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

Reserved on : 10.07.2012
Decided on :30.07.2012

\+ **ITA 1289/2010**

COMMISSIONER OF INCOME TAX ..... Appellant
Through : Sh. N.P. Sahni and Sh. Ruchesh Sinha, Advocates.

versus

M/S. DCM SHRIRAM CONSOLIDATED LTD ..... Respondent
Through : Sh. S. Ganesh, Sr. Advocate with Sh. V.P. Gupta, Sh. Basant Kumar and Sh. Naveen Kumar, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.V. EASWAR

MR. JUSTICE S. RAVINDRA BHAT

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1. The question of law framed in this appeal by the assessee, impugning an order of the Income Tax Appellate Tribunal ("ITAT") dated 16-10-2009, in ITA No. 1039/Del/2009, is as follows:

> *"Was the Tribunal justified in deleting the loss claimed in respect of the advance given to M/s Kaveri Engineering Industries Ltd for supply of chlorine gas cylinders, in the circumstances of the case"*

2. The facts necessary to decide this appeal are that the assessee manufactures fertilizers, power, cement, PVC, Chloro Alkali products and

also trades in fertilizers, seeds and pesticides. It uses a special type of cylinder in which chlorine is filled in and supplied to its customers. It was regularly purchasing such cylinders from M/s Kaveri Engineering Industries Ltd. for several years. The assessee used to advance amounts in the course of its business, to the said supplier, to ensure timely supply of cylinders. M/s Kaveri Engineering Industries Ltd. went into liquidation. The assessee approached the liquidators but despite its efforts, could not recover the money from the liquidators. The assessee therefore wrote off such outstanding advances, as business loss and claimed it as deduction while computing its income for the year in question. The assessee wrote off the balances in its books of account. According to it, those advances were made in the course of business and had to be considered as losses arising in the course of business and the profits under Section 28 are to be computed *after* deducting loss and expenses incurred for the purpose of business, unless such expenses or losses are expressly or by necessary implication disallowed by the Act. The AO did not accept this contention, and held that the outstanding amount had the character of an investment, on the basis of his appreciation of the observations of the Supreme Court, in *C.I.T. v Mysore Sugar Co. Ltd* 46 ITR 649; it was held that the assessee had suffered a capital loss, which could not be allowed as a revenue loss. The AO therefore, added back the sum of Rs. 2,26,73,164/- and also held that it was liable for penal action under Section 271(1) (c) of the Act. The assessee's appeal to the Appellate Commissioner was unsuccessful. Therefore, it appealed to the ITAT.

3. Before the ITAT, the assessee relied upon the decisions of Supreme Court in the cases of *Badridas Daga Vs. CIT*, 34 ITR 10 (SC); *Calcutta*

Discount Company Vs. CIT, 37 ITR 1 (SC); and *Madeva Upendra Sinai Vs. CIT* 98 ITR 209 (SC). After considering the rival contentions, the ITAT allowed the assessee's appeal. It reasoned that:

> *"12. We have heard both sides and find ourselves in complete agreement with the contention of the assessee. There is no dispute that the assessee had been purchasing these containers required for dealing with chemical chlorine. Chlorine can only be stored in cylinders and can be dealt filled in cylinders. There is no dispute that chlorine itself is the subject matter of trade in the course of the assessee's business. It cannot be said that the containers which are used for storing such stock in trade will become a capital asset. It is nobody's case that the assessee has not made this advance in the course of its business. After all it has to ensure the timely supply of cylinders which are required for the purpose of dealing in chlorine which is a very dangerous chemical. In our view such loss has fallen upon the assessee as revenue loss and the same should have been allowed as deduction while computing the profits and gains of business, having regard to the ratio laid down by the Supreme Court in the cases of Badrdas Daga Vs. CIT (supra); and Calcutta Discount Co. Vs. CIT (supra). Respectfully following the aforesaid decisions the issue is decided in favour of the assessee. Ground raised by the assessee is accordingly allowed.*
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> *13. In the result, assessee's appeal is allowed and the revenue's appeals are dismissed."*

4. Counsel for the revenue submitted that a proper application of the decision in *Mysore Sugars* would have meant that the advances were investment, and had to be in the nature of capital expenditure, which did not qualify for disallowance. It was urged that the supplied cylinders would have entitled the assessee to depreciation. It was argued that the advance was for the purpose of acquiring an asset of an enduring nature, and not revenue

expenditure. Reliance was placed on the following passage of the said decision:

> *" If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the appropriate class; but there may be an expenditure which, though not exactly covered by any of the enumer-ated classes, may have to be considered in finding out the true assessable profits or gains. This was laid down by the Privy Council in Commissioner of Income-tax v. Chitnavis (1932) L. R. 59 I. A. 290 ; [1932] 2 Com. Cas. 464, and has been accepted by this court. In other words, section 10(2) does not deal exhaustively with the deductions, which must be made to arrive at the true profits and gains.*
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> *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 of capital. But this is not true of all losses, because loosed in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for what 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 circums-tance, it is a loss of capital, but if lost in the second circumstance, 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.*
>
> *This distinction is admirably brought out in some English cases, which were cited at the bar. We shall refer only to three of them. In English Crown Spelter Co. Ltd. v. Baker (1908) 5 Tax Cas. 324.), the English Crown Spelter Co. carried on the business of zinc smelting for which it required large quantities of "blende". To get supplies of blende, a new company called the Welsh Crown Spelter Company was formed, which received*

assistance from the English company in the shape of advances on loan. Later, the English company was required to write off £ 38,000 odd. The question arose whether the advance could be said to be an investment of capital, because, if they were, the English company would have no right to deduct the amount. If, on the other hand, it was money employed for the business, it could be deducted. Bray J., who considered these questions, observed :

> *"If this were an ordinary business transaction of a contract by which the welsh Company were to deliver certain blende, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the Appellants...It is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered...I can come to no other conclusion but that this was an investment of capital in the Welsh Company, and was not an ordinary trade transaction of an advance against goods..."*

The second case, Charles Marsden & Sons Ltd. v. Commissioners of Inland Revenue (1919) 12 Tax Cas. 217, is under the excess profits duty in England, and the question arose in the following circumstances : An English company carried on the business of paper making. To arrange for supplies of wood pulp, it entered into an agreement with a Canadian company for supply of 3,000 tons per year between 1917-1927. The English company made an advance of £3,000 against future deliveries to be recouped at the rate of £ 1 per ton delivered. The Canadian company was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the Canadian company (appropriately called the Ha! Ha! Company) neither delivered the pulp nor returned the money. Rowlatt J. held this to be a capital expenditure not admissible as a deduction. He was of opinion that the payment was not an

advance payment for goods, observing that no one pays for goods ten years in advance, and that it was a venture to establish a source and money was adventured as capital.

The last case to which we need refer to illustrate the distinction made in such cases is Reid's Brewery Co. Ltd. v. Male (1891) 3 Tax Cas. 279. The brewery company there carried on, in addition to the business of a brewery, a business of bankers and money-lenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the brewery company. Certain sums had to be written off and the amount was held to be deductible. Pollock B. said :

> *"Of course, if it be capital invested, then it comes within the express provision of the Income-tax Act, that no deduction is to be made on that account."*

but held that :

".... no person who is acquainted with the habits of business can doubt that this is not capital invested. What it is this. It is capital used by the Appellants but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money-lenders, be they pawnbrokers or money-lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word."

It was thus held to be use of money in the course of the company's business and not an investment of capital at all."

5. It was submitted that advances given, in instances where the cylinders were supplied, would result in acquisition of capital assets and there can be no dispute with that proposition. It was urged that applying the purpose test,

it is apparent, that the advances for buying cylinders never fell within the description of revenue expenditure.

6. Learned senior counsel for the assessee contended, on the other hand, that in modern commercial and industrial operations the test of enduring benefit is, not a certain or conclusive test and incapable of mechanical or universal application, regardless of the facts and circumstances of a given case. It was submitted that the cylinders in this case were in the nature of stock in trade, essential for day to day functioning of the assessee's business. Without these, the chlorine manufactured by it cannot be supplied to its customers. The customers' used cylinders are taken back, and then refilled. It was submitted that merely because the rules admitted a high rate of depreciation which led the assessee to claim it, cannot be held to preclude its contention the advances in this case were not capital, and could be validly written off.

7. Learned counsel relied on the decisions reported as *Alembic Chemical Works v CIT* 1989 (77) CTR 1 and *Empire Jute Co Ltd v Commissioner of IT* 1980 (17) ITR (SC) 113 and submitted that there can be no iron clad rule for determining whether an advance given, but not recovered, is in the nature of capital expenditure which cannot be written off in the course of business.

8. Before analysing the law, it would be necessary to notice that the order of the AO reveals that to claim a bad debt of Rs. 2,26,73,164/-. The assessee had issued a letter of intent dated 16.12.1994 for supply of 1500 Chlorine cylinders to Kaveri Engineering. That letter of intent was confirmed by purchase order dated 14.7.95. The purchase order was later on amended by letter dated 27.11.1996; resultantly the quantity of chlorine

cylinders to be supplied was reduced - from 1500 to 595. Against the payments made, 208 chlorine cylinders were supplied for the total sum of Rs. 97,33,048/-. Besides the 208 chlorine cylinders supplied (valued at Rs. 97,330,48/-) a separate purchase order was issued by the assessee to M/s Kaveri Engineering for supply of chlorine tanks. The payment towards this was Rs. 65,44,588/-. Out of the amount advanced - Rs.3,89,50,800/-, 208 chlorine cylinders (worth Rs. 97,33,048/-) were supplied. Apart from advance for chlorine tanks worth Rs.65,44,588/- the amount outstanding against M/s Kaveri Engg. was Rs.2,26,73,164/-. (Rs.3,89,50,800 – Rs. 1,62,77,636/-). The assessee's stand was that the chlorine cylinders were in the nature of store items and M/s Kaveri Engg., defaulted on their supply. Therefore, money given in advance to that concern for supply (of cylinders) remained due and the party had closed its business.

9 To ascertain whether the money advanced was for day to day running of the business and whether it was on revenue account or capital account, the company was asked to explain the nature of the treatment given to chlorine cylinders and chlorine tanks purchased from M/s Kaveri Engg., and whether the chlorine cylinders were shown as store items in books of accounts or were shown as assets eligible for depreciation for the assessment years when they were purchased. The assessee's reply during assessment proceedings on 24.3.2006 showed following details:

Sl. No	F.Y.	No. of Cylinders purchased from Kaveri Engg.	No. of Cylinders purchased from other parties	Rate which depreciation claimed in books of A/c	Amount of depreciation claimed by assessee under IT Act (Rs.)
1	95-96	156	54	100%	88,65,636

2	96-97	39	589	100%	2,82,28,470
3	97-98	13	0	100%	7,83,003
	Total	208	643		3,78,77,109

10. In *Mysore Sugars,* the governing test for determination of whether a payment made was towards a capital, or revenue expenditure was articulated as *"for what 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 circums-tance, it is a loss of capital, but if lost in the second circumstance, 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."* Yet, such "bright line" tests have, over the years not been considered to be decisive, or accurate in deciding if an expenditure leads to an enduring capital advantage. In *Empire Jute Co Ltd (supra)* the dominant considerations were spelt out in the following terms:

> *"This test, as the parenthetical clause shows, must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd. [1965] 58 ITR 241 (PC), it would be misleading to suppose that in all cases, securing a benefit for the business would be, prima facie, capital expenditure so long as the benefit is not so transitory as to have no endurance at all. There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the*

advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case. But even if this test were applied in the present case, it does not yield a conclusion in favour of the revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or expansion of the profit-making apparatus of the assessee. The income-earning machine remains what it was prior to the purchase of loom hours. The assessee is merely enabled to operate the profit making structure for a longer number of hours. And this advantage is clearly not of an enduring nature. It is limited in its duration to six months and, moreover, the additional working hours per week transferred to the assessee have to be utilised during the week and cannot be carried forward to the next week. It is, therefore, not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing loom hours and the test of enduring benefit cannot help the revenue.

Another test which is often applied is the one based on the distinction between fixed and circulating capital. This test was applied by Lord Haldane in the leading case of John Smith and Son v. Moore [1921] 12 TC 266, 282 (HL) where the learned law Lord drew the distinction between fixed capital and circulating capital in words which have almost acquired the status of a definition. He said:

> *" Fixed capital as what the owner turns to profit by keeping it in his own possession ; circulating capital as what he makes profit of by parting with it and letting it change masters. "*

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), 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 remain, 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."

In *Alembic Chemical Works* (supra) it was observed that:

"The fact that an item of expenditure is wholly and exclusively laid out for purposes of the business, by itself, is not sufficient to entitle its allowance in computing the income chargeable to tax. In addition, the expenditure should not be in the nature of a capital expenditure. In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is well nigh impossible to

formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants but as masters they tend to be over-exacting. One of the early pronouncements which serves to indicate a broad area of distinction is City of London Contract Corporation v. Styles [1887] 2 Tax Cas 239, where Bowen L. J. indicated that the outlay on the "acquisition of the concern" would be capital while an outlay in "carrying on the concern" is revenue. In Vallambrosa Rubber Co. v. Farmer [1910] 5 Tax Cas 529, Lord Dunedin suggested as "not a bad criterion" the test that if the expenditure is "once for all", it is capital and if it is "going to recur every year", it is revenue. In the oft-quoted case on the subject, viz., British Insulated Helsby Cables Ltd. v. Atherton [1926] AC 205, Viscount Cave L. C. said :

> *"But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."*

The Supreme Court quoted *Sun Newspapers Ltd. and Associated Newspapers Ltd. v. Federal Commissioner of Taxation* which indicated the distinction between capital and revenue expenditure, to the following effect:

> *"The business structure or entity or organization may assume any of an almost infinite variety of shapes and it may be difficult to comprehend under one description all the forms in which it may be manifested . . ."*

And further observations to this effect:

> *". . . There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part and (c) the means adopted to obtain it ; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment . . ."*

10. In *Regent Oil Co. Ltd. v. Strick (Inspector of Taxes)* [1966] AC 295, the Court of Appeal emphasised the futility of a strict application of and exclusive dependence on any single principle in the search for the true position and pointed out the difficulty arising from taking too literally the general statements made in earlier cases and seeking to apply them to a different case which their authors certainly did not have in mind.

11. It seems, to this Court, therefore, from a reading of the above decisions that whether expenditure is of a capital nature or revenue, depends on the facts and circumstances in a given case. Especially, whether a particular expenditure is a revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and by applying the principles of commercial trading. The question must be viewed in the larger context of business necessity or expediency. If the outgoing or expenditure is so tied to carrying on of the business that it might be regarded as an integral part of the profit-earning process and not for acquisition of an asset or for a right of permanent character, the possession of which was a condition for the carrying on of the business, the expenditure in such cases can be considered revenue expenditure.

12. In this case, the difficulty this Court experiences in determining whether the unrecoverable advances given to Kaveri Engineering were in order to secure a capital advantage, and thereby create an asset of enduring nature, or if it was in the normal course of business, akin to acquiring stock in trade, is that there is no factual material about the life of the cylinders, the number of times they are used, and the average time they are held before their replacement by the assessee. Undoubtedly, they are necessary to supply the finished product to the assessee's customers. Yet, these facts by themselves are insufficient and not helpful for discerning a complete picture, essential to decide the main issue.

13. For the above reasons, and to ensure a just ascertainment of the nature of the expenditure incurred, this matter is remanded back to the appropriate Assessing Officer. I.T Appeal No. 1289/2010 is disposed of in the above terms.

S. RAVINDRA BHAT
(JUDGE)

R.V. EASWAR
(JUDGE)

JULY 30, 2012