IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 25.11.2024

CORAM :

THE HONOURABLE DR.JUSTICE ANITA SUMANTH
and
THE HONOURABLE MR.JUSTICE G. ARUL MURUGAN

T.C.A.No.304 of 2012

M/s.Electronic Corporation of Tamilnadu
Limited (ELCOT),
692, Anna Salai, MHU Complex,
Nandanam, Chennai-600 035
PAN: AAACE1670K .. Appellant

vs

The Deputy Commissioner of Income Tax,
Company Circle II (1),
Chennai – 600 034. .. Respondent

Prayer : Appeal filed under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Chennai 'D' Bench, Chennai in ITA No.1594/MDS/2008 dated 10.07.2012

For Appellant : Mr.A.S.Sriraman

For Respondent : Mr.T.Ravikumar
Senior Standing Counsel

JUDGMENT

(Delivered by Dr. ANITA SUMANTH.,J)

The Electronic Corporation of Tamil Nadu Limited (ELCOT) is a wholly owned, public sector undertaking of the Government of Tamil Nadu. It is engaged in the promotion of Electronics Industries in the State. The object of the company relates to the promotion, establishment and financing of State Public Sector Enterprises engaged in electronics. One of the measures of promotion, was by way of investing in such company.

2.In the financial year in relation to the Assessment Year in question, the appellant had invested in a total of 39 joint ventures of which four companies had not performed well. The expenditure in the aforesaid four companies had been written of and the question before us relates to whether the writing off of the investments would constitute an allowable deduction under the provisions of the Income tax Act 1961 (Act).

3.The substantial questions of law that have been admitted on 22.11.2012 are as follows:

> *'1.Whether the Appellant Tribunal is correct in law in sustaining the disallowance of investment write off claimed as a deduction in the computation of taxable total income in the assessment year under consideration, consequent to the admitted position to their diminution in value?*
>
> *2.Whether the Tribunal is correct in law in sustaining the loss incurred in the activity of promoting, establishing, running and supporting state owned electronic industries as a 'capital loss' even though the said activity was the main*

business activity?

3.Whether the Tribunal is correct in law in sustaining the loss suffered consequent to the admitted position of diminution in value of the financial/business assets while not noticing the difference between financial/business assets and investments per se and further not noticing the well-established legal principles on the irrelevance of the treatment given to such business assets in the books of account?

4.Whether the Tribunal is correct in law in sustaining the expenses incurred and accrued to the extent of Rs.1,45,371/- classified as prior period expenses in the computation of taxable total income even though the liability to pay had accrued during the previous year relevant to the Assessment year under consideration?'

4.In respect of Assessment Year (AY) 2003-04 taxable income had been returned and an intimation had been issued under Section 143(1) of the Act. The return was thereafter selected for scrutiny and an assessment finalised on 20.01.2006.

5.In the course of assessment, the assessing authority considered the write off of a sum of Rs.2,04,90,274/-. This amount represented investment by ELCOT in four companies being (i) Elcont Trident Automation Ltd (ii) Madras Hightech Circuits Ltd (iii) Satta Information India Ltd and (iv) Encore Infosys Ltd (companies in question).

6.On behalf of the appellant, it was explained that the investments, though in the nature of an advance, were accounted for as equity or working capital. In respect of the four companies in question, the ventures were not successful and hence the investment had been completely eroded.

7.Since one of the main objects of the Appellant, per its Memorandum of

Association (MOA) related to promotion of electronics companies, the Appellant had taken the plea in assessment that the erosion of its investment represented a bad debt liable to be written off. The aforesaid explanation was not accepted as the assessing authority was of the view that the petitioner had assumed the role of a partner in the business and hence, the investment was of the nature of stock-in-trade.

8. Hence, the erosion of the investment would only be a diminution in share value which was on capital account and not on business account. The officer further opined that had the shares been sold, the resultant loss would have arisen only to the account of capital gains. The assessment was hence completed negativing the claim of bad debts.

9. In appeal, the Commissioner of Income Tax (Appeals) (CIT(A)) reversed the order of assessment, being of the view that the promotion was in the nature of a business investment and hence any reduction in value of the shares would enure to business account. Reliance was placed on decisions of this Court in *CIT v. Sri Vinayaka Pictures* (161 ITR 65), the Gujarat High Court in *Vithaldas H.Danjibai Bardhanwala v. CIT* (130 ITR 94) and of the Income Tax Appellate Tribunal (Tribunal) in the case of *V.D.Swami & Co. Ltd. v. DCIT* [IT Appeal No.2592 (Mds.) 95, dated 23.02.2004] and *South India Corporations* (ITA No.1099/Mds/84 dated 10.06.1991). In conclusion, the loss claimed was held to be a business loss which was allowed.

10. The above order was reversed by the Tribunal in an appeal filed at the instance of the Revenue, noticing that for the earlier year, that is, AY 2001-02, the identical disallowance had been made and the Tribunal had decided the matter in favour of the Revenue.

11. However, both learned counsel draw the attention of the Court to the position that the order of the Tribunal for AY 2001-02 has, in fact, been reversed by this Court in a decision reported in 479 ITR 283 in the case of *Electronic Corporation of Tamilnadu Limited v. Deputy Commissioner of Income tax, Company-II(I), Chennai*. In that order, the Court refers to its earlier decision in the case of *CIT v. Tamil Nadu Industrial Investment Corporation* (394 ITR 255) which turns on identical facts and legal position.

12. In the latter case as well, the investment by TIIC was in the form of equity. The loss on investments had been treated as a bad debt and claimed as business expenditure. The Assessing Authority disallowed the claim and the matter travelled to the Tribunal, that decided it adverse to that Assessee.

13. In further appeal to the High Court, the Bench took note of the Memorandum of Association of TIIC that stated unequivocally that the raison d'etre of its incorporation was solely for the purpose of ensuring growth and development of industries in the State of Tamil Nadu. The conclusion of the Court is as follows:

> *"14. Furthermore, we find that the CIT(A) relied upon the decision in the case of Tamil Nadu Industrial Development*

Corporation (TIDCO) and in the said decision also, the investments made by the TIDCO was in the form of equity shares including share application deposit and the profit made on the sale of shares was held to be in the nature of business profit and not as long term capital gains. Further, the loss on investments was treated as bad debts and claims were written off as business expenditure which goes to show that the investments on such shares are in the course of primary business activities of the company. In the case of TIDCO, the CIT(A) relied upon a decision of the ITAT, Chennai B Bench in the case of M/s.V.D.Swami and Company Ltd., Vs. DCIT in ITA No.2592/MDS/95. As pointed out by us earlier, the objects for which the assessee company had been established by the Government of Tamil Nadu is no different from the purpose for which TIIC and TIDCO were established. Therefore, the CIT(A) was fully justified in relying upon the decision in the case of TIDCO. The Tribunal relied on a decision in the case of R.Chidambaranatha Mudaliar (supra). We find that the reliance placed on the decision is thoroughly misconceived as in the said case, the loss was under different connotation namely with regard to Section 45 of the Act. Furthermore, in the said case, the head of income was never in dispute. Therefore, the Tribunal erred in relying upon the decision in the case of R.Chidambaranatha Mudaliar. Thus, for all the above reasons, the order passed by the Tribunal reversing the order passed by the CIT(A) is not sustainable."

14. The above decision has attained finality and the Department has not chosen to file an appeal. The MOA of ELCOT had also been produced before the authorities. The Bench finds as a fact that the main objects of ELCOT included (i) promotion, establishment and running of State of Public Sector Enterprises for electronics items (ii) carrying on of business in and relating to research, development and pilot production and (iii) acquisition and take over from the Government of Tamil Nadu, electronic units, as deemed advisable and

proper.

15. In the books of accounts, the appellant had reflected the investment in question as a trade investment. It has also produced before the Commissioner of Income Tax (Appeals), the share holders agreement entered into with the joint venture companies. As a sample, agreement dated 10.03.1989 between ELCOT and Madras Hitech Circuits Limited had been produced.

16. The CIT (A) notes on a perusal of that agreement that the activities of the joint venture company were controlled by ELCOT as the financing company. The share holders agreement contained, under part-III, the narration that the advance towards equity capital was in the nature of financial participation.

17. It also provided that neither the capital structure of the assisted company, its Articles of Association, or even the location of the project be varied without the promotion of ELCOT. The share holders agreement envisaged additional rights to ELCOT over and above what would be available to an equity share holder normally under Company law. It is in light of these factual findings that the CIT (A) held that the advance towards equity was not a mere investment, but a business venture.

18. In reversing the order of the CIT(A), the Tribunal has merely followed its order for the previous year which has been reversed by this Court.

19. Reliance by the revenue on a judgment of the Supreme Court in the case of *Twenty First Century Management Services Ltd. v. Income Tax Officer*

(OSD), Chennai and the Delhi High Court in the case of *ICS Systems (P.) Ltd. v. Commissioner of Income-tax* (411 ITR 619) is of no avail as those cases turn on facts that are different from the present.

20. The Court has upheld, in the case of *Twenty First Century Management*, the findings of the Tribunal that a claim of business loss cannot be sustained by merely devaluing the book value of the shares purchased. In the present case, there is no such notional loss artificially created by devaluation of the share value.

21. Admittedly, the assessee has made an investment in furtherance of the objects in the MOA, which has become unrecoverable. A business investment cannot be compared with devaluation of shares, in the teeth of the objects in the Appellants' MOA. The case of *ICS Systems* related to payment of compensation for non-execution of an agreement that was held to be capital in nature and such a situation does not arise in the present case.

22. The facts and legal issue has been considered in the assessee's own case for AY 2001-02 and allowed, and in light of the admitted identity of factual and legal position in both the years, we are of the considered view that the appellant must succeed. The substantial questions are answered in favour of the assessee and against the revenue.

23. This Tax Case (Appeal) is allowed. No costs.

[A.S.M., J] **[G.A.M., J]**
25.11.2024

Index:Yes
Speaking order
Neutral Citation:Yes
vs

To

The Deputy Commissioner of Income Tax,
Company Circle II (1),
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DR. ANITA SUMANTH.,J.
and
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