

**Court No. 29
Reserved on 24.10.2009
Delivered on 05.11.2009**

Income Tax Appeal No. 02 of 2007

**The Commissioner of Income Tax-I
Aayakar Bhawan, Lucknow**

Versus

**M/s Kohli Brothers Color Lab (P) Ltd.
50 Hazaratganj, Lucknow**

**Hon'ble V.K. Shukla,J
Hon'ble Rajiv Sharma,J.**

Present income tax appeal has been filed under Section 260A of Income Tax Act, 1981 against the judgment and order dated 4.8.2006 passed by Income Tax Appellate Tribunal, Lucknow Bench, Lucknow in Appeal No. I.T.A. No. 501/LUC/2006 for Assessment Year 2002-03.

On the presentation of appeal in question, appeal was admitted for final hearing on following substantial question of law:-

(I) Whether on the fact and circumstances of the case the learned Income Tax Appellate Tribunal was right in law in holding that it is not obligatory on the part of the assessee to prove that the debt written off by him is indeed a bad debt for the purpose of allowance u/s 36 (1) (vii) of the I.T. Act, 1961 by relying on the order passed by Income Tax Appellate Tribunal in the case of Dy. CIT Vs. Oman International Bank SAOG, (2006)100 ITD 285 (Mum)(SB) ?

(ii) Whether on the peculiar fact and circumstances of the case the amended provisions of the Income Tax Act, 1961 w.e.f. 1.4.1989, to section 36(1) (vii) read with 36(2) grants specific amnesty to the assessee for claiming any amount of Debt as bad barring the Assessing Officer to question the veracity of the same thus giving overriding power to one section contrary to the general scheme of enactment of the Income Tax Act, 1961 vide which the real income only is envisaged to be taxed ?

Brief background of the case is that the respondent assessee is engaged in the business of developing and printing of photos. The respondent

assessee filed its return showing an income of Rs. 4,65,640.00. The returned income was adjusted from the carried forward losses of the earlier year and thus Nil income had been shown. The case was processed u/s 143(1) on 27.12.2002 on the returned income. The assessment was completed u/s 143(3) on the total income of Rs. 13,14,540.00.

In the income and expenditure account the respondent assessee claimed expenditure of Rs. 4,86,466.00 under the Head "Amounts written off." The Assessing Officer observed that merely stating that the amount has been written off would not suffice as the respondent assessee failed to furnish the information, which may substantiate that the said debt is a bad debt as the onus to prove that it was a bad debt was on the respondent assessee who failed to discharge the same. Therefore, the Assessing Officer held the expenditure claimed by the respondent assessee under the head "amounts written off" as disallowable as per the provisions of Section 36(1) (vii) of the I.T. Act.

The assess Company proceeded in appeal before the learned CIT (A)-I Lucknow, who vide appellate order in A.No. CIT (A)-I/LkO/06/46 dated 4.4.2006 confirmed the disallowance by observing that

"In the written submission, the appellant has placed reliance on the case of CIT Vs. Girish Bhagwat Prasad, 256 ITR 772 and simply stated that the disallowance of the amount, which was old and irrecoverable, has wrongly been made. A perusal of the assessment order reveals that the Assessing Officer has given proper opportunity to the appellant to prove the genuineness of the claim. If the assessee's version that the amount was not recoverable, is considered, details regarding efforts made or legal steps taken by the assessee to recover the bad debts, have not been filed either before the A.O. Or in appeal. It is obvious that the assessee failed to substantiate its claim. On the other hand, the A.O. Has rightly observed that it was not a bad debt. The addition is, therefore, upheld"

Aggrieved with the order the respondent assessee went up in appeal before the learned Income Tax Appellate Tribunal. The learned Income Tax Appellate Tribunal vide its impugned order dated 4.8.2006 vide ITA No.

501/LUC/06 deleted the said dis allowance by placing reliance on the decision of the Income Tax Appellate Tribunal in the case of Dy. CIT Vs. Oman International Bank SAOG, (2006)100 ITD 285 (Mum)(SB) by holding this decision, to be squarely applicable over the facts of the case, as follows.

“We have heard the rival submissions. In our view, the issue is squarely covered in favour of the assessee and against the Department by the decision of the IIAT Mumabi Bench ‘H’ (SB) in the case of Dy. CIT Vs Oman International Bank SAOG (2006) 100 ITD 285 (Mum) (SB), wherein it has been held that as per existing provisions of section 36(1)(vii) after its amendment with effect from 1.4.1989, it is not obligatory on part of assessee to prove that debt written off by him is indeed a bad debt for purposes of allowance under section 36(1) (vii) of the Act. In the instant case, the Departmental authorities have rejected the claim of the assessee on the ground that the assessee failed to furnish the information which may substantiate that the said debt is bad debt. In view of the decision of the Special Bench of ITAT (cited supra), we allow the claim of the assessee. This ground is allowed.

Sri D.D. Chopra, Advocate, learned counsel for the appellant contended with vehemence that in the present case is the income and expenditure statement the respondent-assessee claimed expenditure of Rs. 4,86,466.00 under the Head “Amounts written off.” and qua the same respondent-assessee was asked on 1.3.2005 to submit information on following points, (a) Complete names and addresses of the persons (With reference to whom bad debts written off claimed, mentioning against each amount.(b) Copies of ledger account of these persons for the relevant assessment year and three preceding years. (c) Efforts made to realize these dues, to which, respondent-assessee did not submit details as desired, and to the contrary submitted reply on 14.3.2005 by mentioning that it was bad debt for the purpose of allowance under 36(1) (vii) of the Income Tax Act, 1961, and assessee was not obliged to substantiate that it was bad debt, then in this background by no stretch of imagination deduction could have been accorded, as provision of under 36(1) (vii) of the Income Tax Act, 1961 w.e.f. 1.4.1989 does not bar Assessing Officer to question the veracity/genuinity of the entries made, in this background Income Tax Appellate Tribunal has erred in law in according deduction qua the debt which was written off in book of account for purposes of under 36(1)(vii) of the Income Tax Act, 1961, as such Appeal in question, on the substantial question of law framed deserves to be allowed.

Sri Mudit Agarwal, Advocate, learned counsel for the respondent-assessee on the other hand contended that as per amended Act w.e.f. 1.4.1989 under 36(1)(vii) of the Income Tax Act, 1961, the amount which is irrecoverable and consequently has become bad debt, qua the same deduction can be claimed, if the same is written off in the books of account and further submitted that no proof was required on the said front as there was no such rider that the onus is on the assessee to prove bad debts and as such view which have been taken by the Income Tax Appellate Tribunal is correct view and no substantial question of law arises in the present case.

After respective arguments have been advanced, undisputed factual position which has emerged is that respondent-assessee was engaged in the business of developing and printing of photos and has two work shop. There was income of 4,86,466.00 from the business. During assessment year 2002-03 respondent-assessee showed nil income in the returned income after making adjustment of the earlier losses. The return in question was processed under Section 143(1) on 27.12.2002. and case was taken up for scrutiny. The Assessing Officer completed assessment under Section 143(2) of the Income Tax Act on total income of Rs. 13,14,540.00 which was also inclusive of Rs. 4,65,640.00 shown in bad debt. As per the provisions of Section under 36(1)(vii) of the Income Tax Act, 1961, the amount of any bad debt or part thereof, which is written off, as irrecoverable in the accounts of the assessee for the previous year, is to be allowed. Under the provisions of Section 36(1)(vii) of the Income Tax Act, 1961, deduction had to be allowed in computing the income referred to in section 28 of the Act of the amount of any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year subject to the provision of sub-section (2). Section 36(1)(vii) of the I.T. Act, 1961 provides for deduction on account of bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year. Prior to the amendment in the above section w.e.f. 1.4.1989 the words ' any bad debt, or part thereof, which is established to have become a bad debt in the previous year' were used and after the above amendment these were substituted by " any bad debt or part thereof which is written off as irrecoverable in the account of the assessee for the previous year".

The effect of the above substitution it has been submitted is that w.e.f. 1.4.1989 , it is not necessary for the assessee to establish that debt had become bad; assessee has only to write off as irrecoverable in its account and that is the end.

The CIT (A) Lucknow on 3.3.2006 held that the expenditure claimed by the assessee under the head 'amounts written off' cannot be allowed as per the provision of section 36(1)(vii) of the Income Tax Act, 1961, reason for the same was in-spite of asking for to give detail i.e. (a) Complete names and addresses of the persons (with reference to whom bad debts written off claimed, mentioning against each amount.(b) Copies of ledger account of these persons for the relevant assessment year and three preceding years. (c) Efforts made to realize these dues. The assessee, at no point of time, ever complied with the said directives which have been asked for. The Assessing Officer in this background held that respondent-assessee failed to substantiate that it was bad debt, qua which entry had been made, did not extend the benefit. Income Tax Appellate Tribunal, Lucknow has allowed the appeal by mentioning that as per existing provisions of section 36(1)(vii) of the Income Tax Act, 1961 after its amendment w.e.f. 1.4.1989 it is not obligatory on the part of assessee to prove that debt written off by him indeed a bad debt for purposes of allowance under section under 36(1)(vii) of the Income Tax Act, 1961.

Before proceeding to consider the view point taken by Income Tax Appellate Tribunal, to be correct view or not, the judgment on the subject, cited at bar are being looked into:-

This court in the case of ***Commissioner of Income Tax, Meerut Vs. Sri Ram Gupta, (2005) 149 Taxman 237 (All)*** has held as follows:- Relevant para 7 and 9 are being extracted below:-

7. The Tribunal, on the basis of evidence and material on record has recorded the finding of fact that the respondent-assess who was aged about 88 years had made all efforts to recover/realize this amount of loan and having failed to in his effort, had written off the same as bad debt. Thus, the Tribunal had come to the conclusion that the debt in question which was given by way of loan to M/s La Medica (P) Ltd. Delhi in the year 1977 become recoverable in the assessment year in question and, therefore, the respondent-assessee had rightly written it off and claimed as bad debt. Merely on account of the fact that no legal proceeding was

initiated by the respondent-assessee, it would not make the bad debt recoverable one. It is just like sinking good money for bad money and it is in the wisdom of the respondent-assess to take or not to take legal proceedings to recover the loan amount. However, if there is no chance for recovery, it is in the wisdom of respondent-assessee to write off the loan amount as bad debt than to take recourse to the legal proceedings. Thus, the order of the Tribunal cannot be said to suffer from any legal infirmity. At this juncture present income tax appeal has been filed.

9. In the case of Kamla Cotton Co. Vs. CIT (1997) 226 ITR 605 the Gujarat High Court has held that the requirement that a debt has become bad or irrecoverable does not mean that the Department can insist upon demonstrative and infallible proof that the debt had become bad. It is not compulsory for the assess to take legal proceedings against the debtor in recovery of the claim before writing off as a bad debt. When a creditor bona fide writes off the debt because there appears no chance of ir-recovery in the foreseeable future or where the recovery proceedings would be so cumbersome and expensive as to outweigh any advantage of instituting any recovery proceedings, the assessee discharges the onus and would be entitled to claim deduction of the bad debt under clause (vii) of Section 36(1) of the Act.

Gujrat High court in the case of ***Commissioner of Income Tax Vs. Girish Bhagwat Prasad 772 Income Tax Reports Vol 256*** wherein genuineness of entry of the respondents assessee was not in doubt, has taken following view.

The assessee had written off an amount of Rs. 4,36,307 on account of its having become bad debt. The amount stood in the name of Abhay Textiles as bad debt. The assessee had, in the course of business, advanced some money to that firm which was a sole selling agent of Prasad Mills Ltd., in which it had deposited the loan amount as security. Prasad Milkls Ltd. Incurred losses and ultimately closed down its business on January 24,1984, and therefore Abhay Textiles could not realise its money from that company and the assessee, in turn, could not realise its dues from Abhay Textiles. According to the Assessing Officer, the assessee could not prove that the debt had become bad and that the assessee did not try to recover the amount and further that mere delay in recovery did not convert the debt into a bad debt.

The Commissioner of Income Tax (Appeals) found that the amended provisions of section 36(1)(vii) of the Act were applicable under which the assessee was not

required to establish that the debt had become bad in the previous year and mere writing off of the amount as bad debt was sufficient. Even on the merit, the first appellate authority found that there was no chance for the assessee to recover the amount. Hence, the debt really became bad. The Tribunal also upheld the contention of the assessee on the basis of the provisions of section 36(1)(vii) of the Act which came into force from April 1, 1989, and upheld the findings of the first appellate authority.

Under the provisions of section 36(1)(vii) of the Act, deduction was to be allowed in computing the income referred to in section 28 of the Act of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year subject to the provisions of sub -section (2). Prior to the amendment from April 1, 1989, the allowance under this clause was confined to the debts and loan which had become irrecoverable in the accounting year. Thus, under the provisions of section 36(1)(vii) as in force from April 1, 1989, all that the assess had to show was that the bad debt was written off as irrecoverable. The genuineness of such a claim made by the assessee was not in doubt. Therefore, all that the Tribunal has done is to uphold the first appellate authority's decision, applying the provisions of the amended section section 36(1)(vii) of the Act, and no question of law arises in the matter from such application of the provision to the fact of the case.

The present application is, therefore, rejected. Rule is discharged with no order as to costs.

Reliance has also been placed by the Respondent assessee on the judgment of Madhya Pradesh High Court (In dore Bench) dated 10.2.2006, ***Commissioner of Income Tax Vs. Nai Duniya*** wherein claims could not be controverted by Revenue, in this background, view taken was that there was no occasion for dis allowance. Relevant paragraph is being extracted below:-

“ The question involved in this appeal relates to certain debts being declared as bad debts by the assessee in the assessment year in question and n consequence written off in the books of account. This issue was dealt with by Tribunal in paras 17 and 18 as follows:-

:17 The next grievance of the assessee is that the CIT(A) erred in maitai9ning dis allowance of bad debts of Rs. 4,33,776.

18. W have heard the arguments advanced by the parties. We have also perused the orders of the authorities below. The Direct Tax Laws (Amendment) Act, 1987 brought about an amendment in S. 36(1)(vii)

of the Act w.e.f. 1st April, 1989 applicable to the asst. Yr. 1989-90 whereby the claim for any bad debt or part thereof is to be allowed for and from the asst. Yr. 1989-90 in the year in which such bad debt or part thereof has been actually written off as irrecoverable in the accounts of the assessee for the relevant previous year. A perusal of the appellate order would reveals that it was claimed by the assessee that the impugned debts had actually been written off in the books of account and it was also stated before the CIT (A) that all the debts written off had entered into income of the assessee. These claims could not be controverted by the Revenue at any stage and, therefore, there is absolutely no justification to make the impugned dis allowance which is hereby deleted in view of the amended position of law and applicability of the facts of the assessee's case thereto. The assessee succeeds in this ground"

We do not find any error of law much less substantial error of law as contemplated in S. 260A ibid for answering the question in favour of Revenue. When the assessee has actually written off the debt in their books of account as being bad debt then unless the Assessing Officer had rejected the entire books of account to be totally unreliable and finding extreme perversity in declaration of debt to be bad debt, there arose no occasion for Assessing Officer for not accepting the stand of assessee on this issue. It is essentially for the assess to decide as to whether they are able to recover the debt or that whether there are any viable chances to ensure its recovery or that all hopes have come to an end for recovery. This being in the nature of what is called commercial expediency depending upon the nature of transaction, capacity of debtor, etc, the stand of assessee cannot be ignored by Revenue unless there are very cogent reasons to reject.

The intention of legislature is clear that once in assessment year in question debt or part thereof has been written off, as irrecoverable qua the same deductions are to be accorded as per provision of section 36(1)(vii) of the Act, subject to the provisions of 36(2) of the Act. Prior to amendment in the aforementioned section w.e.f. 1.4.1989 the words 'any bad debt, or part thereof, which is established to have become, a bad debt in the previous year' were used and after the amendment w.e.f. 1.4.1989, same has been substituted by "any bad debt or part thereof which is written off as irrecoverable in the account of assessee for the previous year". Effect of said amendment is that now it is not necessary for the assessee to establish that debt had become bad in the previous year, before getting deductions, and mere writing

of as irrecoverable of debt or part thereof is substantial compliance of the same. The question is, is said entry of writing of bad debt or part thereof, made in books of accounts conclusive and Assessing Officer is precluded from making inquiries, before according/refusing deductions. Under the scheme as provided for under Income Tax Act, the entries which have been made, as to whether same are genuine entry and not imaginary and fanciful entry, qua the same Assessing Officer is fully empowered to make inquiry however, wisdom of the respondent-assessee cannot be in such matter questioned and no demonstrative or infallible proof of bad debt having become bad is required, and commercial expediency is to be seen from the point of view of assessee, depending on nature of transaction, capacity of debtor etc. but qua entry, semblance of genuineness has to be there and same should not be mere paper work. All the judgment, which have been cited at the Bar, genuineness of entries, have never been doubted therein, whereas in the case in hand, specific query has been made from respondent-assessee to furnish i.e. (a) Complete names and addresses of the persons (with reference to whom bad debts written off claimed, mentioning against each amount.(b) Copies of ledger account of these persons for the relevant assessment year and three preceding years. (c) Efforts made to realize these dues. Admitted position is that said queries have not at all been replied and requisite information has not at all been furnished, rather stand has been taken, that entry has been made , no proof is required. Under Section 143(2) of the Act, Assessing Officer is empowered to require the assessee to produce the evidence in support of the return, as such where respondent-assessee has claimed as bad debt or part thereof, written off as irrecoverable in the accounts of the assessee under the provision of section 36(1)(vii) of the Income Tax Act, 1961, then on the strength of the amendment made on 1.4.1989 it cannot be said, that an inquiry is not permissible under the provision of Income Tax Act to see and satisfy that there is some semblance of the genuineness in the entry, which had been made, same is not at all totally fake entry as respondent- assessee would be entitled for deduction only if its bad debt, or part thereof. **Hon'ble Apex Court in the case of Travancore Tea Estates Co. Ltd. Vs. CIT (1999) 151 CTR (SC) 231; (1998) 233 ITR 203 (SC)** has taken the view, that as to whether a debt has become bad or at what point of time it became bad, are pure question of fact. Though standard of proof of proving the same is bad debt, is not required to be adopted and is to be decided on the wisdom of the respondent-

assessee and not on the wisdom of Assessing Officer, but to show that entry which had been made as bad debt there has to be some material in support of the same, giving some semblance of genuineness and truthfulness to the same in the direction of forming opinion, that said debt was arising out of trading activity, there was relationship of debtor or creditor, same was irrecoverable. Merely because entries have been made, in respect of bad debt or part thereof, writing it off, claiming deduction, the said entries can always be examined by the Assessing Officer, before proceeding to award deductions, and not by merely blindly following the same, but stand of the assessee has to be tested from the point of view of assessee, and assessee cannot come forward and say that on account of change brought in by way of amendment w.e.f. 1.4.1989, under Section 36(1)(vii) inquiry is not permissible.

Thus in the present case, on the substantial question of law, posed, provision of Section 143 (2) of Income Act viz-aviz section 36(1)(vii) of the Income Tax Act, 1961 read with section 36(1) both would be harmonized to give purposeful meaning to both the statutory provisions, as one extends benefit to the respondent-assessee of deduction for their debt or part thereof becoming bad and other authorizes Assessing Officer to see that provision of Income Tax Act are not flouted by any means.

Consequently, impugned order dated 04.08.2006 passed by the Income Tax Appellate Tribunal, Lucknow, Bench, Lucknow is hereby quashed and set aside. As in the present case no reply had been submitted to the query made as such in case such reply is submitted, then in that event Assessing Officer is directed to take fresh decision in accordance with law after affording opportunity of the respondent-assessee on the basis of the record produced.

With these observations, Income Tax Appeal is allowed.

No order as to cost.

Dt. 05.11.2009

T.S.