

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI N V VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

ITA No.156/Bang/2017
Assessment year: 2010-11

Velankini Information Systems Ltd., No.43, Electronic City, Phase II, Hosur Road, Bangalore – 560 100. PAN: AABCV 0552G	Vs.	The Deputy Commissioner of Income Tax, Circle 7(1)(2) [erstwhile 12(5)], Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Sudhir Prabhu, CA
Respondent by	:	Shri Sankarganesh, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	20.01.2022
Date of Pronouncement	:	20.01.2022

ORDER

Per Chandra Poojari, Accountant Member

This appeal by the assessee is directed against the order dated 04.11.2016 of the CIT(Appeals)-7, Bengaluru for the assessment year 2010-11.

2. Ground Nos.2 & 3 are with regard to disallowance of advances written off of Rs.20.66 crores [15.98 + 5.85]. The Id. AR submitted that these are advances paid to various vendors at the time of construction of hotel to procure material. However, goods were not received nor the advances recovered. Hence the same was written off to be allowed u/s. 37(1) of the Act.

3. On the other hand, the Id. DR submitted that the advances given by the assessee are not for purchasing any material in the ordinary course of carrying on business, but it was given towards hotel building construction which is in the nature of capital expenditure and write off on that account cannot be allowed as deduction. He submitted that various case laws relied on by the assessee's counsel before the lower authorities were distinguishable and assessee's case would not fit into the ratio laid down in those decisions. He relied on the orders of the lower authorities.

4. We have heard both the parties and perused the material on record. In this case, the assessee advanced money for the purpose of purchase of material to construct the hotel building. The assessee neither received the goods on this behalf or received that amount back from the respective persons. On this ground, it was written off by the assessee and same was claimed u/s. 37 of the Act.

5. Section 37(1) is a residuary provision wherein any expenditure laid out or expended wholly and exclusively for the purpose of business or profession, shall be allowed provided such expenditure is not the one indicated in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee. Section 37(1) being a residuary provision, it cannot be taken aid of unless and until it is established that none of the provisions of section 30 to 36 are applicable to a given case. Where a case specifically falls under any one of the specific provisions of sections 30 to 36, although it was not specifically stated, the AO has to consider the claim of the assessee pertaining to a particular item as a revenue expenditure. The question whether the expenditure is capital or revenue expenditure is not relevant to the application of provisions of sections 30 to 36 of the Act. However, it is relevant only in the case falling

u/s. 37(1) of the Act. Therefore, the approach of the AO in considering the claim of assessee under sections 30 to 36 is altogether different from one applicable to claim u/s. 37(1) of the Act. Therefore, the mere fact that a claim which is not fit under any of the provisions of sections 30 to 36, will not automatically make a claim u/s. 37(1) of the Act. Thus, the expenses which are permitted as a deduction u/s. 37(1) is that the expenditure incurred for the purpose of carrying on business of the assessee i.e., to enable the assessee to carry and earn profit in that business. It is not enough that incurring of expenditure was in the course of business or arises out of or concerned with or made out of the profit of the business, but it must also be for the purpose of earning profits of the business. For this purpose, we rely on the judgment of the Hon'ble Supreme Court in the case of Haji Aziz and Abdul Shakoor Bros., 41 ITR 350 (SC).

6. Before us, the main contention of the Id. AR is that the expenditure was incurred for the purpose of business and which was not recovered from the parties and the same to be allowed as business deduction u/s. 37(1) of the Act on writing off the same. But the primary condition to allow this expenditure is that it should not be capital expenditure. In the present case, the expenditure was incurred by the assessee advances to various vendors at the time of construction of hotel building to procure the materials. The construction of hotel building is in the capital field and that construction has resulted in enduring benefit to the assessee. The primary condition for allowing expenditure u/s. 37(1) should be in the revenue field. However, in the present case, the expenditure is in the capital field and it being a capital expenditure, it cannot be allowed as a deduction.

7. In the case of *Triveni Engineering & Industries Ltd.*, 343 ITR 245 (Del), it was held that loss on account of non-recovery of rent deposit was not in the nature of revenue loss allowable as a deduction and hence

writing off the same on account of non-recovery would be a capital loss not allowable as a deduction.

8. Further in the case of *Badridas Daga v. CIT, 34 ITR 10 (SC)*, the Supreme Court held that, *“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.”*

9. Thus, it is clear from the above that the amount paid to various vendors for supply of construction material for construction of hotel building was not in the normal course of business of assessee. Since the amount was given for the purpose of creation of capital asset, the same cannot be treated as a revenue loss, but a capital loss. Accordingly, the debt arisen in the normal course of business is revenue in nature, but in the present case, the debt arose in the field of capital investment and writing off the same was in the nature of capital loss and cannot be allowed as a deduction. This ground of the assessee is dismissed.

10. The next ground is with regard to treating the incentive deposit received for rebranding of the hotel as income of the assessee.

11. During the Assessment proceedings, the AO found that the assessee has received a sum of \$2,50,000 equivalent INR 1.15,45.000 towards rebranding expenditure of the Hotel business from Inter-Continental Hotel Group (IHG) as income of the Company as incentive deposit. The assessee submitted before the AO that as per the Management Agreement dated November 26, 2009 entered between the

assessee company and IHG, the incentive amount needs to be repaid to the owner at the time of breach of any obligations as per the agreement and on termination of the agreement before the expiry of ten full operating years based on the repayment determined as per the management agreement. It was further contended that the assessee has accounted this amount under Current Liability as there is possibility of repayment of the whole amount in case of premature termination of the management agreement within five years from the date of entering into agreement. It was also argued that assessee is recognizing the incentive over the period of the agreement based on the terms of the management agreement on successful completion of the prescribed management tenure of IHG.

12. The AO observed that the 'incentive' has been received during the year under consideration for rebranding of the hotel and corresponding expenditure has been debited in the instant year itself, the amount received is an revenue receipt. He also observed that in case of premature termination of the contract if the amount is paid back, the same may be claimed as expenditure.

13. As per the agreement the assessee entered into a management agreement for rebranding of crown plaza brand hotel for a period of 5 years. For this purpose IHG, Gurgaon agreed to pay the assessee/owner a sum of US \$2,50,000/- in which it was agreed upon that a sum of US \$1,50,000/- will be used towards the cost of implementing the rebranding programme and the balance of US \$1,00,000/- will be towards the cost of carrying out rebranding works. In clause-24.2 of the agreement it was provided that in case of breach of any obligations under the agreement, the assessee shall pay back the incentives as a gross amount after deducting any taxation as per the law. Clause 24.3 gives the schedule of percentage of repayment after 5 years of the agreement which is 100% after the expiry

of 5th operating year and goes on upto 10th operating year. Clause - 24.3 is as follows:

“Clause - 24.3

Notwithstanding any other term of this Agreement, if the Agreement is terminated before the expiry of ten (10) full Operating Years, Owner will, upon such termination, repay to Manager a portion of the incentive received by Owner as at the date of termination (free of interest) determined as follows:

Termination Year	Percentage of Incentive to be repaid
From the date of the Agreement to the expiration of the 5th	100%
During the 6th Operating Year	80%
During the 7th Operating Year	60%
During the 8th Operating Year	40%
During the 9th Operating Year	30%
During the 10th Operating Year	0%

14. The assessee contended that since the amount given by IHG, Gurgaon are branding deposit to help the appellant to fund the expenses and it is not a kind of reimbursement. It was argued that it is a liability as the assessee is under obligation to repay back in case of premature termination after fifth year of operating year. The assessee has received this amount of Rs.1,15,45,000/- and from sixth operating year which is F.Y. 2014-15 corresponding to A.Y. 2015-16 has offered 20% of this amount, being Rs.31,29,540/- as income for that year. The assessee, therefore, concluded that it is offering the income as per the terms of agreement based on its entitlement and when its right to retain the amount is established as per the management agreement dated 26.11.2009 entered between the assessee and IHG.

15. On appeal, the CIT(Appeals) observed that in the instant case the assessee has received this amount of Rs.1,15,45,000/- (equivalent to US \$2,50,000/-) as incentive for rebranding of the Crowne Plaza. It has a Hotel in the name of The Oterra at Bangalore for which it has entered into a management tie-up with Inter-continental Hotel Group IHG, Gurgaon and therefore, w.e.f. 16.02.2010 the same is renamed as Crowne Plaza. He observed that it is correct to say that mere receipt of any amount doesn't makes it taxable unless the same or the part embedded in that receipt partake the character of income. Section 5 of the Act determines the scope of the total income of any assessee. As per this section, profits are chargeable when it accrued, arise or are received. It has also not to be denied that only because an amount has been received by the assessee, it is income accrued. In the year under consideration the amount can be treated as actual receipt of the assessee to the extent of its utilisation.

16. In the case of *M. N. Dastur & Co. Ltd. v. Dy. CIT [1991 61 ITD 167 (Cal.)*, the ITAT, Calcutta Bench observed that the right to receive the payments, which are essentially time-bound, is not the same thing as the right to receive income, which arises only in proportion to or commensurate with the actual performance or the actual discharge of the assessee's duties. Similar views were expressed by Hon'ble Kerala High Court in the case of *CIT v. Kerala State Drugs & Pharmaceuticals Ltd. [1991] 192 ITR 1 (Ker.)* that only accrual of real income (and not hypothetical income) was chargeable to tax.

17. According to the CIT(Appeals), in the instant case the assessee has received the entire amount in the first year of the agreement i.e. F.Y. 2009-10 corresponding to A.Y. 2010-11. The assessee has also claimed expenditure on this amount, thus the amount received by the assessee certainly takes the character of income in this very year. The contention of

the assessee that there is likelihood of repaying the amount in a phased manner after fifth operating year in case the agreement is prematurely terminated, doesn't help the assessee for treating the amount of incentive received as mere liability. The amount is accrued during the year under consideration, the expenses of Rs.1,11,12,359/- have been incurred in this very year between the period 01.12.2009 to 31.03.2010. Further as per the financial statement submitted for F.Y.2014-15 it is also evident that the agreement has not been prematurely terminated. In view of the above the addition of Rs.1,15,45,000/- treating as revenue receipt by AO is sustained by the CIT(Appeals). As against this, the assessee is in appeal before us.

18. We have heard both the parties and perused the material on record. The main contention of the Id. AR is that as per Note No.9 to the Accounts the expenditure relating to rebranding was not claimed as revenue expenditure, however it has been capitalised and only depreciation has been claimed. As such the amount received by the assessee towards rebranding cannot be considered as income of the assessee and income received by the assessee is only a liability. Attention was drawn to Note No.9 to the Accounts at page 88 of the PB which reads as follows:-

“9 Change In Management of hotel

IHG group has taken over the Management of the Hotel Business of the Company hitherto known by brand name of 'The Otterra' during February 2010. Pursuant to the same the Company is operating in the new brand name 'Crowne Plaza'. In view of the same the branding expenses incurred for the earlier brand name of Rs.31,94,075/- and Website development cost of Rs 1,40,43,489/- has been charged off in the books.

The Company incurred certain expenditure of Rs 1,11,12,359/- during the year towards rebranding and refurbishing of the existing Hotel Infrastructure to be in line with the requirements of IHG Group in accordance with the management agreement. The

same has been capitalised in view of the increase in useful economic benefit of the asset beyond its original standards of performance. The same has been amortised over the period of five years. Further, the deposit of Rs 1,15,45,000/- received from IHG as a Incentive towards rebranding expenses have been accounted as current liability in view of the same being refundable in case of premature termination of the management contract before five years from the date of agreement. The company recognizes the incentive over the period of contract based on the terms of management agreement on successful completion of the prescribed management tenure of IHG.”

19. He further submitted that every assessee is at liberty to arrange its affairs and follow the method of accounting [CIT v. Bilahari Investment P. Ltd., TS 49 SC 2008]. No income to be taxed on hypothetical income [CIT v. Excel Industries Ltd., TS 506 SC 2013]. Income really accrued to the assessee taxable [State Bank of Travancore v. CIT, TS 13 SC 1986]. The argument of the assessee is that income not at all accrued to the assessee, as such, incentive cannot be taxed in the hands of the assessee in the year under consideration. In our opinion, the assessee is following mercantile system of accounting. The assessee treated the expenditure as an asset and claimed depreciation on it and charged it to P&L account. However, corresponding incentive received by the assessee towards brand building has been shown as liability which is against the provisions of Section 5 of the Act. Accordingly, in our opinion, the AO rightly brought it to tax. The assessee cannot postpone it on the reason that it is liability and there is likelihood of repaying the amount in a phased manner after 5th of every year in case agreement is prematurely terminated. If the assessee refunds back to the payer, then it could be claimed as deduction in the year in which was paid back by the assessee. Therefore, there is no merit in the arguments of the Id. AR. This ground of the assessee is dismissed.

20. In the result, the appeal by the assessee is dismissed.

Pronounced in the open court on this 20th day of January, 2022.

Sd/-
(N V VASUDEVAN)
VICE PRESIDENT

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 20th January, 2022.

/Desai S Murthy/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.