* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.405/2007**

% **Reserved On: 20.04.2011**
**Date of Decision: 11.05.2011**

**Mohan Meakin Limited** .... **APPELLANT**
*Through*: Mr. C.S. Aggarwal, Sr. Advocate with Mr.Prakash Kumar, Advocate for the appellant.

Versus

**Commissioner of Income Tax, Delhi** .... **RESPONDENT**
*Through*: Ms. Prem Lata Bansal, Sr. Advocate with Mr. Deepak Anand, Advocate for the respondent.

**CORAM:**
**HON'BLE MR. JUSTICE A.K. SIKRI**
**HON'BLE MR. JUSTICE M.L. MEHTA**

**1.** Whether reporters of Local papers be allowed to see the judgment? Yes
**2.** To be referred to the reporter or not? Yes
**3.** Whether the judgment should be reported in the Digest? Yes

**M.L. MEHTA, J.**
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1. This is an appeal under Section 260A(1) of the Income Tax Act, 1961 (for short "the Act") against the order of the Income Tax Appellate Tribunal (for short "the Tribunal") dated 3rd January,

2005 for the assessment years 1986-87. The appellant/assessee is engaged in the manufacturing of liquor, beer, juices, canned products and glass bottles etc. During the relevant assessment year 1986-87, the assessee filed revised return wherein beside other things it had claimed deduction of Rs.4,48,462/- as un-recovered bad debts. This amount comprised of various small amounts and also a sum of Rs.4,22,114/- shown against Kanpur Boot House. Regarding small amounts, it is seen that they represented mostly advances given to various parties and the assessee tried to recover but could not do so. The Assessing Officer allowed deductions of those small amounts, but declined that of Rs.4,22,114/- in respect of M/s.Kanpur Boot House of Shri Bhagwan Dass. He was not satisfied with the explanation given by the assessee with regard to the reasons for being unable to recover the said amount. He disallowed the deduction observing that the assessee had failed to produce any evidence regarding efforts made for the recovery of the said amount and thus had not established that it became bad during this year.

2. In appeal, the CIT(A) reversed the order of the Assessing Officer and allowed the said deductions holding the debt having become bad and thus irrecoverable against deceased Bhagwan Dass or his legal heirs. The Tribunal reversed the order of the CIT(A) and

maintained that of the Assessing Officer vide its impugned order dated 3rd January, 2005. It is against this order that the assessee is in appeal before us. The following substantial question of law arises for consideration:

> Whether the ITAT erred in disallowing deduction of Rs.4,22,114/- to the assessee as bad debts for the assessment year 1986-87?

3. Before proceeding to deal with the legal aspect of the matter, we may note that in its reply dated 9th March, 1989 addressed to the Assessing Officer, the assessee had stated that they had established an export division for the export of various items including leather products. After exploring the markets abroad, they established business contacts with M/s.Comtec Commercial Corporation of USA. They obtained huge orders from them and had exported goods of aggregate value of Rs.63.15 lakhs to the said Corporation. To maintain their commitment for the supply of hand-made leather shoes, they entered into an agreement with M/s.Kanpur Boot House (sole proprietorship firm of Bhagwan Dass) for carrying out the necessary manufacturing of hand-made leather shoes. As the quantity and the value involved in the transaction was substantial and to ensure regular supplies, they had to advance from time to time different amounts to M/s.Kanpur Boot House to enable them to keep their supplies in

time. Since they could not realize Rs.25.32 lakhs from said Corporation, they had to suspend the supplies to them and ultimately had to suspend the orders placed by them on M/s.Kanpur Boot House. In view of this development, Kanpur Boot House showed its inability to refund the advances and pleaded inability stating that they had in turn given substantial advances to the workers engaged by them. They also stated that a lot of amount was also invested on the wooden blocks made for the types of shoes ordered by them. Mr.Bhagwan Das also pleaded that all these wooden blocks are of no use and value in case further orders were to be cancelled. In the meantime, Shri Bhagwan Das, sole proprietor of said Kanpur Boot House was diagnosed for Cancer and ultimately died on 19th October, 1985. The assessee stated that they could not take legal action against Bhagwan Das or his legal heirs in view of the fact that they would have made counter claims on account of the firm orders placed having been cancelled. Since they also failed to recover the outstanding amount of Rs.25.32 lakhs from M/s.Comtec Commercial Corporation, USA, despite all efforts through the Embassy of India in Washington, Consulate General of India, New York and other debt collection agencies, this amount had to be written off in consultation with and after approval of the Reserve Bank of India.

4. As noted above, the Assessing Officer was not satisfied with the explanation of the assessee and proceeded to disallow on the ground that the assessee had not been able to produce any evidence regarding efforts made for recovery of the said amount and was also not able to establish that this debt became bad during this year.

5. Learned counsel for the assessee initially submitted that the Tribunal erred in disallowing deduction of bad debt under Section 36(1)(vii) inasmuch as the same has been given during the course of its trade and had been written off as irrecoverable in the accounts. However, during the course of further arguments, learned counsel conceded that the requirement of Section 36(2), a pre-requisite for the application of Section 36(1)(vii), was not fulfilled in the case of the assessee for the relevant assessment year, in respect of the debt in question. However, learned counsel submitted that the deduction was allowable as business loss under Section 28 read with Section 37 of the Act. To bolster his submissions that the non-recovery of trade advances amounted to business loss and were allowed to be deducted under Section 28 and Section 37 of the Act, learned counsel has placed reliance on the cases of ***Chenab Forest Co. v. Commissioner of Income-Tax, Patiala***, 96 ITR 568; and

***Commissioner of Income-Tax, Mysore v. Mysore Sugar Co. Ltd.***, 46 ITR 649. On the other hand, learned counsel appearing for the Revenue submitted that the advances, which had been made, cannot be regarded as expenditure and it would be in the nature of debt. As it was not such a debt which would come within the purview of Section 36, so the assessee cannot claim any deduction on this account. With regard to submissions of assessee regarding applicability of Section 28 and Section 37, it was submitted by learned counsel for the Revenue that the assessee cannot seek protection under Sections 28 and 37 because when Section 36 is applicable, then Section 37 will not be applicable.

6. The facts of Chenab Forest Co. (*supra*) are similar to the instant case. In this case, the assessee was engaged in exploitation of forests, i.e., felling of trees, cutting them into sizeable logs, etc. In that case, the assessee had to engage various sub-contractors, who were to be given advances before coming to the works. The advances as also the cost of rations supplied to them had to recouped from the sub-contractors' earnings during the working season. Any balance left as debit or credit was being carried forwarded to the year following, when again some advances had to be made for the labour to come out to the

works. The assessee for the assessment years 1964-65 filed its return claiming some amount to be deducted as bad debts. The Assessing Officer did not allow any deduction on account of the fact that the assessee had not taken any steps for realisation of those debts. The appellate authorities also agreed with the finding of the Assessing Officer. The Tribunal also did not agree with the alternate plea of the assessee that if its case was not covered under Section 36, the same could be allowed under Section 37. In that case also, the learned counsel appearing for the assessee conceded this position that he could not claim deduction on account of its being bad debt if it did not come within the purview of Section 36(2) of the Act, and this position was also not disputed that in this reference such matter cannot be gone into which relates to facts on the question whether it was a bad debt or not as contemplated by Section 36 of the Act. It was then submitted by the learned counsel that the assessee was entitled to deduction under Section 28 read with Section 37 of the Act since the nature of the business was such that the assessee had to keep his business going on, had to advance money to the sub-contractors because without doing so it would not have been able to get the labour in time and carry on the supplies.

7. The Division Bench of J&K High Court has held as under:-

> "In my opinion if section 28 is read along with section 29 then it would be clear that the computation of the income as contemplated by section 28 has to be in accordance with the provisions contained in sections 30 to 43 which means that it should be also in accordance with section 37 if the case falls under section 37. In the present case out of sections 30 to 43 the only sections which can be made applicable are either section 36 or 37. I have already stated above that the assessee-company's learned counsel is not relying on section 36 but is relying on section 37 and to me it appears that sections 28 and 29 read together do not show that if a case comes under section 36 then the applicability of section 37 will be taken out but rather means that a case may come either under Section 36 or section 37 and a computation may be made under either of the sections.
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> It also appears that there is a clear distinction between a business expenditure and a business loss, the former is indicative of a volition but in loss it comes upon him so to speak as ab extra and I am also of opinion that non-capital expenditure incurred for the purpose of business would fall to be deducted under the omnibus residuary Section 37 to which I will be now referring. Section 37(1) lays down as follows:-
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> "Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'."
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> The essential ingredients of the section are, therefore:
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> "(i) that it should be an expenditure of the nature not described in Sections 30 to 36;
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> (ii) it should not be in the nature of capital expenditure or personal expenses of the assessee;
>
> (iii) that it should be laid out or expended wholly and exclusively for the purposes of the business, etc."

> The facts and the circumstances which I have stated above would in my opinion clearly show that the advances which had been made by the assessee in the present case were certainly of a type which would be within the contemplation of the words "laid out or expended wholly and exclusively for the purposes of the business". Now, with regard to the contention whether Section 37 would be applicable when Section 36 is applicable in the present case, in my opinion it is important to note that the legislature has advisedly used the word "described" and not "covered" in Section 37. Section 37 clearly appears to be a residuary section extending the allowance to items of business expenditure and not of business losses which are deductible on the ordinary principles of commercial accounting."

8. The facts of the case before us being similar to the case of Chenab Forest Co. (*supra*), we find ourselves in complete agreement with the findings recorded by the Division Bench of J&K High Court.

9. The case of CIT v. Mysore Sugar Co. Ltd. (*supra*) related to claim of bad debts under the Act of 1922. In that case also, case of the assessee company was changed from one section (S.10(2)(xi) corresponding to S.36(1)(vii) & S.36(2) of 1961 Act) to another (S.10(1) & S.10(2)(xv) corresponding to section 28(1) and Section 37 of 1961 Act) from time to time. In that context, the Hon'ble Supreme Court observed that they did not wish to emphasise the nature of the question posed, because the central point to decide is whether the money which was given up

represented a loss of capital, or must be treated as revenue expenditure. The supreme Court held as under:

> "The tax under the head "Business" is payable under section 10 of the Income-tax Act. That section provides by sub-section (1) that the tax shall be payable by an assessee under the head "profits and gains of business, etc." in respect of the profits or gains of any business, etc., carried on by him. Under sub-section (2), these profits or gains are computed after making certain allowances. Clause (xi) allows deduction of bad and doubtful business debts. It provides that when the assessee's accounts in respect of any part of his business are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of the his business is deductible but not exceeding the amount actually written off as irrecoverable in the books of the assessee. Clause (xv) allows any expenditure not included in clauses (i) to (xiv), which is not in the nature of capital expenditure or personal expenses of the assessee, to be deducted, if laid out or expanded wholly and exclusively for the purpose of such business, etc. The clauses expressly provide what can be deducted; but the general scheme of the section is that profits or gains must be calculated after deducting outgoings reasonably attributable as business expenditure but so as not to deduct any portion of an expenditure of a capital nature. If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the appropriate class; but there may be an expenditure which, though not exactly covered by any of the enumerated classes, may have to be considered in finding out the true assessable profits or gains. This was laid down by the Privy Council in Commissioner of Income-tax v. Chitnavis, (1932) L.R. 59 IA 290 and has been accepted by this Court. In other words, Section 10(2) does not deal exhaustively with the deductions, which must be made to arrive at the true profits and gains.
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> To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital.

> But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for that was the money laid out ? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business? If money be lost in the first circumstances, it is a loss of capital, but if lost in the second circumstances, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses."

10. Applying the principles of law as regard interpretation of Sections 28, 29, 36(1)(vii), 36(2) and Section 37 of the Act as enunciated by the Division Bench of J&K High Court and the Apex Court in the afore-cited cases, we are of the considered view that it was in the totality of overall situation of the matter that the assessee decided to write off the advances made to M/s.Kanpur Boot House as bad debt. The reason as given by the assessee was apparently well-founded and was abruptly rejected by the Assessing Officer and the Tribunal. They did not appreciate the fact that the continuity of supply was essential to honour the agreement with the Corporation and that it was to continue the business without any break that the advances were made to the manufacturer, M/s.Kanpur Boot House. It was only on account of non recovery of the huge amount from the Corporation that the work had to be cancelled and the supplies had to be abruptly stopped by the Assessee and consequently production was

necessarily required to be stopped. It is known practice that usually manufacturer gives advances to the workers which are adjusted or carried forward in the coming times against the works done by them. This was not an unusual practice which was liable to be outrightly rejected by the department. When the assessee had written off the dues recoverable from the Corporation and the same were accepted by the Department and it had also so written off, the advances made to M/s.Kanpur Boot House in its books of accounts, what else could be the proof with the assessee for its being unable to recover the same. The other reason for writing off was the demise of the proprietor, Bhagwan Das, of M/s.Kanpur Boot House and the assessee in its wisdom did not choose to take the matter to the court apprehending counter claim and this decision of the assessee seems to be well reasoned. In any case, the Revenue could not compel the assessee to have recourse to litigation to recover the amount against dead person or his legal heirs when in the given circumstances, the same may not be recoverable. The CIT(A) rightly recorded that the debt had become bad and not recoverable and it would be a futile exercise to take any action against the legal heirs of the deceased. In view of the discussion as made by the Division Bench of J&K High Court and the Hon'ble Supreme Court, as quoted above, that the advances

made by the assessee in the case were certainly of a type which would be within the contemplation of the words "laid out or expended wholly and exclusively for the purposes of the business". As no portion of the said advances could be stated to be loss of capital expenditure, but it being a plain case of business loss, it would certainly be allowable to be deducted under the provisions of Section 37 of the Act.

11. Learned counsel for the Revenue also half-heartedly submitted that this alternative plea of applicability of Section 28 and Section 37 was not raised by the assessee before the Authorities below and so could not be raised before this Court in the present appeal. The learned counsel for the assessee submitted otherwise and relied upon ***Commissioner of Income-Tax, Madras v. Mahalakshmi Textile Mills Ltd.,*** 66 ITR 710. In this case, it was held that the right of the assessee to relief was not restricted to the pleas raised by him before the departmental authorities or before the Tribunal. It was held that if for reasons recorded for the departmental authorities in respect of the contention raised by the assessee, grant of relief to him on another ground is justified, it would be open to the departmental authorities and the Tribunal, and indeed they would be under a duty to grant that relief. It was also held that there was nothing

in the Income Tax Act which restricts the Tribunal to determine all questions raised before the departmental authorities and that all questions, whether on law or facts, which relates to the assessment of the assessee may be raised before the Tribunal.

12. Merely because the claim was not made out under one particular provision of the Act, but was so made out under another provision of law, we failed to understand as to how the assessee could be debarred to raise such legal question. Having regard to all this, we are of the considered view that it was legally permissible to raise question of deduction under Section 37 of the Act even if it was not raised before the authorities below.

13. In view of our discussion as made above, we answer the question in the affirmative and allow the appeal.

**M.L.MEHTA**
**(JUDGE)**

**A.K. SIKRI**
**(JUDGE)**

**MAY 11, 2011**
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