IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "B", HYDERABAD

BEFORE SHRI P.MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER

ITA No. 503/Hyd/2012
Assessment Year: 2008-09

M/s Visaka Industries Ltd., Hyderabad. PAN – AAACV7263K (Appellant)	vs.	Addl. Commissioner of Income-tax, Range - 3, Hyderabad. (Respondent)

Assessee by : Shri M.V, Anil Kumar
Revenue by : Shri B. Kurmi Naidu

Date of hearing : 04-11-2015
Date of pronouncement : 27-11-2015

O R D E R

PER S. RIFAUR RAHAMAN, A.M.:

This appeal by assessee is directed against the order dated 31/01/2012 of ld. CIT(A) – IV, Hyderabad for the AY 2008-09.

2. Briefly the facts of the case are that assessee is engaged in the business of manufacture of asbestos sheets, synthetic blended Yarn and Garments. Assessee filed its return of income and declared total income of Rs. 16,56,27,491/-. The assessment was completed u/s 143(3) of the Income-tax Act (Act) on 22/12/2010 determining taxable income of Rs. 17,37,54,026/-. AO had made two additions, Viz.:

a) Disallowance of bad debts relating to write off of rental advance.

b) 'Other income' not considered for allowing deduction u/s 80IB.

2.1 The grounds raised by the assessee in the appeal are as under:

> *"1. The CIT (A) ought to have allowed Rs. 7,65,028/- as business expenses under section 37 being the irrecoverable rent deposit made exclusively for the purpose of business and written off in the normal course of business.*
>
> *2. The CIT (A) ought to have appreciated the fact that in the earlier years rent paid was allowed as revenue expenses, therefore on the same analogy advance rent given as rent deposit being forfeited/ irrecoverable ought to have been allowed as business expenses.*
>
> *3. The CIT (A) based on the facts of the case and circumstances of the case should have allowed the write off of the advance rent as revenue expenses in the year of vacating the premises taken on rent or termination of the agreement.*
>
> *4. The CIT (A) ought to have considered the other income in the nature of sale of scrap, claims on damaged sheets etc., as business income of the undertaking eligible for deduction under section 80rB of the Income Tax Act, 1961.*
>
> *5. Your Appellant submits that the CIT (A) as well as the Assessing Officer ought not to have restricted the claim of deduction under section 80IB of the Income Tax Act, 1961, when other income is being derived from the business of the undertaking."*

3. As regards the issue raised in ground Nos. 1 to 3 regarding disallowance of bad debts claim of Rs. 7,65,028/- relating to rent deposit, the assessee had debited Rs. 7,65,028/- towards non-recovery of rent deposit. Subsequently, in reply to AO's enquiry, Assessee submitted a copy of the ledger account along with a copy of letter dated 20/02/08 addressed by it to M/s Chettipunyam Properties P. Ltd. requesting them to return the security deposit. The AO observed that the assessee had only written a letter in the last week of February, 2008 and the amount was written off in the month of March, 2008. He noted that as per the letter dated 20/02/08, Sri K. V. Sooriya Narayanan President (Corporate) and Company secretary, had called upon the said party to pay the balance security of Rs. 8,50,000 within 15 days, failing which legal action may be initiated. The AO observed that no information was furnished by the Assessee on further action taken for recovery of rental advance. He, therefore,

disallowed the claim of the assessee to write off the unrecovered rental advance.

4. On appeal, before the CIT(A), the AR of assessee contended that the AO had not disputed that the amount of Rs. 7,65,028 being rent deposit was not recoverable. He submitted that the premises had been vacated and all rents were also paid. The premises was taken for the purpose of business and such non-recovery of deposit amounts to bad debt. The payment of rental deposit was exclusively for the purpose of business and hence allowable.

5. After considering the submissions of the assessee, the CIT(A) observed that the rent deposit paid was not directly related to carrying on of the business of the assessee nor those were incidental to the assessee's business. He further observed that even though the rent deposit was connected to the business of the assessee, and was given for the purpose of carrying on the business therein, it is clear that the same had not been given in the ordinary course of business but only for securing the premises on rent. The CIT(A), therefore, following the decision of the Hon'ble Delhi High Court in case of CIT Vs. Triveni Engg. and Industries Ltd., [2010[INDLAW DEL 2397, dtd. 14/09/10, held that the loss on account of non recovery of rent deposit of Rs. 7,65,028 was not in the nature of a revenue loss allowable as a deduction.

6. Aggrieved by the order of CIT(A), the assessee is in appeal before us.

7. The ld. AR filed a petition for admission of additional evidence. Since the assessee could not file the copy of the lease agreement before the AO and CIT(A), now, they want to file copy of the lease agreement, which was found recently in their Madras Office. However, ld. DR submitted that this copy is very much available in the records of the revenue. Hence, we permit the assessee to file additional evidence.

7.1 Ld. AR submitted that this property was taken on lease from 01/07/05 to 30/06/06 for the purpose of manufacturing garments. Under this agreement, assessee has paid security deposit of Rs. 30 lakhs as per the agreement filed. . Ld. AR drew our attention to lease covenants, point No. F of the lease agreement wherein lessee cannot assign, sublet or part of the demised premises or any part thereof except to their sister concerns. Ld. AR submitted that this lease was taken only for the purpose of business and paid rent for the same claiming it as revenue expenditure. It does not create any capital asset since the lease was conditional as enumerated from clause 'f' (supra) of the agreement. Hence, it does not form any capital asset. . He relied on the following judgments:

1. LG Soft India (P) Ltd., Vs. DCIT, 35 taxmann.com 202 (Bang.)
2. . ACIT Vs. Appollo tyres Ltd., 33 taxmann.com 575
3. United Motors (India) Ltd. Vs. ITO, 6 taxmann.com 32 (Mum.)
4. Kanoria Securities & Financial Services (P) Ltd., Vs. ACIT, (Mum.) 15 SOT 191
5. Badridas Daga Vs. CIT 34 ITR 10 (SC)

8. The ld. DR, on the other hand, relied upon the orders of AO as well as relied on the decision of the Hon'ble Delhi High Court in the case of Triveni Engg. Industries Ltd. (supra) and the order of CIT(A). He submitted that the property taken on lease gives right of occupancy exclusively and thereby creates a capital asset, hence, writing off such advance as non-recoverable amounts to capital loss.

9. We have heard the arguments of both the parties and perused the material on record as well as the orders of revenue authorities. We have also applied our mind to the decisions cited above. The admitted facts of the case are that as the rental advance given by the assessee as security deposit to the lessor M/s Chettipunyam Properties Pvt. Ltd. for taking their premises on lease vide lease

agreement dated 24th June, 2005 for manufacturing of garments, no doubt, it is for the business of the assessee . The assessee get a right to occupy and run the business uninterruptedly. The question arises, the rental advance given by assessee whether a capital asset or revenue asset is created. As per the ratio laid down in the case of Triveni Engg. (supra), capital asset is created, not the revenue asset. The submissions made by the ld. AR relying on the other judgments; In the case of LG Soft India Pvt. Ltd. (supra), the assessee paid rent free advance to obtain permissive use or licence to use premises. This was not the case in the present appeal on hand. The Appollo case is not subject under consideration. Since the ratio laid down were, which reconfirms the provisions that write off of advance given for capital assets liable to be disallowed. Similarly, write off of advance given for revenue items was allowable as deduction u/s 37. The other decisions relied on by the assessee are relating to claiming bad debts which were purely relating to commercial transactions and revenue in nature. Hence, these judicial pronouncements were irrelevant for the present case under consideration since the tenancy rights creates capital assets. In the case of Badri Dass Daga (supra), the Hon'ble Supreme Court has held as under:

> "*The result is that when a claim is made for a deduction for which there is no specific provision in section 10(2), whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it. If that is established, then the deduction must be allowed, provided of course there is no prohibition against it, express or implied, in the Act.*"

It is clear that this advance payment was not for the normal course of business/trade. Since the capital asset is created, the same cannot be treated as revenue loss but capital loss.

9.1 In the other cases raised by assessee, the bad debts arose in the normal course of business and are revenue in nature, but, in the present case,

advance written off was in the nature of capital asset. . Accordingly, ground Nos. 1, 2 & 3 are dismissed.

10. As regards the second issue claim of deduction u/s 80IB raised in ground Nos. 4 & 5, the AO noticed that while calculating the profits eligible for deduction u/s 80IB, the assessee had considered the other income of Rs. 22,56,743/- as eligible income u/s 80IB also. He opined that since such other income was not derived from the business of the assessee, the same was not eligible for claim of deduction u/s 80IB. The assessee contended that the other income was generated out of normal course of business. However, the AO did not accept the said contention opining that in view of various court pronouncements, other income is not to be considered as derived from the business. Accordingly, he computed the deduction u/s 80IB at Rs. 2,53,07,225 as against Rs. 2,59,84,248 claimed by the assessee and disallowed the excess claim of Rs. 6,77,023.

11. Before the CIT(A), it was submitted by assessee that the other income constituted receipt from sale of scrap, broken/damaged sheets, gunnies etc., which were derived from the business of the assessee . He, therefore, argued that the same should have been included for the purpose of calculation of deduction u/s 80IB.

12. After considering the submissions of the assessee, the CIT(A) following the decisions of the ITAT and the decision of the Hon'ble Supreme Court, held that since the assessee could not establish that the scrap or broken/damaged sheets were generated from the industrial operations of the assessee company only, the other income on this account cannot be considered as eligible for deduction u/s 80IB.

13. Aggrieved with the decision of CIT(A), the assessee is in appeal before us.

14. The ld. AR submitted that the CIT(A) ought to have considered the other income in the nature of sale of scrap, claims on damaged sheets, etc. as

business income of the undertaking eligible for deduction u/s 80IB of the IT Act. The ld. AR relied on the following cases:

1. ACIT Vs. Biotech Medicals (P) Ltd., 119 ITD 143 (Hyd)
2. CIT Vs. Sadhu Forging Ltd., 336 ITR 444 (Del.)

15. The ld. DR, on the other hand, relied on the orders of the revenue authorities.

16. We have heard the arguments of both the parties and perused the material on record as well as the orders of revenue authorities. We have also applied our mind to the decisions cited. The AO disallowed the claim of assessee u/s 80IB by holding that other income was not derived from the business of assessee. The CIT(A) confirmed the action of the AO.

16.1 The cases referred by the assessee and the ratios laid down in these judgments were, the assessee had done a process on the raw material which was nothing but a part and parcel of the manufacturing process of the industrial undertaking. The receipts like job work, scrap and labour charges could not be said to be independent income of the manufacturing activities of the undertaking of the assessee and, thus, could not be excluded from the profits and gains derived from the industrial undertaking for the purpose of computing deduction u/s 80IB. Those were gains derived from the industrial undertaking and so, entitled for the purpose of computing deduction u/s 80IB.

16.2 Considering the above ratios laid down in the cases, we are of the opinion that the assessee is eligible to claim income from scrap sales. The scrap is part and parcel of any industrial undertaking, without which, there is no manufacturing activity. Hence, entitled to claim benefit u/s 80IB.

16.3 Coming to the income from insurance, the undertaking claimed loss from insurance company, it is nothing but compensation for the

finished goods lost after manufacturing in the undertaking and during transit. It is similar to the scrap sales income derived as part of the industrial process. Similarly, the insurance income derived due to loss of manufactured finished goods. Hence, it is entitled to claim benefit u/s 80IB.

16.4 With respect to other income like interest, which is not part of industrial activities or manufacturing, hence, it is not entitled for the benefit u/s 80IB. In the result, assessee is allowed to claim benefit on scrap sales and insurance income, rest are dismissed. Accordingly, ground Nos. 4 & 5 are partly allowed.

17. In the result, appeal of the assessee is partly allowed.

Pronounced in the open court on 27th November, 2015

Sd/-	**Sd/-**
(P. MADHAVI DEVI)	**(S. RIFAUR RAHMAN)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated: 27th November, 2015

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Copy to:-

1) M/s Visaka Industries Ltd., C/o M. Anandam & Co., CAs, 7A, Surya Towers, SP Road, Secunderabad.
2) Addl. CIT, Range - 3 Hyderabad
3) CIT(A)-IV, Hyderabad
4) CIT-III, Hyderabad
5) The Departmental Representative, I.T.A.T., Hyderabad.

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