



* IN THE HIGH COURT OF DELHI AT NEW DELHI

+ ITA No.1442/2006

COMMISSIONER OF INCOME TAX Appellant
! Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma, Adv.

versus

\$ MORGAN SECURITIES & CREDITS Respondent
^ (P) LTD.

Through Mr. C.S. Aggarwal, Sr. Adv.
with Mr. Prakash Kumar, Adv.

% Date of Decision : 7th December, 2006

CORAM:

* HON'BLE MR. JUSTICE VIKRAMAJIT SEN
HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether reporters of local papers may be allowed to see the Judgment? ^A
2. To be referred to the Reporter or not? ✓
3. Whether the judgment should be reported in the Digest? ✓

J U D G M E N T

1. The facts that have arisen in this Appeal under Section 260 A of the Income-Tax Act (IT Act) are indeed singular and have, therefore, warranted a detailed hearing. The Assessee Company



is entirely engaged in the business of money lending by way of Inter-corporate Deposits(ICDs) and other loans. On a perusal of its Profit and Loss Account the Assessing Officer(AO) noted that the Assessee had written off Rupees Six Crores as bad debts - Rupees Two Crores from S. Kumar Nation Wide Foundation Ltd.; and Rupees Four Crores from Shithir Housing & Construction (P) Ltd.. Since the CIT(A) had allowed the claim pertaining to the former, we are only concerned with the latter transaction which comprised of a loan of Rupees Two Crores extended on 4.12.2002 and another sum of Rupees Two Crores, granted on 5.12.2002, both of which have been written off as bad debts on 31.3.2003 by the Assessee in its Books of Account. Mr. C.S. Aggarwal, learned Senior Counsel appearing for the Assessee, has laid emphasis on the fact that it has not been controverted that the Assessee has made advances to third parties of monies aggregating approximately to Rupees One Hundred and Twenty Two Crores, out of which only Rupees six crore has been written off.

2. The High Courts of Bombay, Calcutta, Rajasthan, Gujarat, Allahabad and Madras have, in the following cases, taken the view that it is for the Assessee concerned to make an honest judgment as to whether a debt is recoverable or not:-



Jethabhai Hirji and Jethabhai Ramdas -vs- CIT, [120] ITR 792 (Bom); ***Nandlal Vithaldas -vs- CIT***, [180] ITR 609(Bom); ***CIT -versus- Bhagptia Food Industries***, [217] ITR 1045(Raj.); ***CIT -vs- Dunlop India Ltd.***, [209]ITR 987(Cal); ***CIT -vs- Coates of India Ltd.***, [232] ITR 324(Cal); ***CIT -vs- Alegemene Bank Netherlands***, [73]Taxman 307(Cal); ***Sarangpur Cotton Manufacturing Co. -vs- CIT***, [143] ITR 166(Guj.); ***Hindustan Commercial Bank Ltd. -versus- ITO***, [16] ITJ 65(All); ***ITO -vs- Janki Das Laxmi Narain***, [21] TTJ 233(All); ***V.D. Swami & Co. Ltd. -vs- Dy. CIT***, [44]ITD 91(Mad).

3. The Assessee has taken the following legal actions against the Debtor, namely, Shithir Housing & Construction (P) Ltd.:-

- (a) Issuance of a legal notice;
- (b) Filing of a Winding-up Petition;
- (c) Issuance of a legal notice under Section 138 of the Negotiable Instruments Act and
- (d) Initiation of arbitration proceedings in January, 2003.
- (e) Filing a criminal complaint under the Negotiable Instruments Act.

4. The AO, however, added back the bad debts amounting to Rupees Six Crores together with interest accrued thereon,



holding inter alia that their writing off as bad was not predicated on an honest opinion formed by the Assessee and further that the provisions could not be used as a *carte blanche* to treat any debt as bad during the year in which it had become exigible to tax. By the time the matter came up for consideration of the CIT(A) prosecution under the Negotiable Instruments Act had also commenced. The CIT(A) had expressed the self-evident opinion that the provisions of Section 36 (1) (vii) read with Section 36(2) of the IT Act would come into play only if (1) the amount of loan or part thereof which is claimed as a deduction should be established to have become bad and (2) the amount should shown to have become irrecoverable and written off in the accounts of the assessee for that accounting year in which the claim for deduction is made. In our opinion a debt becoming "bad" or "irrecoverable" are but two sides of the same coin. The CIT(A) had endorsed the reasoning of the AO to the effect that "assessee has merely written off the debts at the end of the year and so that its taxable income gets reduced". The CIT(A) as well as the AO were influenced by the fact that there had been no previous dealings between the Assessee and Shithir Housing & Construction (P) Ltd.; no security was taken for the loan and the sequence of events from the advance of the loan to its writing off



did not span across even one year. To the contrary, it appears to us that these factors would be relevant if the stand of the Department is that the transaction itself was sham or false. Once it is accepted that the transaction actually took place, these factors would, in fact, quell an doubt that the decision to write off the loan as a bad debt was a consequence of an "honest judgment". Any prudent person, on learning that an unsecured loan had become perilously unrecoverable, would expeditiously initiate each and every legal remedy available to him, as has been manifested itself in the present case. The CIT(A) accepted the Assessee's decision to write off as a bad debt the sum of Rupees Two Crores relating to S. Kumar Nation Wide Foundation Ltd. but sustained the addition in respect of Shithir Housing & Construction (P) Ltd.. The ITAT, in the impugned Order, has deleted the dis-allowance of the said amount of Rupees Four Crores treating it to be irrecoverable. It further held that since the principal is not recoverable, there is no reason or justification to charge interest on this sum.

5. A conjoint reading of Section 36(2) and Section 36 (i) (vii) makes it clear that the Assessee would be entitled to a deduction of the amount of any bad debt which has been written off as



irrecoverable in its Accounts for the previous year. Any lingering doubt would vanish on a careful reading of Circular Number 551 dated 23.1.1990, the relevant portion of which reads as follows:-

6.6 The old provisions of clause (vii) of sub-section(1) read with sub-section (2) of the section laid down conditions necessary for allowability of bad debts. It was provided that the debt must be established to have become bad in the previous year. This led to enormous litigation on the question of allowability of bad debt in a particular year, because the bad debt was not necessarily allowed by the Assessing officer in the year in which the same had been written off on the ground that the debt was not established to have become bad in the year. In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalize the provisions, the Amending Act, 1987 has amended clause (vii) of sub-section (1) and clause (I) of sub-section (2) of the section to provide that the claim for bad debt will be allowed in the year in which such a bad debt has been written off as irrecoverable in the accounts of the assessee.

6.7 Clauses (iii) and (iv) of sub-section (2) of the section provided for allowing deduction for a bad debt in an earlier or later previous year, if the Income-tax Officer was satisfied that the debt did not become bad in the year in which it was written off by the assessee. These clauses have become redundant, as the bad debts are now being straightway allowed in the year of write off.



The Amending Act , 1987 has, therefore, amended these clauses to withdraw them after the assessment year 1988-89.

6. The conundrum which has arisen before us had also engaged the attention of the Gujarat High Court in ***Commissioner of Income-Tax -versus- Girish Bhagwatprasad***, [2002] 256 ITR 772 with which we are in respectful agreement. Our learned Brothers had pointedly observed that the genuineness of the claim predicated on Section 36(1)(vii) of the IT Act was not in doubt. Where the loan transaction is itself shrouded in uncertainty other provision of the statute would immediately come into play. Our learned Brothers further observed that prior to the amendment from April 1, 1989, the allowance under the said section was confined to debts and loans which had become irrecoverable in the Accounting Year. Without adverting to the above extracted Circular, it was opined that with effect from April 1, 1989 "all that the assesses had to show was that the bad debt was written off as irrecoverable". One year later an altogether different Bench of the Gujarat High Court had to decide the question of whether it was enough if the assessee writes off the debt as bad in its Books of Accounts and



whether the assessee company need not establish the debt to have become bad, in *Deputy Commissioner of Income-Tax -versus- Patidar Ginning & Pressing Co.*, [1999] 157 CTR Reports 177. The Appeal of the Revenue was dismissed.

7. It is our view that the Circular Number 551 leaves no scope for debate since it specifically notices the previous practice of having to establish that a debt had become bad in the previous year, which had generated enormous litigation on the question of allowability of bad debt in a particular year. The Circular expressed the hope that this litigation would be eliminated by permitting a debt to be treated as a bad or recoverable no sooner it was written off in the books of the Assessee concerned.

8. In these circumstances no substantial question of law arises in the present case. Dismissed.

VIKRAMAJIT SEN, J

S. MURALIDHAR, J

DECEMBER 07, 2006
tp