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

Date of decision: 06.09.2018

\+ **ITA 271/2005**

COMMISSIONER OF INCOME TAX DEL ..... Appellant
Through: Mr. Raghvendra Singh, Advocate.

versus

M/S BHARAT HOTELS LTD. ..... Respondent
Through: Mr. Ajay Vohra, Sr. Advocate with Mr. Gaurav Jain, Mr. Prakash Kumar and Mr. Aniket D. Agrawal, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE A. K. CHAWLA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)
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1. Three questions of law arise in this case:-

"(1) Whether the Income Tax Appellate Tribunal was correct in law and on the facts of the case in deleting the addition of Rs.1.2 crores made by the Assessing Officer as deemed dividend under Section 2(22)(e) of the Income Tax Act, 1961?
(2) Whether the payment of provident fund and employees state insurance dues deposited by the Assessee within the grace period would qualify for deduction under Section 43B of the Income Tax Act, 1961?
(3) Whether the Income Tax Appellate Tribunal was correct in law in deleting the disallowance of Rs.74,01,771/- on the ground that it was a revenue expenditure?"

Question No.1

2. The facts here are that the Assessing Officer (hereafter 'AO') brought to tax a total amount of ₹1.2 crores for the relevant Assessment Year (A.Y.) 2000-01 holding that these denoted amounts as deemed dividend under Section 2(22)(e) of the Income Tax Act, 1961 (hereafter 'the Act'). The AO rejected the assessee's contention that these amounts were not covered by the exceptions stipulated by the statute i.e. proviso (ii) to Section 2(22)(e) of the Act. The CIT(A) confirmed the additions. Upon the assessee's appeal, the Income Tax Appellate Tribunal (hereafter 'ITAT') re-apprised the records and found that the amounts were received from two companies M/s Deeksha Holdings Pvt. Ltd. and M/s Jyotsana Holdings Pvt. Ltd. The ITAT disagreed with the findings of facts rendered by the lower authorities to the effect that since the business of the said lender companies did not involve substantial money lending, the amounts did not fall within the proviso (ii) to Section 2(22)(e) of the Act but rather were taxable as deemed dividend.

3. Learned counsel for the Revenue contended that a bare look at the pattern of income and investments of the two lending companies would show that money lending constitutes a fraction of their activities. With reference to M/s Deeksha Holdings Pvt. Ltd. it was pointed out that the total income from interest was only to the tune of 8.18% of the investments. Likewise, it was stated that of the total investments, lending constituted only 18.77% of M/s Deeksha Holdings Pvt. Ltd.'s business.

As far as M/s Jyotsana Holdings Pvt. Ltd.'s investments went, the AO had noticed that the lending business was to the tune of about 32%. Counsel for the Revenue relied upon the circular of the Reserve Bank of India, which spells out as to what constitutes a "Non-Banking Financial Company (NBFC)" in terms of Section 45-1A of the Reserve Bank of India Act, 1934. It was urged that since in this case the business of money lending constituted less than 50% and was in any case did not constitute the pre-dominant business of the lending companies, the amounts received, could not be excluded by virtue of proviso (ii) to Section 2(22)(e) of the Act.

4. The assessee in this case – as the record reveals, sought exclusion from the treatment of the income as deemed dividend under Section 2(22)(e) of the Act stating that the loan received was from two companies (M/s Deeksha Holdings Pvt. Ltd. and M/s Jyotsana Holdings Pvt. Ltd.), which were concededly NBFC. The record would show that these two companies were also engaged in other activities, some of which constitute non-banking financial activities, such as investments, lease funding in different sectors etc. Apparently, some part of the activities was also investments in paintings and commodities.

5. In this Court's opinion the ITAT's findings cannot be faulted given that almost 19% of the investments of one lender and over 30% of the business activities of the other lending company, fell within the expression mentioned in proviso (i) to Section 2(22)(e) of the Act. The test of substantiality, in our opinion, is not confined to what the RBI declares it to be, generally. There can be NDFC and NBFC – i.e. an entity

which may carry out more than one financial non-banking activity. In the present case too these companies carry on more than one non-banking financial activity – up to 3 or 4. In such event, the 50% test to benchmark whether the amounts fall within or outside the 2nd proviso to Section 2(22)(e) of the Act would fail. This Court notices that this view is reflected in the judgment of the Bombay High Court in *Commissioner of Income Tax vs. Parle Plastics Ltd.*, 332 ITR 63 (Bom).

The Court had then held as follows:-

> *"As rightly observed in Stroud's Judicial Dictionary, it is not possible to give any fixed definition of the word "substantial" in relation to "a substantial business of a company". Any business of a company which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business. Various factors and circumstances would be required to be looked into while considering whether a part of the business of a company is its substantial business. Sometimes a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be a substantial part of the business. Similarly, a portion which relatively a small as compared to the total turnover, but generates a large, say more than 50 per cent, of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of a manpower used for a particular part of business in relation to the total man power or working force of the company would be required to be taken into consideration. Employees of a company are now called its "human resources" and, therefore, the percentage of "human resources" used by the company for carrying on a particular division of business may also be required to be taken into consideration while considering whether a particular business forms a substantial part of its*

> *business. Undisputedly, the capital employed by a company for carrying on a particular division of its business as compared to the total capital employed by it would also be relevant while considering whether the part of the business of the company constitutes "substantial part of the business" of the company."*

6. In view of the above discussion, the first question of law is answered against the Revenue.

Question No.2

7. The issue here concerns the interplay of Section 2(24)(x) of the Act read with Section 36(1)(va) of the Act alongside provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (especially Regulation 38 of the Employees' Provident Funds Scheme, 1952) and the provisions of the Employees' State Insurance Act, 1948. The AO had brought to tax amounts which were deducted by the employer/assessee from the salaries and wages payable to its employees, as part of their contributions. It is not in dispute that the employer's right to claim deductions under the main part of Section 43-B of the Act is not an issue. The question the AO had to then decide was whether the amounts deducted from the salaries of the employees which had to be deposited within the stipulated time (in terms of notification/circular dated 19.03.1964 which was modified on 24.10.1973), as far as the EPF contribution went and the period of three weeks as far as the ESI contributions went. The AO made a tabular analysis with respect to the contributions deducted and actually deposited. The cumulative effect of notifications under the Employees' Provident Funds Act, 1952 and the

Employees State Insurance Act, 1948 was that in respect of the EPF Scheme contributions the deductions were to be deposited within 15 days of the succeeding wage period with a grace period of 5 days; for ESI contributions the deposit with the concerned statutory authority had to be made within three weeks of the succeeding wage month/period. The CIT in this case confirmed the additions – made by the AO based on the entire amounts that were disallowed. The ITAT however granted complete relief.

8. Having regard to the specific provisions of the Employees' Provident Funds Act and ESI Act as well as the concerned notifications which granted a grace period of 5 days (which appears to have been late withdrawn recently on 08.01.2016), we are of the opinion that the ITAT's decision in this case was not correct. The assessee undoubtedly was entitled to claim the benefit and properly treat such amounts as having been duly deposited, which were in fact deposited within the period prescribed (i.e. 15 + 5 days in the case of EPF and 21 days + any other grace period in terms of the extent notification). As far as the amounts constituting deductions from employees' salaries towards their contributions, which were made beyond such stipulated period, obviously the assessee was not entitled to claim the deduction from its returns.

9. In view of this discussion, the Revenue's appeal is partly allowed. The AO is directed to examine the contributions made with reference to the dates when they were actually made and grant relief to such of them which qualified for such relief in terms of the prevailing provisions and

notifications. We also clarify that the assessee would be entitled to deduction in terms of Section 36(1)(va) of the Act.

Question No.3

10. On this issue we notice that three amounts were sought to be disallowed by the AO. The first item pertains to expenditure incurred by the assessee for the construction of a hotel in Sri Nagar. In appeal the CIT noticed that the assessee had conceded to a ratio of 75%:25%, as constituting the capital and Revenue streams and confirmed such treatment. The Revenue appealed against this decision to the ITAT which dismissed it, by a separate order of 02.06.2006. That order was the subject matter of an appeal (by the Revenue) being Commissioner of Income Tax vs. Bharat Hotels Limited, ITA 62 of 2007. In the judgment of 31.07.2015 the ITAT's decision was upheld. As a consequence, the question of law is answered in favour of the assessee and against the Revenue (which has appealed against the rejection in the appeal filed by the assessee).

11. So far as the other two amounts – noting the expenditure on account of salary (which the assessee claimed was expenditure towards salary which was claimed as a deduction and the interest paid for loans, that were used for creating infrastructure in Mumbai and Goa; the ITAT had granted complete relief to the assessee. This Court finds no infirmity with the treatment of salaries as Revenue expenditure. As far as the interest expenditure goes, this Court notices that the period in question is covered by the provisions of Section 36(1)(iii) of the Act as it stood prior to its amendment in 2003. In respect of that provision, the law as it existed at

the relevant time i.e. in A.Y. 2000-01, was governed by India Cements Ltd. vs. Commissioner of Income Tax, 60 ITR 52 which held that there can be no distinction between expenditure of one kind or the other, when it came to borrowed funds and the treatment of interest thereon. Consequently, this question of law has to be and is answered against the Revenue and in favour of the assessee.

12. For the above reasons, save and except the partly relief granted in question no.2 the appeal is dismissed.

S. RAVINDRA BHAT, J
(JUDGE)

A. K. CHAWLA, J
(JUDGE)

SEPTEMBER 06, 2018
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