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IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: 24.11.2020
DELIVERED ON: 04.12.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE M.S.RAMESH

Tax Case Appeal No.521 of 2017

Shri Allu Arvind Babu .. Appellant

Vs.

The Assistant Commissioner of Income Tax
Non Corporate Circle-20(1)
Chennai .. Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal 'C' Bench, Chennai dated 15.07.2016 passed in ITA No.1253/Mds/2015 for the Assessment Year 2006-07.

For Appellant : Mr.R.Vijayaraghavan
For Subbaraya Iyer Padmanabhan

For Respondent : Mr.M.Swaminathan
Sr. Standing Counsel
Assisted by Ms.V.Pushpa
Jr. Standing Counsel

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JUDGMENT

Dr.Vineet Kothari,J

The present appeal, though arises out of a common order passed against the appellant by the Income Tax Appellate Tribunal, "C" Bench, dated 15.07.2016, for the Assessment Years 2006-07 and 2007-08, the issues involved in both the appeals are entirely different and therefore, both the writ appeals are being disposed of by separate orders.

2. The substantial questions of law arising in the present appeal filed by the Assessee, as framed by the Assessee, are as under:

(i) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the bad debt was not written off as required by law as per the provisions of Section 36 of the Act, though the write off of the debt is made from the accounts of the debtors, and the amount of loans and advances at the year end in the balance sheet is shown as net of the provisions for impugned debt?

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(ii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in not considering the alternate claim that the amount was allowable as business loss under Section 28 or under Section 37 of the Act, as the debt has occurred during the course of business and was exclusively incurred for the purpose of business and incidental to the business and was not capital in nature?

3. By consent of both sides, the matter was heard finally at this stage and is being disposed of.

4. The relevant finding of the Tribunal with regard to the questions raised in the present appeal filed by the Assessee are quoted below:

"7. The facts of the issue are that the assessee is the proprietor of ***Nest Foundations*** *which is engaged in development of properties. The assessee has entered into a development agreement with* ***Mr.C.Sriramulu, landlord*** *to*

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develop a building at Erramanjali, Hyderabad vide development agreement dated ***02.11.1998****. As per the terms of agreement, the assessee had paid a sum of Rs.30,00,000 towards security deposit, which shall be refunded by the landlord on satisfaction of the terms of the contract. As per terms of the contract, the assessee is under obligation to construct a pent house but due to non-approval of the permission from local authorities, the assessee could not construct the pent house. Hence, it is claimed that the landlord did not return the deposit as the assessee failed to satisfy the terms of the agreement. Relevant portiions of the agreement are as follows:*

"10. The second party has paid an amount of Rs.30,00,000/- (Rupees Thirty lakhs only) by way of cheques as security deposit interest free for due performance of the contract which the first party shall return without interest after completion of the first party's share of the total built up area including the penthouse as per the specifications and acceptance

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thereof by the second party and in the case the penthouse is not constructed for want of permission the settlement is made as per condition mentioned in clause 7."

"7. The second party has also agreed to construct a penthouse exclusively for the first party admeasuring 1250 sq.ft. out of which 1000 sq.ft. at its own cost and for the balance 250 sq.ft. the cost of construction will be borne by the first and second party equally. The construction of the penthouse by the second party shall be made by taking necessary permission for construction from MCH or any other concerned authority. In the event of permission for construction of the penthouse from MCH or any other concerned authorities could not be obtained, the second party shall compensate the first with equivalent area by allotting the same at first instance out of the total constructed area arid the balance shall be shared equally by both the parties."

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The Assessing Officer did not allow the claim of the assessee on the ground that it is a "provision" and the amount is still retained in the balance sheet of the assessee. Aggrieved by the order of ld. Assessing Officer, the assessee carried the appeal before the Ld. CIT(A).

8. On appeal, the Ld. CIT(A) observed that the balance sheet of M/s. Nest Foundation that is the proprietorship concern of the assessee clearly reflects ***Rs.30 Lakhs as provision for claims and compensation****. The P&L A/c for the accounting year ending 31st March 2006, shows the same amount under the head "provisions for claims and compensation". further CIT(A) observed that the said amount is a provision for compensation. This cannot be treated as bad debt written off, as it is still appearing in the balance sheet. This is also cannot be treated as a trading loss.* ***This amount was deposited as security deposit. Therefore, it is capital in nature.*** *Thus CIT(A) observed that the said amount cannot be held as an expenditure and confirmed the order of AO.*

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9. We have heard both the parties and perused the material on record. The amount of Rs.30 lakhs was still appearing in the balance sheet of assessee under the head ***"provisions for claims and compensation" and it was not written off in the books of accounts of assessee****. Being so, it cannot be treated as bad debt in the assessment year under consideration. Accordingly, placing reliance on the judgment of Supreme Court in the case of M/s. T.R.F. Ltd., reported in [2010] 323 ITR 397 (SC) wherein held that:-*

> "After the amendment of section 36(1)(vii) of the Income Tax Act, 1961, with effect from April 1, 1989, in order to obtain a deduction in relation to bad debts, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable: **it is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.**"

Accordingly, this ground is dismissed."

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5. The learned counsel for the Assessee, Mr.Vijayaraghavan,

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submitted that since the Security Deposit or advance of Rs.30.00 Lakhs given by the Assessee/the developer, to the land owner Mr.C.Sriramulu, in the present Assessment Year 2006-07, the Assessee made a provision for this expenditure of Rs.30.00 Lakhs in its Books of Accounts and therefore, the same could be allowed as an expenditure or deduction in the Assessment Year 2006-07. Even though the advance given to the land owner Mr.C.Sriramulu was shown as receivable in the Balance Sheet for the previous year ending on 31.03.2006 relevant for the Assessment Year 2006-07, the Revenue as well as the Tribunal were not justified in disallowing the same as "**provisions for claims and compensation**" on the ground that it was not written off in the Books of Accounts of the Assessee.

6. The learned counsel for the Assessee re-iterated his submissions, placing reliance on the decision of the Supreme Court in the case of ***M/s. T.R.F. Ltd. reported in [(2010) 323 ITR 397 (SC)]***, quoted in paragraph 9 of its order by the Tribunal itself, that to claim a deduction in relation to bad debts under **Section 36(1)(vii)** of the Act it was not for the Assessee to establish that the debt in fact had become irrecoverable and deduction should have been allowed in

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the hands of the Assessee, since a provision was made with regard to the said compensation of Rs.30.00 Lakhs.

6. Per contra, Mr.M.Swaminathan, learned Senior Standing Counsel appearing for the Revenue, argued that mere creating of a provision for the said advance of security deposit made by the Assessee in favour of the land owner will not entitle the Assessee to claim deduction, as the Assessee, by his own conduct, has shown it as outstanding receivable in the Balance Sheet of the Assessee for the relevant previous year. The fact that the Assessee has not written off the said claim against the land owner and has not actually paid the said amount to the land owner during this year, mere creating of a provision for the same does not entitle the Assessee to claim it as an expenditure and defer taxation to that extent. He also refuted the alternative claim of the Assessee under Section 37 of the Act as the expenditure incurred wholly and exclusively for the purpose of business.

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7. Having heard the learned counsel for the parties, we are of the clear opinion that there is no merit in the contention raised by the

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learned counsel for the Assessee and the appeal filed by the Assessee deserves to be dismissed.

8. The claim of creation of provision for such expenditure, which is not yet incurred and is only intended to be written off as compensation paid to the land owner for the admitted failure of the Assessee to complete the contract in the manner as agreed between the parties, does not entitle the Assessee to claim the same either as Bad Debts under **Section 36(1)(vii)** of the Act or as Business Expenditure under **Section 37** of the Act. If mere creation of a provision for intended liability to be settled in future, which claim is contradicted by the accounting treatment given by the Assessee himself, namely by not reversing the entry of debit to the account of the land owner and continuing to show the same as receivable in the Assets side of the Balance Sheet of the year in question, cannot entitle the Assessee to claim any such deduction. Either the Assessee admits this liability and pays the said amount to the land owner or the advance given thereafter is written off in its Book of Accounts to conclusively express its intention not to claim anything back from the land owner only could have been a reasonable conclusion of such

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expenditure being claimed as Compensation or a Business Expenditure under **Section 37 of the Act.**

9. It is not a question of such advance turning to be a bad debt but the more relevant provision applicable to such facts would be **Section 37** of the Act. A developer of a building could claim it as an expenditure in the year in which such expenditure is actually incurred or the advance is written off and its right to claim the refund of such security is completely waived off. Nothing of this sort has happened in the present case and merely by making a book entry for creating a provision for future expenditure or compensation, the Assessee cannot be permitted to claim deduction under **Section 36 or 37 of the Act**. Therefore, in our considered opinion, the judgment relied upon by the learned counsel for the Assessee is of no application to the facts of the present case and the provision as such, cannot be allowed as Business Expenditure in the hands of the Assessee.

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10. The appeal filed by the Assessee is liable to be dismissed and accordingly, it is dismissed and the questions framed above are answered against the Assessee and in favour of the Revenue. No

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costs.

Index : Yes
Order : Speaking

(V.K.J.) (M.S.R.J.)
04.12.2020

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To

The Assistant Commissioner of Income Tax
Non Corporate Circle-20(1)
Chennai

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DR.VINEET KOTHARI,J,
and
M.S.RAMESH,J

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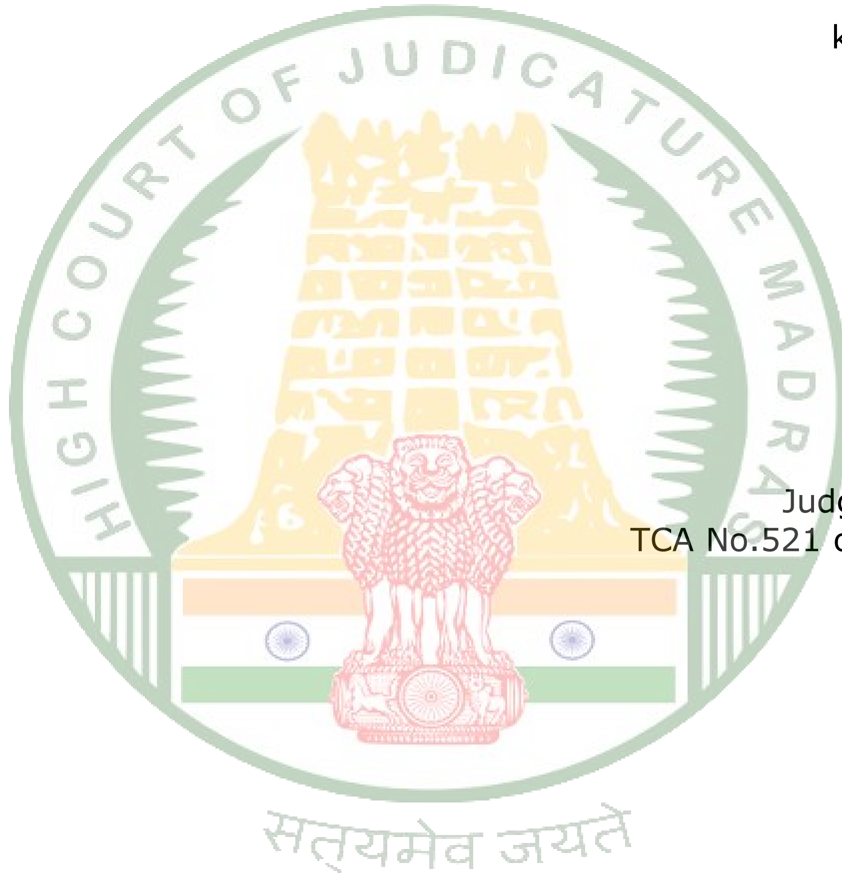

Judgment in
TCA No.521 of 2017

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