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Payment made by bank for compensating client's loss to safeguard bank reputation/goodwill, is an allowable expense

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Facts of the case

- M/s Hong Kong and Shanghai Banking Corporation Ltd. (taxpayer or the company) is a bank. In the tax return for the FY 1999-00, the taxpayer claimed loss amounting to INR 35,000,000.
- The taxpayer acted as a mediator and performed several functions on behalf of its client, such as:
 - Hold securities,
 - Collect dividends,
 - Obtain deliveries,
 - Ensure transfer in the name of the client and
 - Deliver the securities when the same are sold by clients.
- One of the clients, Capital Emerging Growth Fund (EMGF) had purchased shares of Zee Telefilms Limited (Zee). These shares were duly registered in the name of EMGF.
- However, subsequently Jas One Diamonds Pvt. Ltd. (Jas One) filed a suit in the Bombay High Court claiming that they sent these shares for registration. However the shares were subsequently stolen and circulated in the market.
- On account of above dispute, the client (i.e. EMGF) and its Global Custodian suffered a loss amounting to INR 35,000,000.
- The company agreed to compensate a sum of INR 35,000,000 by way of loss for maintaining relations with customers in question and to safeguard the bank's interest / goodwill.
- The Assessing Officer (AO) did not allow the deduction of the above loss during the assessment proceedings of HSBC. However, the first appellate authority allowed the above claim. The revenue filed the appeal with a higher forum.
- The Hon'ble Income Tax Appellate Tribunal (ITAT) allowed the appeal in favour of the HSBC. Aggrieved by the order of ITAT, the revenue filed the appeal before the Jurisdictional High Court.

Issues under consideration

Whether disallowance of loss, which was borne by HSBC to safeguard its interest and reputation, is correct given the fact that there was no contractual liability?

Ruling of the High Court

- While analysing the issue, the HC relied on the apex court ruling in case of **Nainital Bank Ltd (1966) [62 ITR 638](SC)** which was also referred to by the ITAT while deleting the addition.

- In the aforesaid ruling of apex court, it was held that the credit of a banking business is very sensitive. It largely thrives on the confidence which its constituents have in its management. To maintain such confidence, the management had to make concessions to preserve the goodwill and relations with its clients. Under such circumstances, the expenditure was allowed.
- In the instant case, the HC noted that that the client of the taxpayer was a regular client and to maintain dignity in the market, despite no contractual obligation, the assessee had made such payment.
- Thus, such loss should be allowed as business expenditure under section 37 of the Act.

Conclusion

The Honourable High Court has held that a payment made by the bank to a client for safeguarding its reputation is an allowable expense. Accordingly, the Hon'ble High Court has affirmed the deletion of the additions made by the AO and dismissed the Revenue's appeal.

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