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

\+ **ITA 215/2005**

THE COMMISSIONER OF INCOME TAX
DELHI-IV ..... Appellant
Through: Ms. Vibhooti Malhotra, Advocate.

versus

ESCOTRAC FINANCE
AND INVESTMENTS LTD. ..... Respondent
Through: Mr. Simran Mehta & Ms. Swati R.K., Advocates.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE PRATHIBA M. SINGH

O R D E R

% 19.07.2017

Dr. S. Muralidhar, J.:

1. This is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act') against the order dated 31st March, 2003 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.453/Del/1997 for the Assessment Year ('AY') 1993-94.

2. By the order dated 10th November, 2006 while admitting the appeal, the following substantial question of law was framed:

> "Whether the order of ITAT is perverse, inasmuch as having rejected the assessee's claim of debt, the ITAT ought to have dismissed the assessee's appeal and not remanded the matter to the AO for re-computation of the same as a speculative loss?"

3. The facts leading to the present appeal are that the Respondent/Assessee is engaged in the business of finance and investment. The Assessee filed its return of income for the AY in question on 31st December, 1993 declaring an income of Rs.93,38,110. The Assessee reduced its profits by writing off a sum of Rs.71.82 lakh in the profit and loss account claiming it to be a bad debt.

4. During the course of the assessment proceedings, the AO called upon the Assessee to clarify the aforementioned claim for bad debt. The Assessee submitted a detailed reply dated 27th October, 1995. The Assessee explained that out of sum of Rs.151.82 lakh due from a broker, Kamlesh Kamal & Co. the aforementioned sum of Rs.71.82 lakh had been written off. The Assessee stated that it had advanced money to the broker for purchase of shares, which unfortunately were not purchased by the broker. The broker was unable to repay the money advanced. It was stated that a Memorandum of Agreement ('MOA') had been entered into with the broker and that "the balance amount of Rs.80 lakh due from M/s. Kamlesh Kamal & Company is included in sundry debtors and is grouped in Schedule E on page 42 of the printed accounts."

5. The AO, however, was of the view that the amount cannot be treated as a bad debt since (i) there is no specific waiver of any liability (ii) No debt as such has arisen at all or been recognised as such (iii) "M/s. Kamlesh Kamal have undertaken to pay sums due to you and for the balance have undertaken to furnish you with shares" (iv) "At best the shortfall between sums given by you and payments agreed to be made

to you can be considered as the cost of shares to you" and (v) "Any loss arising, if at all, out of above transaction can only be speculative in nature."

6. Before the AO, the Assessee gave a further elaborate explanation that the Assessee along with another group company Escorts Holdings Limited ('EHL') advanced a sum of Rs.3.01 crore to the aforementioned broker for investment in *badla* transactions. Some portion of the money was utilised by the broker for investment in *badla* transactions and a part was returned. It was stated that as of 30th September, 1992 the outstanding amount owed by the broker was Rs.2,86,99,698. The Assessee volunteered that "the income generated on account of *badla* transactions has been duly included in income from *badla* transactions as shown in Profit and Loss account on page 39 of the printed accounts."

7. The Assessee further explained that the cheques issued by the broker towards repayment of the aforementioned sum were dishonoured. It was noticed that the broker had applied to the Delhi Stock Exchange to resign from the membership and transfer the ticket to some other person. This led to the Assessee, along with EHL, filing a petition before this Court seeking an injunction on the sale of the stock exchange ticket by the broker.

8. During the pendency of the said petition, the broker is stated to have approached the Assessee for an out-of-court settlement. This led to the signing of the MOA whereby it was agreed by the broker that the

following sums would be paid to the Assessee:

"i. Rs.65,00,000 within 7 days of the signing of the agreement.
ii. Rs.60,00,000 on or before 31.03.93.
iii. Rs.20,00,000 in 4 equal instalments of Rs.5,00,000 each payable on or before 30th June, 1993, 30th September, 1993, 31st December, 1993 and 31st March, 1994."

9. In addition the broker agreed to transfer shares worth Rs.55,62,589 as mentioned in Annexure 'B' to the MOA to the Assessee. It appears that thereafter a sum of Rs.65 lakh was received by the broker and credited to the broker's account. The balance of Rs.80 lakh was retained in the broker's account and included in the sundry debtors. It was explained that of the total outstanding amount of Rs.2,86,99,698, Rs.1.45 crore was agreed to be paid by the broker by cheques and Rs.55,62,589 by way of shares to be transferred by the broker. The balance sum of Rs. 86,37, 109 was written off as bad debt in the books of the Assessee as well as EHL. The Assessee's share of these bad debts worked out to Rs.71,82,012.

10. The Assessee informed the AO that the apprehension about the loss arising out of the transaction of being speculative in nature was misplaced since the Assessee had advanced money to be invested in *badla* transactions and the money was repayable by way of cheques. The Assessee maintained that "by no stretch of imagination, it can be said that the loss arising for non-payment of money due to the assessee can be in the nature of speculative loss."

11. As regards the observations of the AO that the money advanced to the broker had not been taken into account in computing the income of the previous year in which the amount of such debt was written off, it was contended by the Assessee that the *badla* income earned had been duly included in the P&L account. The Assessee pointed out that Kamlesh Kamal & Co. had filed a copy of the account before the AO which showed that "they are committed to pay the amount due to the Assessee Company." It was pointed out that the balance amount of Rs.80 lakh due under the MOA had not been paid by the broker and therefore, the Assessee had filed a suit for recovery of the said sum together with interest.

12. The above explanation was not accepted by the AO. It was pertinently pointed out by the AO in the assessment order that "the shortfall perceived by the Assessee has not found mention in the MOA, so it did not assume the colour of debt owed by the broker to the Assessee. An amount which is not owed cannot crystallise in the shape of a debt, in the first place and therefore cannot become a bad debt. The amount that the Assessee calls irrecoverable is not seen to be recoverable at all in the first place. What was not recoverable was therefore never a debt. It may be cost of shares purchased, speculation loss of the Assessee or may assume any other form." Consequently the aforementioned sum was disallowed and added back to the income of the Assessee.

13. The Commissioner of Income Tax (Appeals) ['CIT (A)'] by the

order dated 29th November, 1996 confirmed the order of the AO and dismissed the Assessee's appeal.

14. By the impugned order, the ITAT while disposing of the appeal of the Assessee was of the view that the Assessee was engaged in a speculative transaction. It held that the investment made with the broker was in speculative business and the loss suffered on account thereof was a speculative loss "which can only be set off against the speculative income." It was concluded that since in the AY in question the Assessee had earned certain speculative income against which the set off of speculative loss should be allowed to the Assessee the matter should be restored to the file of the AO to re-compute the speculative loss after allowing the set off of speculative income and to carry forward the loss, if any, as per law.

15. The grievance of the Revenue, as articulated by Ms. Vibhooti Malhotra, learned counsel appearing on its behalf, is that the ITAT was in error in proceeding on the basis that the above sum claimed by the Assessee as bad debt was its speculative loss. She submitted that once the AO found on facts that the case of the Assessee that the sum written off was a bad debt was unsustainable in law, the matter should have ended there. There was no question of treating the said amount as the Assessee's speculative loss, particularly when that was not even the Assessee's case. She submitted that unless the said sum constituted the income of the Assessee in the earlier previous year the question of writing it off as a bad debt in the AY in question did not arise. The mere failure to recover the sum from the broker which was given as

advance for *badla* transactions could, at best, be a business loss but would not be a bad debt. She referred to the decisions in ***A.V. Thomas & Company Limited v. Commissioner of Income Tax (1963) 48 ITR 67 (SC)*** and ***Commissioner of Income Tax v. Abdullabhai Abdulkadar (1961) 41 ITR 545 (SC)***.

16. Replying to the above submissions, Mr. Simran Mehta, learned counsel appearing for the Assessee, submitted that it was the AO's own suggestion that if the amount was not a bad debt, it could be a speculative loss. While Mr. Mehta did not deny that the Assessee had initially taken the stand that the said amount could not be a speculative loss, since it was the Revenue's suggestion that it could be, the Assessee was prepared to accept it. Therefore, a submission to that effect was put forth before the ITAT, which was accepted by it, that such speculative loss should be set off against the speculative income of the Assessee. He accordingly submitted that the impugned order the ITAT did not call for interference.

17. In the considered view of the Court, the ITAT appears to have misconstrued the nature of the transaction involving the Assessee and the broker Kamlesh Kamal & Co. It also overlooked the basic fact that the Assessee was a finance and investment company. This is evident from its observation in the impugned order that: "Since the assessee himself was not engaged in dealing of shares, it cannot be said to have been engaged in trading of shares." This was plainly contrary to the factual position. Thirdly, it was not the Assessee's case to begin with before the AO, that the amount written off by it was a 'speculative

loss'.

18. The AO's analysis of what really the transaction was, was based on the correct understanding of the legal position emanating from Section 36 (1) (vii) of the Act. This corresponds to Section 2(10)(xi) of the Income Tax Act, 1922, which was interpreted by the Supreme Court in ***A.V. Thomas & Company Limited v. Commissioner of Income Tax*** (*supra*). There, the Court explained that "a debt means something more than a mere advance. It means something which is related to business or results from it. To be claimable as a bad or doubtful debt it must first be shown as a proper debt."

19. The Revenue is right in the contention that what was not shown to be part of the income of the Assessee for an earlier previous year could not possibly be written off as a debt in the year in question. The failure by the broker to return the aforementioned sum was at the highest a business loss and nothing more. It was not even the Assessee's case that it was a speculative loss. The observations of the AO have been taken out of context. It was observed by the AO, in the process of negativing the claim of the Assessee that it was a bad debt, that "it may be cost of shares purchased, speculation loss of the Assessee or may assume any other form." This could not be construed as the AO holding it to be a speculative loss.

20. Consequently the question framed is answered in the affirmative, i.e., in favour of the Revenue and against the Assessee.

21. The appeal is accordingly allowed. The impugned order dated 31st March, 2003 is accordingly set aside.

S. MURALIDHAR, J.

PRATHIBA M. SINGH, J.

JULY 19, 2017
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