In the High Court of Judicature at Madras

Dated : 26.10.2018

Coram :

The Honourable Mr.Justice T.S.SIVAGNANAM

and

The Honourable Mrs.Justice V.BHAVANI SUBBAROYAN

Tax Case Appeal No.1588 of 2008

M/s.Deccan Agency, Chennai-17 ...Appellant

Vs

The Deputy Commissioner of Income Tax, Central Circle III(4), Chennai-34 ...Respondent

APPEAL under Section 260A of the Income Tax Act, 1961 against the common order dated 12.10.2007 in ITA Nos.686/Mds/2006 on the file of the Income Tax Appellate Tribunal Madras 'A' Bench for the assessment year 2001-02.

For Appellant : Ms.Sree Lakshmi Valli
For Respondent : Mrs.R.Hemalatha, SSC

Judgment was delivered by T.S.SIVAGNANAM,J

We have heard the learned counsel on either side.

2. This appeal, by the assessee, is directed against the order passed by the Income Tax Appellate Tribunal, Chennai 'A' Bench in ITA.No.

686/Mds/2006 dated 12.10.2007 for the assessment year 2001-02.

3. The above appeal was admitted on 03.11.2008 on the following substantial question of law :

> *"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the appellant is not entitled to deduction of the sum of Rs.16,05,000/- in computing the income of the appellant?"*

4. The appellant/assessee is a partnership firm engaged in the business of lottery agency. For the assessment year 2001-02, the appellant filed return of income on 10.10.2001 declaring a total income of Rs.1,33,83,287/-. The return was processed under Section 143(1) of the Income Tax Act, 1961 (for brevity, the Act). Subsequently, the notices under Sections 143(2) and 142(1) of the Act were issued. The assessment was completed under Section 143(3) of the Act on 29.3.2004 and the total income was determined at Rs.1,44,83,290/-. While doing so, the Assessing Officer disallowed a sum of Rs.16,05,000/- representing bad debts written off by the assessee.

5. The assessee's case was that in the normal course of business, they advanced money to a firm namely M/s.Deccan Pictures Private Limited for a Telugu movie project. According to the assessee, the project did not take off

and the assessee was not in a position to realize the amount so advanced by them for the said venture. Hence, the assessee had written off the amount as normal business expenditure.

6. For the assessment year 2001-02, the assessee claimed a sum of Rs.16,05,000/- representing bad debts as deduction. However, the Assessing Officer disallowed the same. On appeal before the Commissioner of Income Tax (Appeals) [for short, the CIT (A)], the assessee contended that the amount advanced by them in the normal course of business became bad and irrecoverable and that therefore, the claim for deduction of the amount as bad debt was in accordance with law. The CIT(A), vide order dated 29.12.2005, accepted the case of the assessee and held that the money had been advanced by the assessee in the normal course of business and that since the amount advanced had become bad and irrecoverable, the assessee was entitled to deduct the amount in computing the income.

7. As against the order passed by the CIT(A), the Revenue preferred an appeal before the Tribunal. Ultimately, the Tribunal, by order dated 12.10.2007, allowed the appeal filed by the Revenue. Challenging the same, the assessee is before us by way of this appeal, which has been admitted on the aforementioned substantial question of law.

8. Section 36 of the Act deals with 'other deductions'. Sub-Section (1) of Section 36 of the Act states that deductions provided for in the Clauses mentioned therein shall be allowed in respect of the matters dealt with therein in computing the income referred to in Section 28 of the Act. The assessee claimed deduction under Clause (vii) to Section 36(1) of the Act. The said Clause states that 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 account of the assessee for the previous year, shall be allowed.

9. The First Proviso states that in the case of an assessee, to which, Clause (viia) applies, the amount of deduction relating to any such bad 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 Second Proviso states that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year, in which, the amount of such debt or part thereof has become irrecoverable or for any earlier previous year on the basis of income computation and disclosure standards notified under Sub-Section (2) of Section 145 of the Act without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes

irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of the said Clause.

10. Explanation 1 states that for the purposes of Clause (vii), any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee. Explanation 2 states that for the removal of doubts, it is clarified that for the purposes of the proviso to Clause (vii) to Sub-Section (2) of Section 36 of the Act and Clause (v) to Sub-Section (2) of Section 36 of the Act, the account referred to therein shall be only one account in respect of provision for bad and doubtful debts under Clause (viia) and such account shall relate to all types of advances, including advances made by rural branches. Sub-Section (2) of Section 36 states that in making any deduction for a bad debt or part thereof, the provisions under Clauses (i) to (v) shall apply. ***In the case on hand, Clause (i) would be relevant, which states that no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year, in which, the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending, which is carried on by the assessee.***

11. The Assessing Officer, while completing the assessment under Section 143(3) of the Act, vide order dated 29.3.2004, stated that during the assessment year under consideration, the assessee had written off a sum of Rs.16,05,000/- representing the money advanced by the assessee to M/s.Deccan Pictures Private Limited, Telugu and that this amount did not represent the debt, which had arisen in the normal course of the assessee's business namely business of lottery agency. Accordingly, the Assessing Officer held that the said sum of Rs.16,05,000/- was nothing but a capital loss, which could not be allowed as a revenue expenditure and therefore, the same was added back to the income returned.

12. Thus, the question would be as to whether the assessee had advanced the said amount in the normal course of the assessee's business, which, according to the Assessing Officer, was only the business of lottery agency.

13. Before the CIT (A), the assessee contended that as a prudent business entity, they lent surplus amount to M/s.Deccan Pictures Private Limited, Telugu in order to earn interest income, that the said company faced severe liquidity problem, that the assessee could not recover the amount in spite of several efforts and that therefore, it was written off. At the time of

hearing before the CIT(A), the authorized representative filed detailed written submissions along with relevant records and stated that the transaction was a simple financial transaction, that the assessee was the best judge to decide the commercial aspect of the business, that since the amount could not be recovered and it became a bad debt, it had passed the necessary entry for writing off the debt as the bad debt in the profit and loss account and that in view of Section 36(1) of the Act, any bad debt or part thereof written off as irrecoverable could be claimed as deduction. The assessee furnished copies of the accounts of M/s.Deccan Pictures Private Limited, Telugu, as reflected in the books of the assessee.

14. The CIT (A), after considering the facts, the documents placed before him as well as the profit and loss account for the year 1997-98, came to the conclusion that the advances were out of the excess liquidity available with the assessee in order to earn extra income from the excess funds available. Furthermore, the partnership deed, by which, the assessee was established, provided a clause for the assessee to invest the surplus funds on ventures like that of movie production. Thus, the CIT (A) concluded that the assessee advanced money to its sister concern possibly for producing a film and perhaps, it could not get back the advance and therefore, they had written off the entire sum due and ultimately agreed that the assessee's case squarely fell under Section 36(1)(vii) of the Act and it could not be

disallowed. Accordingly, the appeal filed by the assessee was allowed.

15. On appeal by the Revenue, the Tribunal, while reversing the order passed by the CIT(A), relied upon the decision of the Tribunal of Mumbai 'G' Bench in the case of ***Grindwell Norton Ltd. Vs. DCIT [(2004) 91 ITD 412]*** and held that the amount advanced to sister concern was not for business purposes of the assessee and therefore, the amount so advanced, when lost, would not constitute trading loss and accordingly rejected the plea of the assessee. The Tribunal also placed reliance on the decision of this Court in the case of ***CIT Vs. R.Chidambaranatha Mudaliar [reported in (1999) 240 ITR 552].***

16. Before we proceed to examine as to whether the Tribunal was justified in allowing the appeal filed by the Revenue, by placing reliance on the decision of the Bombay Tribunal in the case of ***Grindwell Norton Ltd.,*** and whether the decision in the case of ***R.Chidambaranatha Mudaliar*** would apply, we will have to first steer clear of as to what is the nature of business of the assessee.

17. It is no doubt true that in the order of assessment dated 29.3.2004, the Assessing Officer stated that the assessee firm is doing business of lottery agency. However, we find that the assessee was also engaged in the business of financing. We say so because in an appeal filed by

the Revenue against an order passed by the CIT (A) in ITA.No.4/2008-09 dated 21.2.2011, which was an appeal arising out of penalty proceedings for the very same transaction, the Department had categorically taken a stand that the assessee is in the business of distribution of lottery tickets and financing.

18. Mrs.R.Hemalatha, learned Senior Standing Counsel appearing for the Revenue would contend that this submission made on behalf of the Revenue cannot be taken as a candid proof to establish the line of business of the assessee.

19. Mrs.R.Hemalatha, learned Senior Standing Counsel is partly right in saying so. However, we do not wish to rest our finding solely based on what has been stated by the Tribunal in its order dated 29.11.2011 made in ITA.No.1190/Mds/2011. We render our finding after looking into the other documents, which are placed before us. In the paper book, the assessee filed details of interest received for the assessment years from 1998-99 to 2001-02, the details of other debtors for the assessment years from 1999-2000 to 2001-02, the details of loans, advances and deposits for the assessment years 2000-01 and 2001-02 and the details of bad debts for the assessment year 2001-02. A cumulative consideration of all these documents makes it evidently clear that the assessee is in the business of not only lottery agency,

but also financing as well. Therefore, we hold that the business of the assessee firm is distribution of lottery tickets and financing.

20. If such is the situation, the case of the assessee would squarely fall within Clause (i) of Section 36(2) of the Act, which provides for money lending business carried on by the assessee. The CIT(A) had given a factual finding that the amount advanced to M/s.Deccan Pictures Private Limited, Telugu was not out of borrowed funds, but out of surplus income of the assessee firm. Therefore, the case of the assessee would squarely fall within the ambit of Section 36(1)(vii) of the Act.

21. Now, the question would be as to whether the Tribunal was justified in rejecting the case of the assessee by relying upon the decision of the Tribunal at Bombay in the case of ***Grindwell Norton Ltd.***

22. Firstly, we find that the facts of the said case are totally different, as, in the said case, the claim for deduction was under Section 28 of the Act. The Tribunal at Bombay, after taking into consideration the factual situation, held that the claim of the assessee therein had to be considered under Section 37(1) of the Act and not under Section 28 of the Act as claimed by the assessee therein. Therefore, under the said context, the Tribunal at Bombay came to the conclusion that the assessee therein was not entitled to

deduction of irrecoverable advances under Section 37 of the Act. Therefore, we are of the considered view that the decision in the case of ***Grindwell Norton Limited*** will not apply to the facts and circumstances of the case on hand.

23. Next, we proceed to consider the effect of the decision in the case of ***R.Chidambaranatha Mudaliar.*** In that case, the question was as to whether the assessee therein was entitled to set off of Rs.20,000/- being the loss sustained in the assessment year 1972-73 against the long term capital gains relating to the assessment year 1975-76. Under the said context, a Division Bench of this Court held that the loss is not a loss, which arose in computation of the loss under the head 'capital gains' and that it was merely a capital loss but it did not arise by the transfer of a capital asset, which is a precondition for the loss to be treated as a capital loss under Section 45 of the Act. We find that the decision in the case of ***R.Chidambaranatha Mudaliar*** also can be of no assistance to the case of the Revenue.

24. At this juncture, we wish to point out that as per the details of bad debts furnished for the assessment year 2001-02, it is seen that in Schedule U, the details have been shown wherein there is an entry stating that a sum of Rs.16,05,000/- has been written off as bad debt paid to M/s.Deccan Pictures Private Limited, Telugu.

25. The Hon'ble Supreme Court in the case of ***T.R.P. Ltd. Vs. CIT [reported in (2010) 323 ITR 0397]*** held that after 01.4.1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable and that it is enough if the bad debt is written off as irrecoverable in the accounts of the assessee. As pointed out earlier, we find that the assessee has written off the bad debt as irrecoverable in their accounts thereby fulfilling the statutory requirement.

26. Ms.Sree Lakshmi Valli, learned counsel for the appellant relies upon the decision of the Hon'ble Supreme Court in the case of ***S.A.Builders Ltd. Vs. CIT (A) [reported in (2007) 288 ITR 0001].***

27. In the decision in the case of ***S.A.Builders Ltd.,*** the Hon'ble Supreme Court pointed out that that the expression 'commercial expediency' is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. It was further pointed out that the expenditure may not have been incurred under any legal obligation, but yet, it is allowable as a business expenditure if it was incurred on grounds of commercial expediency. It was pointed out that it is not the opinion of the Court that in every case, interest on borrowed loan had to be allowed if the assessee advances it to a sister concern and that it all depends on the facts

and circumstances of the respective case. It was also pointed out that a holding company has a deep interest in the subsidiary, that if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would ordinarily be entitled to deduction of interest on its borrowed loans.

28. On the other hand, Mrs.R.Hemalatha, learned Senior Standing Counsel for the Revenue submits that while issuing notice on 30.4.2012, in the applications for condonation of delay and also on the special leave petitions in the case of ***ACIT Vs. Tulip Star Hotels Ltd. [reported in (2012) 21 Taxmann.com 97],*** the Hon'ble Supreme Court doubted the decision in the case of ***S.A.Builders*** and held that it needs reconsideration.

29. However, the decision in the case of ***S.A. Builders*** holds the field as on date and can be relied upon by this Court as a precedent.

30. In the instant case, we have seen that the assessee is not only in the business of lottery agency, but also in the business of financing as well. Records disclose that from the assessment year 1998-99, they have been advancing loans and receiving interest. Therefore, as a part of commercial expediency, the assessee, with a view to earn additional income, has advanced the surplus money available to their sister concern, which, on

becoming irrecoverable, has been written off as a bad debt. For all the above reasons, we find that the Tribunal committed an error in reversing the order passed by the CIT (A).

31. In the result, the tax case appeal filed by the assessee is allowed and the order passed by the Tribunal is set aside. The substantial question of law is answered in favour of the assessee and against the Revenue. No costs.

26.10.2018

Speaking Order

Internet : Yes

To

1.The Income Tax Appellate Tribunal, Madras 'A' Bench.
2.The Deputy Commissioner of Income Tax, Central Circle III(4), Chennai-34

RS

T.S.SIVAGNANAM,J

AND

V.BHAVANI SUBBAROYAN,J

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TCA.No.1588 of 2008

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