In the High Court of Judicature at Madras

Dated: 15.07.2015

Coram

The Honourable **Mr.JUSTICE R.SUDHAKAR**
and
The Honourable **Ms.JUSTICE K.B.K.VASUKI**

Tax Case (Appeal) No.598 of 2006

Late M.S.Ramasamy
rep. by
M.R.Saraswathy

.... Appellant

Vs.

The Income Tax Officer,
ard I (7), Salem - 7.

.... Respondent

APPEAL under Section 260A of the Income Tax Act against the orders dated 25.11.2005 in I.T.A.No.1838/Mds/2000 on the file of the Income Tax Appellate Tribunal Madras 'D', Chennai for the assessment year 1996-97.

For Appellant : Mr.S.Sridhar
For Respondent: Mr.J.Narayanasamy
Standing Counsel for Income Tax

<u>J U D G M E N T</u>

<u>(Judgment of the Court was delivered by R.SUDHAKAR,J.)</u>

This Tax Case (Appeal) filed by the assessee as against the order of the Income Tax Appellate Tribunal for the assessment year 1996-1997 was admitted by this Court on the following substantial questions of law:

> "1. Whether the Appellate Tribunal is correct in upholding the orders of the lower authorities in rejecting the claim of business loss comprised of deposit of Rs.1,00,650/- relatable to dealership/distributorship and the balance of Rs.8 lakhs referable to cylinder hire charges due to fraud/cheating on him?
>
> 2. Whether the Appellate Tribunal is correct in not considering the claim of business loss especially with reference to the proviso to Section 3 of the Act?
>
> 3. Whether the Appellate Tribunal is correct in disallowing the claim of loss as capital loss even though Rs.1,00,650/- could be alone attributable to the deposit relatable to dealership/distributorship?
>
> 4. Whether the Appellate Tribunal is correct in not considering the alternate claim of bad debt in the computation in terms of section 36(2) of the Act in view of no dispute on the non recoverability of the said amount comprised of deposit of Rs.1,00,650/- relatable to dealership/distributorship and the balance of Rs.8 lakhs referable to cylinder hire charges due to fraud/cheating on him?"

2. The brief facts of the case are as follows:

The assessee/respondent was engaged in the manufacture of handloom silk and proceeded to venture into a new business in the distribution of LPG Cylinders. In this regard, it appears that the assessee had paid a sum of Rs.9.00 lakhs to M/s.Jagmeeta Enterprises LPG Private Limited for getting dealership/distributorship of LPG manufactured by Birla Blue Flames Ltd. However, the distributorship business never commenced and the assessee wanted the money back from the said Jagmeeta Enterprises (LPG) Pvt. Ltd. Since the assessee came to know that there was no possibility of any recovery of payment, the assessee claimed it as loss to be set off against the income from other business. The Assessing Officer disallowed the claim holding that as the distributorship business never commenced and the loss is not business loss, the assessee was not entitled to set off his loss against the profits from other business. The Assessing Officer further held that the loss in question was a capital loss and could not be claimed as a deduction. The Assessing Officer also held that this loss could not be claimed as bad debt, as the conditions laid down under Section 36(2) of the Income Tax Act are not fulfilled.

3. Aggrieved by the said order of the Assessing Officer, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), who by placing reliance on the decision of the Allahabad High Court reported in *79 ITR 530 (Jwala Prasad Radhakrishnan Vs. CIT)*, held that the loss of deposit has to be considered as a capital loss and not allowable as deduction. The Commissioner of Income Tax (Appeals) further held that the payment have not been made for the purpose of acquiring an enduring benefit of capital nature and the business have never been commenced, the loss could not be treated as business loss. Consequently, the Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer, thereby dismissed the appeal. For better clarity, the relevant portion of the order of the Commissioner of Income Tax (Appeals), reads as follows:

> *"12.The next issue in the appeal relates to rejection of the appellant's claim of loss of Rs.9,00,650/- as loss from Agency business. During the previous year, the appellant had made payment of Rs.9,00,000/- to M/s.Jagmatha Enterprises (LPG) Pvt. Ltd., Madras for getting dealership/distributorship of LPG, manufactured by Birla Blue Flames Ltd. The A.O. has given the following reasons for making the disallowance of Rs.9,00,650/-.:*

"The distributorship business, however, never commenced and when the assessee wanted his money back from M/s.Jagmeetha Enterprises (LPG) Pvt. Ltd., Madras, he came to know that the company was a fraud and there was no possibility of any recovery of payment made to them. It has been explained by the assessee inthe course of assessment proceedings that since the entire payment made to M/s.Jagmeetha Enterprises (LPG) P. Ltd., had gone bad, he is entitled to claim it as a loss to be set-off against his income from the other business. On the fact and in the circumstances of the case, it appears clearly that the assessee is not entitled to set-off his loss against the profits from the other business as the payment made for distributorship of LPG, a business which never commenced, is not a business loss. It cannot also be claimed as bad debt because the conditions laid down u/s.36(2) are not fulfilled. The loss in question is clearly a capital loss which cannot be claimed as a deduction in assessment. Considering the facts and circumstances of the case, the loss of Rs.9,00,650/- claimed by the assessee is rejected.".

13. The authorised representative for the appellant submitted that the disallowance made by the A.O. is incorrect and the addition of Rs.9,00,650/- should be deleted as it is not in accordance with law.

14. I have carefully considered the submissions made on behalf of the appellant and also the facts of the case as discussed by the A.O. in the assessment order. For the purpose of acquiring another business, the appellant had made payment of a sum of Rs.9 lacs, to M/s.Jagmeetha Enterprises (LPG) P. Ltd., Madras for getting dealership/distributorship of LPG manufactured by Birla Blue Flames Ltd. The A.O. has rightly rejected the appellant's claim for deduction as it is a capital loss because the business of distributorship of LPG had never commenced. In the case of Jwala Prasad Radhakrishnan -vs- CIT 79 ITR 530 (All.) the High Court held that loss of security deposit must be considered in relation to the business of the assessee as the deposit is generally made for the purpose of acquiring any capital asset or acquiring new business, and if so, it must be considered a capital loss not allowable as deduction. In the case of CIT -vs- Mothiram Nandram 8 ITR 132 (PC), it was held that the deposit having been made for the purpose of securing an enduring benefit of capital natue, loss was not allowable. In the case of Shah Construction Co.Ltd., - vs- ITO 26 TTR 378 (Bom.), it was held by the Tribunal that where the assessee has placed an order for purchasing a machinery along with security deposit and the assessee could not purchase the machinery resulting in forfeiture of security deposit, such loss was capital loss. In the case of Pragati

Construction Co. -vs- DCIT 54 ITD 153 (Del.) where the amount deposited by the assessee firm with DDA, was forfeited in terms of the agreement, the claim of the assessee to allow the amount of advance as trading loss was rejected by the Tribunal. In the instant case, the appellant had paid Rs.9 lacs., to M/s.Jagmeetha Enterprises which was for the purpose of acquiring a new business or a capital asset and, therefore, the loss of deposit has to be considered as a capital loss, not allowable as deduction. The payment having been made for the purpose of securing an enduring benefit of capital nature, the loss of Rs.9 lacs, is clearly a capital loss as the business had never commenced. I, therefore, uphold the order of the A.O., disallowing the appellant's claim for deduction of Rs.9,00,965/-."

4. As against the said order of the Commissioner of Income Tax (Appeals), the assessee once again pursued the matter before the Income Tax Appellate Tribunal.

5. The Tribunal by placing reliance on the decision of the Supreme Court in the case of *Haseemara Industries Ltd. v. CIT 230 ITR 927*, came to the conclusion as follows:

"the assessee was not in the dealership/distributorship business of LPG. The deposit made was clearly to secure dealership i.e., to acquire a profit making asset to carry on LPG Distributorship business. Hence it cannot be said that the deposit was made of revenue account or that the loss thereof should be treated as business loss. Since in the present case loss incurred is squarely covered against the assessee on the anvil ratio decedendi of the aforesaid Apex Court decision, we decide this issue against the assessee and confirm the order of the ld. CIT(A)."

6. Aggrieved by the above-said order of the Tribunal, the assessee is before this Court.

7. Heard learned counsel appearing for the assessee and the learned Standing Counsel appearing for the Revenue and perused the materials placed before this Court.

8. Admittedly, the assessee had not commenced its distributorship business. The deposits made by the assessee was for the purpose of acquiring profit and securing dealership/distributorship. Originally, the assessee was in the business of manufacturing handloom silk and not in the business of LPG distributorship. Hence,

the purpose of entering into such a new business must be considered to be for the purpose of securing an enduring benefit of a capital nature and hence, the deposit made in that regard cannot be treated as expenditure in the course of carrying on the existing business. The deposit was made by the assessee pursuant to an agreement between the parties for getting dealership/distributorship of LPG. Hence, the deposit made by the assessee was for the purpose of acquiring a profit-making asset to carry on business in LPG. Therefore, the said deposit made should not be treated as revenue in nature and the loss thereof must be treated as business loss.

9. The above-said view of ours is fortified by the Supreme Court in the case of ***Hasimara Industries Ltd. v. Commissioner of Income Tax and another*** reported in ***[1998] 230 ITR 927 (SC),*** wherein, the Supreme Court in an identical circumstance, followed the decision of the Privy Council in the case of ***CIT V. Motiram Nandram [1940] 8 ITR*** 132, held as follows:

> *"It must be said at once that the case of Motiram Nandram [1940] 8 ITR 132 (PC) bears considerable similarity to the case that is before us. The assessee therein carried on business in cloth, yarn and money-lending. In 1930 it deposited with an oil company Rs. 50,000 in consideration of an agreement. Thereunder, the*

assessee was appointed the organising agents of the oil company for a period of five years for a stated area. It was to recommend selling agents. Sales were to be conducted entirely by the oil company and the selling agents, but the assessee was to receive a certain commission on all goods sold by the selling agents within the stated area and also on all sales of oil effected in the stated area by the oil company. The deposit was to remain at the disposal of the oil company for the purpose of the oil company's business and was to carry interest at the rate of 7 per cent. per annum until it was repaid out of the deposits made by the selling agents. After the assessee had recovered a part of its deposit, the oil company went into liquidation and, though the assessee obtained a decree for Rs. 39,500 against the oil company, it was unable to realise the decretal amount. The assessee claimed in the year 1932-33 that the aforesaid amount should be deducted from its other income as a business loss. The Privy Council did not accept the assessee's case. It said (page 138) :

"When the deposit is considered in relation to the organising agency, the special terms of the agreement of December 17, 1930, are important since various suggestions have been made as to the true character of the deposit. One suggestion is that the deposit should be looked upon as the purchase price of goods paid to the company in advance and thus a mere trading expense ; but this cannot be accepted. It would be a highly

inaccurate statement of the effect of the agreement. The Rs. 50,000 was doubtless laid out with a view to earning profits in the business of organising agents in addition to the interest of 7 per cent., but it was not so laid out with reference to any particular transaction carried out in the course of such business. It was in one aspect a loan made to the company but it was not a loan made in the course of carrying on the business of organising agents or in the course of the business of a money-lender. It was not a recurring expenditure. On the other hand, it was contemplated that in whole or in part the deposit should be returned to the assessees by the receipt of deposit from selling agents ; so that if the Rs. 50,000 does fall to be regarded as invested in a business of organising agents, it was invested with a prospect that it might be a temporary investment and not a permanent one—in other words that the capital might later be withdrawn from the business. The question in such a case as the present must be 'what is the object of the expenditure?' And it must be answered from the standpoint of the assessees at the time they made it—that is, when they were embarking upon the business of organising agents for the company. The deposit was clearly exacted by the company as a condition of the assessees being given an agency which they hoped to manage profitably. Their Lordships think that the purpose of being permitted to engage in such a business must be considered to be a purpose of securing an enduring benefit of a capital nature, and that the deposit *cannot, upon a true view of the terms of the agreement and the circumstances of the case, be regarded as an expenditure made in the course of carrying on an existing agency, or any other business.*

We are in no doubt whatever that the High Court was right in concluding that the amount of Rs. 20 lakhs had been deposited by the assessee with the licensor company for the purpose of securing the licence under which the assessee had acquired the right to work the licensor's cotton mills. This is clear from the fact that the deposit was made pursuant to a clause in the leave and licence agreement. Had a deposit as required by that clause not been made, the assessee would not have secured the licence of the cotton mill. At that time the assessee was doing no business in cotton. The deposit was, clearly, made for the purpose of acquiring a profit-making asset to carry on business in cotton. It cannot, therefore, be held that the deposit was made on the revenue account or that the loss thereof must be treated as a business loss. The loss thereof was a loss suffered on the capital account and could not be deducted on the basis that it was a business loss.

The High Court has answered the question correctly. The appeal is dismissed, with costs."

10. The LPG distributorship was for a profit making business which did not start. As in the above case, the deposit cannot partake the character of Revenue account and a business loss.

11. In the light of the above, following the above-said decision of the Supreme Court, the questions of law are answered against the assessee and in favour of the Revenue. Accordingly, this Tax Case (Appeal) stands dismissed. No costs.

Index :Yes/No (R.S.,J) (K.B.K.V.,J)
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To

1. The Income Tax Appellate Tribunal Madras 'D' Bench, Chennai.
2. The Commissioner of Income Tax (Appeals) XII, Chennai.
3. The Income Tax Officer, Ward-I(7), Salem.

R.SUDHAKAR,J.

AND

K.B.K.VASUKI,J.

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