer that the database was ever sold to third parties. It certainly did not result in an advantage of enduring nature. Even, enduring benefit test as elucidated by the Supreme Court in ***Empire Jute Company versus CIT*** (1980) 124 ITR 1 (SC), is not applicable when the expenditure consists of merely facilitating trading or business operation or enables the management to conduct the business more efficiently as elucidated in detail in paragraphs below. The Commissioner of Income Tax (Appeals) rightly referred to and observed that the verification reports regarding creditworthiness of individual/ party, had a short useful life and the information could lose

usefulness within a short time. It would be unfit and superfluous given the transient and ephemeral nature of the said data. In any case, the principal and main object of the assessee was to appraise and ascertain financial position and creditworthiness of the person, so as to issue a credit card and earn money. In fact, in some cases, no credit card would have been issued, due to a negative report. These were direct business expenses, revenue in nature. No one would issue a credit card or enter into a transaction on the basis of database and credit valuation 6 or 8 months old without ascertaining the true and correct position at the relevant time. On each occasion, fresh and new valuation had to be undertaken.

6. The second addition of Rs. 73,50,418/- made by the Assessing Officer was by disallowing 75% of the expenditure of Rs.98,00,557/-, incurred on scanning or capturing the applications data into electronic form. The disallowance was on the ground that 75% of the said expenditure was capital in nature. The balance, Rs.24,50,139/- was allowed as revenue expenditure. Applications from the prospective clients, upon receipt were scanned/captured for scrutiny and evaluation. Computer data entry or scan was undertaken. The Assessing Officer held that the expenditure was incurred once and for all and thus the transcription, capture or e-format

conversion expenditure would be capital in nature. This reasoning is unacceptable and untenable. Criteria/test of once for all/lump-sum payment and periodical payments may not and in several cases would not be the true and correct test to determine, revenue or capital nature of an expense. The aim and object of the expenditure would be decisive. Expenditure for running of business or working with a view to produce profits, would be revenue expenditure, whereas expenditure to acquire or bring into existence as asset or advantage of enduring benefit, would be of capital nature. [See, ***CIT versus J.K. Synthetics Ltd*** [2009] 309 ITR 371 (Del)]. Application capture and data entry facilitated and helped the assessee to conduct their day to day business operations. Profiles of applicants and their creditworthiness had to be assessed and evaluated on specific parameters. To make the process of evaluation faster, accurate and more systematic, the information/details were scanned or captured/converted into e-format. E-formated data processing ensured objectivity and fairness. This reduced possibility of errors and of issuance of credit cards to "undeserving candidates". We entirely agree with the Commissioner of Income Tax (Appeals) and the Tribunal that this expenditure incurred was revenue in nature.

8. The third and the last issue raised in the present appeal pertains to addition of Rs.42,11,31,848/- on account of brand creation and advertisement expenditure. The assessee had advertised and incurred sale promotion expenditure to the tune of Rs.56,15,09,131/-. The Assessing Officer held that this expenditure was in the nature of brand building as it had helped the assessee to increase their market share and enhance volumes/turnover and therefore, an "asset" was created. He however allowed depreciation on the amount disallowed.

9. Again, it is difficult to accept the reasoning as given by the Assessing Officer. The break-up of the expenditure incurred by the respondent assessee as noticed by the Commissioner of Income Tax (Appeals), is as under:

"Particulars	**Amount (Rs.)**
Advertising -Electronic and Print Media	64,136,170
Advertising-Outdoor Publicity	9,879,435
Sales Commission	553,440,265
Branch Incentives and Dealer Incentives	14,300,908
Gifts	25,981,120
Insurance Incentive	16,184,963
Merchant Tile ups	4,150,131
Others	13,940,478
Total	702,014,470
Less: Deferment of The expenditure	140,505,339
Expenses as per the Profit and Loss account	**561,509,131"**

Major expenditure of about Rs.55,34,40,265/- was on account of sales commission which had nothing to do with, what the Assessing Officer regarded as the brand building exercise. This expenditure was in the nature of direct selling expenses and relatable to and generated the turnover. The commission payment was for day to day operations and directly connected with the trading/business itself. No benefit of enduring nature or capital asset was created by incurring the said expenditure.

10. The Commissioner of Income Tax (Appeals) in his order has referred to data for earlier years relating to advertisement and sales promotion expenditure. For the sake of convenience we reproduce the details:

> "The year-wise details of gross sales vis-a-vis advertisement and sales promotion expenses along with the ratio of expenses to sales are reproduced hereunder:

Assessment Year	Advertisement Expense (Rs. in Crores)	Turnover (Rs. in crores)	(% age of turnover
2004-05	25.44	307.90	8%
2005-06	42.69	357.01	11%
2006-07	56.15	498.65	11%
2007-08	125.11	878.58	14%
2008-09	140.37	918.77	14%"

The Commissioner of Income Tax (Appeals) rightly observed that the assessee had been incurring the aforesaid expenditure in preceding years and in the succeeding years without any major fluctuations. The Commissioner

of Income Tax (Appeals) held that in the rapidly and constantly changing economic environment with cut-throat competition, advertisement and publicity expenditure has to be incurred on day to day basis. It was an expenditure for keeping the business a profitable proposition. It was directly associated with the running of the business. No intangible asset was created because of the said expenditure.

11. When examining the question, whether expenditure is capital or revenue in nature, one has to be guided by commercial considerations and only when the advantage is in the capital field, the expenditure can be disallowed applying the enduring benefit test. If the advantage consists of merely facilitating trading operations or increasing profitability or enabling the management to conduct business more efficiently, while leaving the fixed capital untouched, the expenditure is still on revenue account. Thus the enduring benefit test, though the primary test, cannot be applied without reference to the practical business and commercial considerations. The enduring benefit test falters if the main purpose of the expense is to facilitate business operations, increase profitability and conduct business in an efficient manner, while leaving the capital assets untouched. The second test of fixed or circulating capital test, would be debatable and may not be

applied unless the expenditure necessarily falls within one of the two categories. Normally expenditure incurred by the assessee as working expenditure as a part of process of profit earning, would be treated as operational expenditure.

12. Certainly the expenditure under consideration were not for acquisition of a source of profit or income but to secure better financial results and ensure greater or increased profits from the assets already created. It was to increase business turnover and attract more and new customers. It was expenditure incurred for increasing profits/income. Appropriate reference can be made to the judgment of the Supreme Court in ***Empire Jute Co. Ltd.*** (supra), wherein it has been held:-

> "Now so long as the expenditure in question can be clearly referred to the acquisition of an asset which falls within one or the other of these two categories, such a test would be a critical one. But this test also sometimes breaks down because there are many forms of expenditure which do not fall easily within these two categories and not infrequently, as pointed out by Lord Radcliffe in *Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd.* [(1965) 58 ITR 241 (PC) : 1964 AC 948] the line of demarcation is difficult to draw and leads to subtle distinctions between profit that is made "out of" assets and profit that is made "upon" assets or "with" assets. Moreover, there may be cases where expenditure, though referable to or in connection with fixed capital, is nevertheless allowable as revenue expenditure. An illustrative example would be of expenditure incurred in preserving or maintaining capital assets. This test is therefore clearly not one of universal application. But even if we were to apply this test, it would not be possible to characterise the amount paid for purchase of loom hours as capital expenditure, because acquisition of additional loom hours does not add at all to

the fixed capital of the assessee. The permanent structure of which the income is to be the produce or fruit remains the same; it is not enlarged. We are not sure whether loom hours can be regarded as part of circulating capital like labour, raw material, power etc. but it is clear beyond doubt that they are not part of fixed capital and hence even the application of this test does not compel the conclusion that the payment for purchase of loom hours was in the nature of capital expenditure.

xxx

…Now it is true that if disbursement is made for acquisition of a source of profit or income, it would ordinarily, in the absence of any other countervailing circumstances, be in the nature of capital expenditure. … Undoubtedly, the profit-earning structure of the assessee was enabled to produce more goods, but that was not because of any addition or augmentation in the profit-making structure, but because the profit-making structure could be operated for longer working hours. The expenditure incurred for this purpose was primarily and essentially related to the operation or working of the looms which constituted the profit-making apparatus of the assessee. It was an expenditure for operating or working the looms for longer working hours with a view to producing a larger quantity of goods and earning more income and was therefore in the nature of revenue expenditure. … Similarly, if payment has to be made for securing additional power every week, such payment would also be part of the cost of operating the profit-making structure and hence in the nature of revenue expenditure, even though the effect of acquiring additional power would be to augment the productivity of the profit-making structure.

xxx

When dealing with cases of this kind where the question is whether expenditure incurred by an assessee is capital or revenue expenditure, it is necessary to bear in mind what Dixon, J., said in *Hallstrom's Property Ltd.* v. *Federal Commissioner of Taxation* [72 CLR 634] : "What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted is the process." The question must be viewed in the larger context of business necessity or expediency. If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of

> the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure. See *Bombay Steam Navigation Co.* (*1953*) *Pvt. Ltd.* v. *CIT* [1965] 56 ITR 52 (SC). The same test was formulated by Lord Clyde in *Robert Addie and Son's Collieries Ltd.* v. IRC [1924] 8 TC 671, 676 (C Sess) in these words: "Is it part of the company's working expenses, is it expenditure laid out as part of the process of profit-earning? — or, on the other hand, is it a capital outlay, is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at all?" It is clear from the above discussion that the payment made by the assessee for purchase of loom hours was expenditure laid out as part of the process of profit-earning. It was, to use Lord Soumnar's words, an outlay of a business "in order to carry it on and to earn a profit out of this expense as an expense of carrying it on". It was part of the cost of operating the profit-earning apparatus and was clearly in the nature of revenue expenditure."

13. The Delhi High Court has repeatedly held that advertisement expenditures in the present day context should normally be treated as revenue expenditure, unless there are special circumstances and reasons to hold that the expenditure was capital in nature. The reason is that the advertisements do not have a lasting and long term effect and the memory of the customers or targeted audience is short lived. The advertisements fade away and do not have an enduring impact. If there is a lack of advertisement by one, the vacuum and space is taken over by others with benefit and advantage to the detriment of the first. Reference can be made to ***CIT vs. Salora International Ltd.*** (2009) 308 ITR 199 (Delhi) and the subsequent

decision in ITA No.597/2014 titled ***CIT vs. M/s Spice Distribution Ltd.*** decided on 19th September, 2014.

14. This brings us to ITA No.604/2014. Addition of Rs.17,93,59,566/- was made by the Commissioner of Income Tax (Appeals) after issuing notice of enhancement. The Assessing Officer had not made the said addition. The Commissioner of Income Tax (Appeals) held that the expenditure under the head, "Card Acquisition Expenses" had been amortised or divided into two years in the books of accounts and accounts prepared under the Companies Act, 1956. But, in the Profits & Loss account etc. prepared for the purpose of income tax, the entire amount was treated as revenue expenditure in one assessment year. The Commissioner of Income Tax (Appeals) held that the assessee being a company was bound to prepare profit and loss accounts and the balance sheet which would give true and fair account of its financial affairs. Reference was made to the provisions of the Companies Act and the Accounting Standard 5, issued by the Institute of Chartered Accountants of India (ICAI), to the effect that the same accounting policy should be normally adopted for similar events and transactions in each period. With reference to Section 145 of the Act, it was observed that CBDT has notified accounting standards vide SO 69(E) dated

25th January, 1996, which mandated an assessee to follow accounting policy which represents the true and fair view of the state of affairs of business, profession etc. Relying upon the decision of the Supreme Court in ***Madras Industrial Investment Corp. Ltd. vs. CIT*** (1997) 225 ITR 802 (SC), the Commissioner of Income Tax (Appeals) held that the expenditure in question should be treated as deferred revenue expenditure and Rs.1,70,79,469/- should be allowed in the current assessment year and the balance amount of Rs.17,93,59,566/- should be allowed as expenditure in the next assessment year, i.e. 2007-08.

15. The aforesaid addition has been deleted by the Tribunal and we are in agreement with their findings. Before, we elucidate, it will be relevant and important to reproduce the reply of the assessee, which for the sake of convenience is reproduced below:

> *"Till 31 March, 2005 sales force compensation, card acquisition cost (sales service provider expenses, incentives related to card acquisition, credit investigation cost, application printing cost), consumption of plastic cards, and delivery charges were recognized on an upfront basis.*
>
> *During current year (with effect from 1 April, 2005), the Company has company has changed its policy to recognize productive sales force compensation, card acquisition cost, consumption of plastic cards and delivery charges over a period of one year as this more closely reflects the period o which the fee relates to. As a result of this change in accounting policy, profit before tax for the current year is higher by Rs 19,64,39,035/-.*

> 9.2 This accounting treatment is being explained by the under-noted illustration.
>
> "If card-marking expense of Rs. 1000/- has been incurred in the month of July 2005, then as per the above accounting policy, the amount to be charged to the Profit & Loss Account for the Financial Year 2005-06 would be computed as under:
>
> = Rs. 1000*9/12 = Rs. 750
>
> The balance amount to be deferred & claimed in the next Financial Year i.e. 2006-07 would be calculated as under:
>
> = Rs. 1000*3/12 = Rs. 250"

16. It is clear from the aforesaid reply and is an accepted position that till the assessment year in question, sales force composition, card acquisition costs etc. were recognised on upfront basis i.e. in the year in which they were incurred. In the current assessment year in question, i.e. 2006-07, the assessee consequent to change in policy had spread over or divided the expenditure over a period of one year in the books of accounts from the date they were incurred. It is meant that the expenditure could partly fall in the current year and partly in the next year. The change would have imperatively impacted the first assessment year. Albeit, from the second year, it would not make much difference, though the figures for each year would be different. The aforesaid change or modification was restricted to the entries in the books of account and was as per the mandate of the Companies Act, 1956. However, in the Income Tax Return and tax accounts,

the earlier method or treatment was continued. Section 145 postulates that accounts should give true and fair picture of the financial position or the income of the assessee. It is further noticeable that the Act i.e. the Income Tax Act, 1961 only refers to capital or revenue expenditure. There is no provision in the Act which postulates or refers to deferred revenue expenditure. Deferred revenue expenditure is, therefore, not as such recognised in the Act. The Act to this extent is at variance and does not accept deferred revenue expenditure as a plausible and acceptable method. Accounting principles or standards have to be applied and adopted and they must disclose fair and true financial position and the income, but they cannot be contrary to the provisions or the mandate of the Act. The Act would then override the accountancy principles. There are several provisions in the Act like Section 43B which provide for different treatment than required under the provisions of the Companies Act or the accounting principles or standards. Reference can be made to ***Kedarnath Jute Mfg. Co. Ltd. versus CIT***, (1971) 82 ITR 363 where it was held,

> "… We are wholly unable to appreciate the suggestion that if an assessee under some misapprehension or mistake fails to make an entry in the books of account and although under the law, a deduction must be allowed by the Income Tax Officer, the assessee will lose the right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of

account be decisive or conclusive in the matter. …"

In ***Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT***, (1997) 227 ITR 172 at page 184, it was observed,

> "It is true that this Court has very often referred to accounting practice for ascertainment of profit made by a company or value of the assets of a company. But when the question is whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not, the question has to be decided according to the principles of law and not in accordance with accountancy practice. Accounting practice cannot override Section 56 or any other provision of the Act. As was pointed out by Lord Russell in the case of B.S.C. Footwear Ltd. [(1970) 77 ITR 857, 860], the Income Tax law does not march step by step in the footprints of the accountancy profession."

It was held by the Bombay High Court in ***Commissioner of Income-Tax versus Bhor Industries Limited*** (2003) 264 ITR 180,

> "… If (*sic*, It) is well settled that, ordinarily, revenue expenditure, which is incurred wholly and exclusively for the purposes of business, must be allowed in its entirety in the year in which it is incurred and it cannot be spread over a number of years even though the assessee has written it off in its books over a period of years. It is only in cases of special type of assets that the spread over is warranted. …"

Judgment of the Supreme Court in ***Madras Industrial Investment Corp. (supra)*** was considered and distinguished in ***CIT vs. Panacea Biotech Ltd.,*** ITA No. 22 & 24/2012 and ***CIT vs. Citi Financial Consumer Fin Ltd.*** (2011) 335 ITR 29 (Del.)**,** holding that the assessee's claim to spread over the expenditure over a period of time is tenable provided it is justified as in the case of issue of bonds at a discount. However, the same principle would not apply if the assessee treats the same as revenue expenditure and in fact

per Section 37(1) of the Act, the expenditure is revenue in nature and has been incurred or has accrued. This right to claim deferred revenue expenditure is given to the assessee and not to the revenue. In the facts of the present case, as already noticed, the expenditure as per the Commissioner of Income Tax (Appeals) should be partly spread over two years, instead of the year in which it was incurred. But it is accepted and admitted that the expenditure in question was revenue in nature. It had accrued and was paid. Nothing and no acts had to be performed and undertaken in future. It is not shown how and why, if the said expenditure was allowed in the current year, it would not reflect true and correct financial position or income of the assessee in the current assessment year. We, therefore, do not see any reason to interfere with the order of the Tribunal and issue notice in ITA No.604/2014.

The appeals are thus dismissed.

SANJIV KHANNA, J

V. KAMESWAR RAO, J

SEPTEMBER 29, 2014/an/kkb