MGN

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.114 OF 2009

Director of Income Tax (International)
Taxation) Scindia House, Bellard)
Pier, Mumbai-400 038.)..APPELLANT

Vs.

M/s.Oman International Bank SAOG,)
201, Raheja Centre, Nariman Point)
Mumbai-400 021.).. RESPONDENT

Mr. Parag Vyas i/b. Mr. R.Asokan for the Appellant.
Mr. Pratapsinha Rananavare for the Respondent.

CORAM: F.I. REBELLO &
R.S.MOHITE, JJ.
DATED: 9th February, 2009

JUDGMENT (PER F.I. REBELLO, J.):

. The appellant had raised several questions as amounting to substantial questions of law. In our opinion, the question of law can be reframed in terms of the order of the Tribunal. Appeal is, therefore, admitted on the following question and by

consent of parties heard forthwith:-

> " Whether as per the existing provisions even after the amendment with effect from 1-4-1989, is it 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)?"

2. The assessee had claimed writing off of Bad Debts in the sum of Rs.4,59,60,393/-. The bad debts written off were in respect of Mysore Timber Mart Rs.81,44,000/- and Overseas Commercial Pvt. Ltd. Rs.11,52,000/-. In Appeal before the C.I.T. (A) it was the contention of the assessee that the write off was done after creating provisions in accordance with the guidelines of the R.B.I. and was a bonafide write off and as such deduction should be allowed. The C.I.T. (A) was pleased to hold that as per the amended provisions under Section 36(1)(viia) the assessee is not required to establish that the debt had actually became bad and what was required was whether the amount is written off during the year or not. Allowance of deduction has to be made in the year of write off. On facts it held that as of the date of the order, no recovery has been made and if recovery is made in future the same will be automatically offered to

tax. As the appellant had written off the amount in question after due approval of the Competent officials of the bank, the same has to be allowed as a deduction and accordingly allowed Rs.92,96,000/- as bad debts which were disallowed by the A.O. Appeal was partly allowed.

3. Revenue aggrieved by the order of the C.I.T. (A) had preferred an Appeal before the I.T.A.T. A Special Bench was constituted, as there were differences of opinion amongst the Benches of the Tribunal. The argument advanced on behalf of the Revenue before the Tribunal was, that two conditions had to be satisfied before the deduction under Section 36(1)(vii) could be allowed viz.:-

(i) The debt in respect of which the deduction is claimed, is a bad debt.

(ii) Such debt is written off in the account of the assessee for the previous year.

On the other hand on behalf of the assessee it was submitted that while interpreting the provision, one should look into the intention of the Legislature. If the provisions are amended in order to remove hardship or mischief of the pre-amended provisions, then the Hyden's Mischief Rule of interpretation

should be applied. As per the pre-amended provisions the assessee was required to establish that the debt which was claimed as deduction had become bad during the previous year and the Assessing Officer was empowered in terms of Section 36(2) to allow a deduction in another year, if he was of the view that debt had become bad in an earlier or later year. This had led to disputes. In order to avoid such disputes, the provisions were amended with effect from 1st April, 1989. A circular was issued explaining the provisions of the Direct Tax Laws (Amendment) Act, 1987 by which the provisions of Section 36 were amended. Now the deduction is allowable in the year in which the amount of debt is written off in the accounts. Reliance was placed on several judgments as to when a debt should be presumed to be bad. It was, therefore, submitted that a debt should be presumed to be bad when it is written off in the books of the assessee. The burden thus shifts on the Department to show that the debt has not been bad.

4. After considering the contentions, by majority opinion the learned Tribunal was pleased to hold that considering the expression "bad debt" in Section 36(1)(vii) strict proof is not required to be established and/or it is uneasy to prove that the debt to has become bad. After considering the

Dictionary meanings, proceeded to hold that it would be within the personal knowledge of the businessman whether a debt has become bad or not as long as it is bonafide and no demonstrative proof can be demanded from the assessee to establish that the debt had actually become bad. The Tribunal proceeded to hold that writing off of a bad debt, is an evidence on the part of the assessee with whom the information rests and is a sufficient requirement of the amended provision.

. The minority Judgment on the other hand took a view that mere writing off of the debt is not sufficient for claiming a deduction under Section 36(1)(vii) effective from 1st March, 1989. In addition, the Assessee is also under an obligation to show atleast prima facie that debt has become bad. Whether a debt has become bad or not will depend on the facts of each case.

. After answering the issues considering the majority opinion the matter was referred to Regular Bench for decision. Revenue has challenged the majority opinion by this Appeal.

5. To answer the issue it will be relevant to reproduce Section 36(1)(vii), which reads as under:-

"36.(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28--

(i) .....
(ia) .....
(ib) .....
(ii) .....
(iia) .....
(iii) .....
(iiia) .....
(iv) .....
(v) .....
(vi) .....
(va) .....

(vii) subject to the provisions of sub-section (2), 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;

Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount

> by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause.

The Finance Act, 2001 inserted the following Explanation after the proviso to Section 36(1(vii):-

> "Explanation - For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provisions for bad and doubtful debts made in the accounts of the assessee."

The above insertion is retrospective with effect from 1st April, 1998.

. The Legislature has, therefore, made it clear that a mere provision for bad or doubtful debts can not be written off. The debt in the assessee's commercial wisdom has to be irrecoverable. The explanation gives clear indication that the word "bad" in Section 36(1)(vii) is of prime importance and cannot be ignored. It is only a bad debt which is irrecoverable which can be written off and not any debt. This also brings about a certainty in respect of which the debt is written off as a bad

debt. The provision of the Act which consolidated the law before the amendment read as under:

> "Subject to the provisions of sub-section (2), the amount of any debt, or part thereof, which is established to have become a bad debt in the previous year was
>
> allowable as a deduction in computing the income chargeable to tax under the head "profits and gains of business or profession".(emphasis supplied).

6. A comparison, therefore, between the provisions as it stood and after its amendment with effect from 1st April, 1989 would show that prior to the amendment the assessee was required to establish that the debt in question had become bad in the previous year. Subsequent to the amendment from the language of the Section it is sufficient if the bad debt or part thereof is written off as irrecoverable in the accounts of the assessee based on commercial expediency. If we apply the Rule of interpretation as spelt out in Hyden’s case, it would lead to an irresistible conclusion, that the Legislature by the amendment has sought to exclude the burden on the assessee to prove that the debt is bad debt and leaves it to the commercial wisdom of the assessee

to treat the debt as bad, once it is written off as irrecoverable in the accounts of the assessee.

7. Subsequent to the amendment the Board has issued Circular 551 dated 23rd January, 1990. The issue pertaining to bad debt is set out in para.6.6. and the relevant portion reads as under:-

> "In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalise 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."

With reference to the Board's Circular on behalf of the Revenue the learned Counsel sought to contend that considering the judgment of the Supreme Court

in **Commissioner of C.Ex., Bolpur vs. Ratan Melting & Wire Industries, 2008 (231) E.L.T. 22 (S.C.)** the said circular is not binding on the Court. In our opinion there can be no dispute on the said proposition. The law as now settled is that the Departmental Circulars and Instructions issued by the Board would be binding on the authorities, but would not bind on the Court. This is as it should be. Ultimately it is for the Court to read the Section in its proper context. While so reading the Court will bear in mind the circular issued by the C.B.D.T. The Circulars sometimes are issued to obviate difficulties in the operation of the provisions. These are aspects which the Courts do bear in mind while considering the Circulars. But as observed by the Court they are not binding upon the Court. It is for the Court to declare what the provisions of statute say and it is not for the Executive. The Supreme Court in Ratan Melting & Wire Industries (supra) was pleased to observe that looking at it another angle a Circular which is contrary to statutory provisions has really no existence in law. It is, therefore,, ultimately for the Court to declare the law and while so declaring it will take into consideration the circular issued by the Board considering that it is how the Revenue has understood the subject which is the subject matter or the Circular.

8. The Circular of the Board clearly spells out that it is to eliminate the disputes in the matter of determining the year in which the bad debt is written off as irrecoverable. If inspite of this provision the assessee is again called upon to establish that the debt has become bad debt, the object behind the amendment will not be achieved. The Legislative intent appears to be to avoid litigation and to do away with disputes regarding the allowability of bad debts as a deduction in computing the income of an assessee. The dispute regarding the year in which the debt has to be allowed as a deduction has been resolved by the clear statement of the amended law that the deduction shall be allowed in the year in which the debt has been written off as irrecoverable. Considering these aspects it would be clear that there is no burden now on the assessee to establish that in fact the debt has become bad. If this interpretation is read with the Board's Circular it would be clear that the Board's Circular reflects this very object which the Legislature had in its mind while amending the provisions. The amendment clearly was brought to cure a defect and/or in other words to avoid the mischief. So read the distinction pre or post amendment to Section 36(1)(vii) becomes clear.

9. It was sought to be argued on behalf of the Revenue that what has to be written off as irrecoverable is bad debt or part thereof and not any debt or part thereof. In our opinion the argument does not take the case of the Revenue any further as to when a debt can be said to be bad. Our attention was also invited to the Judgment in **Travancore Tea Estates Co. Ltd. vs. Commissioner of Income Tax, Cochin, (1998) 8 SCC 667** to point out that it is settled law that whether a debt became bad or the point of time when it became bad, are pure questions of fact. In our opinion the ratio of that judgment would really not be applicable to answer the interpretative issue which has been raised in this Appeal.

10. Let us refer to some Dictionary meanings of the word "bad debt". Chambers 20th Century Dictionary refers to bad debt as "A debt that cannot be recovered". Mitra’s Legal & Commercial Dictionary refers to bad debt as "A debt becomes bad debt when the Creditor has no reasonable chance of recovering it from the debtor as held in **Deoniti Prasad vs. Commissioner of Income Tax, AIR 1953 Pat. 360.** The Law Lexicon refers to bad debt as "Debt which cannot reasonably be collected. A debt about which there is no reasonable expectation of

recovery; A debt believed to be unrecoverable." Reference may also be made to page 878 of the "Law and Practice of Income Tax Law by Kanga, Palkhiwala and Vyas, 9th Edition, where the learned Jurist opined as under:-

> "Under the amended clause, the requirement of "establishing" that the debt had become bad in the relevant accounting year is dispensed with; all that the assessee has to show is that the bad debt has been written off as irrecoverable. But the subject matter of the clause is still "any bad debt" and "not any debt". The consequences of the amendment are mainly three:
>
> (ii) The assessee cannot arbitrarily, irrationally or malafide treat a good debt as bad write it off in his accounts.,
>
> (iii) Where the assessee has acted bona fide and reasonable, the Assessing Officer cannot substitute his own subjective judgment, but must accept the assessee’s decision, as to the quality of the debt.
>
> (iv) The assessee is not obliged to write

off and claim the debt in the very year in which it becomes bad. He can write it off and claim it in a subsequent year in which the debt continues to remain bad.

11. All this would indicate that when the assessee treats the debt as a bad debt in his books the decision which has to be a business or commercial decision and not whimsical or fanciful. The decision must be based on material that the debt is not recoverable. The decision must be bonafide. The difference between the position, pre-amendment and post amendment would be that the burden is no longer on the assessee and can be claimed in the year it is written off in the books of account as irrecoverable. The A.O. if he is to disallow the debt as a bad debt must arrive at a conclusion that the decision was not bonafide. The A.O. only in those circumstances and to that extent may interfere. All that the assessee must do is to be prima facie satisfied based on the information available that the debt is bad and that would be sufficient requirement of the amended provisions.

12. Our attention was invited to the judgment of the Madras High Court in **South India Surgical Co. Ltd. vs. Assistant Commissioner of Income-tax, (2006) 287 ITR 62 (Mad.).** In case the amount was

payable by a Government Department (Hospital). The Tribunal there had taken the view that the debt could not be claimed as bad on the mere ground that the hospital and the Departments might make payments as and when funds are provided. The Madras High Court after considering the various judgments was pleased to observe that it is not sufficient for the assessee to say that he has become pessimistic about the prospect of recovery of debt in question. The assessee must honestly feel convinced that the financial position of the debtor was so precarious and shaky that it would be impossible to collect any money from him. The question is really one of fact depending upon the various facts and diverse circumstances bearing on the debtor's pecuniary position, his commitments and obligations. Further that the judgment of the assessee in regard of the debt as a bad debt must be a honest judgment and not a convenient judgment.

. Reference was also made to the judgment of the Delhi High Court **Commissioner of Income-tax vs. Global Capital Ltd., (2008) 306 ITR 332 (Delhi).** The Delhi High Court has taken the view that post the amendment the assessee is not required to establish that the concerned debt has actually become bad in the relevant year for the purpose of claiming deduction under this Section and the only

requirement for claiming deduction is that the assessee has to write off the relevant debt in his book treating it as bad.

. This Court in an unreported judgment in **The Commissioner of Income Tax vs. M/s.Star Chemicals (Bombay) P. Ltd., Income Tax Appeal Lodging No.1915 of 2007 dated 27th February, 2008** had also taken a view that post amendment on a reading of the Section and the Circular, what was required was to write off the debt as a bad debt based on the assessee's commercial wisdom and that will satisfy the purpose of the Section.

13. Considering the above discussion, in our opinion to treat the debt as bad debt has to be commercial or business decision of the assessee based on the relevant material in possession of the assessee. Once the assessee records the debt as bad debt in his books of account that would prima facie establish that it is a bad debt unless the A.O. for good reasons holds otherwise. The writing in the accounts no doubt, has to be bonafide. Once that be the case the Assessee is not called upon to discharge any further burden. In our opinion, therefore, we are in agreement with the view taken by the majority constituting the Bench of the the learned Tribunal.

14. The question as framed will have to be answered by holding that after the amendment it is neither obligatory nor is the burden on the assessee to prove that the debt written off by him is indeed a bad debt as long as it is bonafide and based on commercial wisdom or expediency. Appeal disposed of accordingly.

(R.S.MOHITE, J.) (F.I.REBELLO,J.)