IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 8TH DAY OF JULY, 2022

PRESENT

THE HON'BLE MR. JUSTICE P.S. DINESH KUMAR

AND

THE HON'BLE MR. JUSTICE C.M. POONACHA

I.T.A NO.221 OF 2015

BETWEEN :

1. THE COMMISSIONER OF INCOME-TAX
C.R. BUILDING
QUEENS ROAD
BANGALORE

2. THE DEPUTY COMMISSIONER
OF INCOME-TAX
CIRCLE-11(4)
RASHTROTHANA BHAVAN
NRUPATHUNGA ROAD
BANGALORE. …APPELLANTS

(BY SHRI. K.V. ARAVIND, ADVOCATE)

AND :

M/s. ING VYSYA BANK Ltd.,
ING VYSYA HOUSE, NO.22
M.G. ROAD
BANGALORE - 560 001
PAN: AABCT0529M …RESPONDENT

(BY SHRI. A. SHANKAR, SENIOR ADVOCATE FOR
SHRI. M. LAVA, ADVOCATE)

. . . .

THIS ITA IS FILED UNDER SECTION 260-A OF THE INCOME TAX ACT, 1961 ARISING OUT OF ORDER DATED: 30/12/2014 PASSED IN ITA NO.1143/BANG/2010, FOR THE ASSESSMENT YEAR 2004-2005, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE INCOME-TAX APPELLATE TRIBUNAL, BANGALORE IN ITA NO.1143/BANG/2010 DATED:30/12/2014 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-11(4), BANGALORE.

THIS ITA, HAVING BEEN HEARD AND RESERVED FOR JUDGMENT ON 21.06.2022 COMING ON FOR PRONOUNCEMENT OF JUDGMENT, THIS DAY, **P.S.DINESH KUMAR J,** PRONOUNCED THE FOLLOWING:-

JUDGMENT

This appeal by the Revenue is directed against order dated December 30, 2014 in ITA No.1143/Bang/2010.

2. We have heard Shri. K.V. Aravind, learned Senior Standing Counsel for the Revenue and Shri. A. Shankar, learned Senior Advocate for the assessee.

3. Brief facts of the case are, assessee, M/s. ING Vysya Bank Ltd., filed its return of income for A.Y. 2004-05 declaring income of Rs.73,43,38,840/-. On December 29, 2006, the Assessing Officer passed the

assessment order under Section 143(2) of the Income Tax Act, 1961[1]. Assessee challenged it before CIT[2](Appeals). In the meanwhile, on March 31, 2008, CIT, Bengaluru-1 vide order F. No.263/CIT-I/2007-08 set-aside the Assessment order under Section 263 of the Act and formally dismissed the appeal before CIT(Appeals) for statistical purpose. Assessee challenged the same in ITA No. 254 and 255/Bang/2009. The ITAT restored the appeal on the file of CIT(Appeals). By his order dated June 30, 2010 under Section 250 read with 254 of the IT Act, the CIT(Appeals) partly allowed the appeal. The assessee challenged the same in ITA No.1143/Bang/2010 for the A.Y.2004-05, before the ITAT and the same has been allowed in part by the impugned order.

4. Revenue has framed following questions in this appeal:

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[1] ' IT Act ' for short

[2] Commissioner of Income Tax (Appeals)-I

"1. Whether the Tribunal was correct in holding that the securities held under 'held to maturity' have the material characteristics of capital asset rather than stock in trade and the form part of investments only?

2. Whether the Tribunal was correct in allowing relief to the assessee writing off entire expense as revenue when the expenditure towards software item is capital in nature having enduring benefit eligible for depreciation at 60%?

3. Whether the Tribunal was correct in allowing relief to the issue on the issue of 'provision for expenses of branch offices' even when the assessing officer rightly disallowed the same on the ground that the liability is purely contingent and not an ascertained one?

4. Whether the Tribunal was correct in allowing relief to the issue on the issue of 'provision of loss on fraud' even when the assessing officer rightly disallowed the same on the ground that the liability is purely contingent and not an ascertained one?

5. Whether the Tribunal was correct in allowing writing off of non-banking assets of Rs.58,24,50,200/- without appreciating the fact that the losses which are contingent in nature cannot be allowed to be written off and charges against the profits of the company?

6. Whether the Tribunal was correct in allowing relief on the issue of 'broken period interest' without

appreciating the fact that the assessee cannot follow receipt basis of accounting for some items of income and follow accrual basis of accounting for other items of income?

7. Whether the Tribunal was correct in allowing expenditure claimed to be incurred in connection with sale of shares without appreciating the fact that the assessee has failed to substantiate that the expenditure on sale of shares is a wholly and exclusively incurred for the purpose of transfer of shares? "

5. This appeal has been admitted to consider questions No.3, 5 and 7.

Re: Question No.1

6. Shri. Aravind and Shri. Shankar jointly submitted that question No.1 is covered against the Revenue in *Commissioner of Income-tax, Hubli Vs. Karnataka Vikas Grameen Bank*[3].

[3] [2017] 79 taxmann.com 359 (Karnataka)

Re: Question No.2

7. Shri. Shankar submitted that question No.2 is covered against the Revenue in ITA No.130/2007[4]. The same was opposed by Shri. Aravind contending that ITA No.130/2007 is with respect to A.Y. 1998-99. Therefore, on facts, the said ruling is not applicable to the facts of this case. He submitted that the expenditure towards software is a Capital expenditure and the Tribunal has erred in treating the same as Revenue expenditure. He further submitted that the rate of depreciation with effect from 2003-04 for Computers including Computer software is 60%. Though the life of hardware is limited for want of up-gradation in technology, the software can be used for long period. Since the depreciation is 60%, the Tribunal's order on this aspect is unsustainable. In reply, Shri. Shankar argued that though the depreciation is allowed at 60% from the A.Y. 2003-04, the assessee will be entitled to

[4] CIT and Another Vs. M/s. IBM India Ltd., decided on 10.04.2013

claim depreciation at 60% in the first year and at the same rate on the remaining capital equipment for subsequent years. In ITA No.130/2007, this Court has recorded detailed reasons and held that software is an aid in manufacturing process rather than a tool itself. Though certain application has enduring benefit, it does not result into acquisition of capital asset. It merely enhances the productivity or the efficiency and therefore, it has to be treated as a Revenue expenditure.

8. We may record that in *Oriental Bank of Commerce Vs. Additional Commissioner of Income-tax*[5] has held as follows:

> " *7. The mere circumstance that the depreciation rate is spelt out in the Schedule to the Income-tax Act in our opinion is not conclusive as to the nature of the expenditure and whether it resulted in enduring advantage to a particular assessee. It is nobody's case that the assessee is dealing with computer softwares or is in the business of any related services. Rather it uses specific customized software, which is specific to its banking activities. But for the use of such software, the*

[5] [2018] 93 taxmann.com 432 (Delhi)

nature of expenditure otherwise incurred for streamlining its functions i.e. towards fee payable to the consultants for systems and employment of special professionals to carry on the tasks that the software in fact performs, would have fallen undoubtedly in the revenue stream. Taking these into account and the further circumstance that the software itself would have run its course or life span as it were, given that the earlier assessment year in question is 2008-09, we are of the opinion that the question of law framed is to be answered in favour of the assessee and against the revenue. "

9. We are in respectful agreement with the said decision. Accordingly, this question, though not framed at the time of admission, is answered in favour of the assessee and against the Revenue.

Re: Question No.3

10. This question is with regard to provision for expenses of Branch Offices. The Assessing Officer has held that provision was made towards expenses. Therefore it amounts to contingent liability and not an ascertained liability. In para 42 of its order, the ITAT has

considered assessee's plea that the amounts recoverable from the customers had been written-off and recorded a finding that the CIT(Appeals) has not disputed this factual position. It has held that the deductions claimed by the assessee has to be allowed either as bad debt or written-off or as incidental loss to business under Section 28 of the Income Tax Act. Shri. Aravind, assailing Tribunal's decision, submitted that any deduction can be considered only under Section 36 and in this case, deduction for bad debt can be allowed only for the 'money lent' in the ordinary course of business of banking under Section 36(2)(i) of the IT Act. In reply, Shri. Shankar contended that the Ministry of Finance, Department of Revenue in Circular No.12/2016 dated May 30, 2016 has clarified that after 01.04.1989, while claiming deduction of bad debt under Section 36(1)(vii) of the IT Act, it is not necessary for the assessee to establish that the debt, had, in fact become

irrecoverable, but, it is enough if bad debt is written-off as irrecoverable in the books of accounts of the assessee.

11. We have perused the said Circular. It is stated therein that in the Direct Tax Laws (Amendment) Act, 1987, the provisions of Section 36(1)(vii) of the IT act and Section 36(2) of IT Act, 1961, has been amended to rationalize the provisions regarding allowability of bad debt with effect from April 1, 1989. It is further stated that the Legislative intention behind the amendment was to eliminate the litigation on the issue of allowability of 'bad debt' by doing away with the requirement for assessee to establish that the debt had in fact, become irrecoverable. He placed reliance on *Big Bags International Pvt. Ltd. Vs. Deputy Commissioner of Income-tax*[6] in support of this contention. In view of the said Circular and the said authority wherein, this Court has held that the Act mandates that in order to claim bad debts, the assessee has to write-off the same in his

[6] (2021) 125 Taxmann.com 338 (para 6)

Books of accounts and he is not required to prove that the debt was irrecoverable, we answer this question in favour of the assessee and against the Revenue.

Re: Question No.4

12. Shri. Aravind submitted that Revenue does not press this Question.

Re: Question No.5

13. Assessee has written off a sum of Rs.58,24,50,200/- under non-banking assets and the Assessing Officer has not allowed the same. The ITAT has accepted assessee's contention that the immovable properties acquired have to be treated as 'Stock in trade' and allowed the deductions. Shri. Aravind argued that ITAT erred in treating the assets as 'Stock in trade' because, if they are treated as such, loss or profit should have been shown every year, but the same is not discernable from the record. In reply, Shri. Shankar

submitted that assessee has taken a specific stand before the CIT (Appeals) that the Non-banking assets have been classified as 'Stock in trade' and grouped under other assets in the Balance Sheet. They have been accounted at costs or net realizable value, whichever is lower. He submitted that the Teak wood plantation was acquired on March 29, 2000 and land in Mumbai was acquired on April 28, 2000.

14. Placing reliance on *Commissioner of Income-tax, Delhi Vs. Woodward Governor India Pvt. Ltd*[7]*.,* Shri. Aravind argued that if an expenditure is deductable, following have to be taken into account (i) whether the system of accounting followed is mercantile; (ii) whether the same system was followed by the assessee from the beginning or whether there is change in the system, whether change was bonafide; (iii) whether assessee has given the same treatment to losses claimed to have accrued and to the gains that may

[7] [2009] 179 Taxman 326 (SC)

accrue to it; (iv) whether assessee has been consistent and definite in making entries in the account books in respect of losses and gains; (v) whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per nationally accepted accounting standards; (vi) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reducing the incidence of taxation. He further submitted that though the acquisition was in the year 2000, the valuation is made on April 1, 2003. It is not discernable from record whether loss or profits have been shown every year.

15. In reply, Shri. Shankar, adverting to para 15 of the same judgment contended that *Woodward Governor* is an authority for Foreign exchange and is not applicable to the facts of this case. He placed reliance on *L.M. Devare, Liquidator of Bank of Karad Vs.*

Commissioner of Income-tax[8] and argued that the Bombay High Court in a similar circumstance has held that the properties continue to represent as 'Stock in Trade' of Banking business. We have carefully gone through both *Woodward Governor and L.M. Devare.* Shri. Shankar is right in his submission that Woodward Governor is an authority for Foreign Exchange. In *L.M. Devare,* certain immovable properties were acquired by the Bank from its debtors in satisfaction of the debts owed to it. In this case also, the Bank has acquired the assets. After considering decisions in the case of *Coimbatore Anupparpalayam Bank Ltd., Vs. Commissioner of Income-tax*[9] and other decisions, the Bombay High Court has held in *L.M. Devare* that the properties continued to be 'Stock in trade'. Shri. Shankar has also relied upon *Karumuru Venkata Ramanadham Vs. Commissioner of Income-tax*[10] in support of the same

[8] (1998) 234 ITR 813 (Bom.)
[9] (1961) 42 ITR 576
[10] (1964) 52 ITR 742

proposition that the properties acquired by the Bank should be treated as 'Stock in trade'.

16. In view of the above, we hold that the ITAT's conclusion that the asset shall be treated as 'Stock in Trade' does not call for any interference and accordingly, this question is answered in favour of the assessee and against the Revenue

Re: Question No.6

17. Shri. Shankar submitted that this question is covered against the Revenue in *Commissioner of Income-tax Vs. The Karnataka Bank Ltd*[11] and the same is not disputed by Shri. Aravind.

Re: Question No.7

18. This question is with regard to sale of shares. The assessee held 60,83,030 fully paid up equity shares of Rs.10/- each in Vysya Bank Housing Finance Ltd. It

[11] ITA No.433/2006 C/W ITA NOs 434/06, 147/08, 148/08 & 149/08 decided on 12.09.2012

entered into an agreement with Dewan Housing Finance Corporation ('DHFC' for short) and sold the shares under the agreement. In the agreement, assessee had undertaken to hold harmless and indemnify DHFC in respect of any material loss suffered within 36 months of the transfer. From the sale proceeds, assessee deducted an amount of Rs.2.66 Crores, which was later paid to DHFL as part of compromise deed and deducted the same as expenditure. The Assessing Officer disallowed the same and the ITAT has allowed deduction.

19. In support of this case, Shri. Aravind urged two contentions. Firstly, the expenditure has taken place after the sale and therefore, deduction could not be allowed. Secondly, under Section 48(i) of the IT Act, there must be nexus between the transfer and deduction. Shri. Shankar argued that the sale of shares has taken place on February 2, 2003 and the compromise was entered into on July 29, 2004. The Compromise Deed was produced and the same has been recorded by the

ITAT. It contains reference to the agreement for assignment of receivables of DHFL. In order to bring quietus to the dispute, assessee agreed to pay and accordingly paid the sum of Rs.2.66 Crores. He placed reliance on *Commissioner of Income-tax Vs. P. Rajendran*[12] and *Commissioner of Income-tax Vs. George Henderson*[13].

20. In *P. Rajendran,* Kerala High Court has held that the crucial test to be applied is whether the expenditure had incurred wholly and exclusively in connection with the transfer. In *George Henderson,* it is held that the expression 'full value of consideration' cannot be construed as the market value, but as the price bargained by the parties to the sale.

21. The ITAT has recorded that the terms of Compromise indicated that the payment of Rs.2.66 Crores was in connection with the transfer of Capital

[12] 127 ITR 810
[13] (1967) 66 ITR 622 (SC)

asset. We have also perused the portion of the compromise terms extracted in the ITAT's order. It is stated therein that parties had amicably agreed upon certain terms and the assessee had paid the said amount. The DHFL has waived all indemnities, liabilities and claims. It is settled that the Revenue shall not sit in the arm chair of an assessee and decide the exigencies of business/transactions. The ITAT is the last fact finding authority and based on the facts, it has held that the expenditure had nexus with the agreement between the parties. In substance, assessee has paid money to DHFL to give quietus to the dispute between the parties. As per Section 48 of the Act, the expenditure incurred in connection with the transfer is permissible. In view of the facts recorded hereinabove, in our considered opinion, payment of Rs.2.66 Crores has nexus with the transfer of shares as per the terms of Compromise. Accordingly, this question is answered in favour of the assessee and against the Revenue.

22. In view of the above, Questions No. 1, 2, 3, 5, 6 and 7 are answered in favour of the assessee and against the Revenue. Question No.4 is not pressed by the Revenue and accordingly the appeal is **dismissed.**

No costs.

Sd/-
JUDGE

Sd/-
JUDGE

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