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**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX APPEAL NO. 1881 OF 2017

Pr. Commissioner of Income Tax – 2
Aayakar Bhavan, M.K. Road,
Mumbai – 400 020.

....Appellant

V/s.

Mahindra Engineering and Chemical
Products Ltd.
Gateway Building, Appollo Bunder,
Mumbai – 400 001.

....Respondent

Mr. Suresh Kumar for Appellant.
Mr. Sanjiv M. Shah for Respondent.

**CORAM : K.R. SHRIRAM &
AMIT B. BORKAR, JJ.
DATED : 27th OCTOBER 2021**

ORAL JUDGMENT : (PER : K.R. SHRIRAM, J.)

1. Respondent had filed the return of income on 27th October, 2005 declaring total income of Rs.8,88,82,290/-. The Assessment Order under Section 143 (3) of the Income Tax Act, 1961 (the Act) was passed on 19th December, 2007 wherein the income was assessed at Rs.14,51,98,159/-. In the Assessment Order, the Assessing Officer had disallowed the interest on deposit written off of Rs.15,73,952/- and deduction of principal amount of deposit of Rs. 4,35,00,000/- written off.

2. As a background to this dis-allowance, respondent had placed deposits aggregating to Rs. 4,35,00,000/- in financial year 2000-01 with

Mahindra Construction Company Ltd., (MCCL) a sister concern of respondent. For the Assessment Year 2005-06, respondent based on an interim assessment of the financial condition of MCCL had provided for total outstanding of Rs.4,50,73,952/- (Principal amount of deposit of Rs.4,35,00,000/-) and interest accrued upto 31st March, 2001 of Rs.15,73,952/- to be written off. According to the Assessing Officer there was no logical explanation nor any basis for waiving of accrued interest and the principle amount lent was not used for business purpose and respondent was also not in the business of lending money and therefore the claim for deduction under Section 37 of the Act and deduction of written off under Section 36 (1) (vii) cannot be allowed.

3. Aggrieved by this order, respondent filed an appeal before the Commissioner of Income Tax (Appeals) (CIT) (A). By an order dated 16th December, 2010 CIT (A) upheld the decision of the Assessing Officer. Impugning this order of CIT (A), respondent filed an appeal before the Income Tax Appellate Tribunal (ITAT). The ITAT by an order dated 30th June, 2016 allowed the appeal relying on the decision of this court in the case of *The Commissioner of Income Tax-V, Pune vs. Pudumjee Pulp & Paper Mills Limited*¹. The ITAT set aside the order of CIT (A) on the issue of deduction for principle amount of Rs. 4,35,00,000/- and directed the Assessing Officer to approve the appropriate relief. Unhappy with this order

1. ITA No.1590 of 2013 dated 5th August, 2015.

of the ITAT, appellant has preferred this appeal under Section 260 A of the Act and has proposed for determination the following substantial questions of law.

QUESTION OF LAW

1. *“Whether on the facts and in the circumstances of the case and in law, the ITAT erred in allowing Rs.4,35 Crores of pure loan as Bad debt on the basis of judgment of the Hon’ble Bombay HC given in the case Pudumjee Pulp and Paper Mills Ltd. without appreciating that the said judgment was rendered on a different set of facts wherein the amount written off consisted of capital loan and interest in an integral manner and thus condition prescribed in Section 36(2) got fulfilled?”.*

2. *“Whether on the facts and in the circumstances of the case and in law, the ITAT erred in allowing the capital loan of Rs.4.35 Crores as integral to interest separately assessed on accrual basis, to erroneously apply the law laid by Hon’ble Bombay HC in the case of udumjee Pulp and Paper Mills Ltd. and Shreyas S. Mokharia?”.*

3. *“Whether on the facts and in the circumstances of the case and in law, the ITAT erred in holding the giving loan of Rs.4.35 Crores as done in ordinary course of business to improve the business health of the assessee company when it is an admitted fact that the said loan to the group company was initially given for 30 days to help them tide over some liquidity problem facted by the said Mahindra Construction Company Ltd. which were never recovered, which fact stand even admitted in its letter dated 24.03.2011 submitted to AO in AY 2002-03 in response to notice of penalty u/s 271(1)(e), thereby rendering the judgment of ITAT erroneous in holding the said loan as given in ordinary course of business?”.*

4. In fact, ITAT had allowed respondent’s appeal even with regard to the addition of Rs.15,73,952/- whereby respondents had impugned the action of the Assessing Officer in bringing to tax interest income of Rs.15,73,952/-. Appellant has not proposed any substantial question of law for determination, the findings of ITAT on this interest component.

5. Mr. Suresh Kumar justified the cause of the Assessing Officer as well as CIT (A) by submitting that respondent could not be said to be in the

business of banking or money lending and therefore the principle amount of deposit/advances to MCCL could not be claimed as deduction under Section 36 (1) (vii) of the Act on account of condition placed in condition 36 (2) of the Act. Mr. Suresh Kumar also submitted that the deposit is more in the nature of investment and therefore its non-recovery at best can be treated as capital loss.

6. Per contra, Mr. Shah submitted that the amount of Rs.4,35,00,000/- written off in the books of accounts as not recoverable be allowed as deduction as a bad debt. Mr. Shah pointed out that respondent fulfills the requirements of Section 36 (1) (vii) read with Section 36 (2) (1) of the Act. Mr. Shah submitted that amount has been written off as irrecoverable in the books of accounts and this is also confirmed by the fact that the interest income for Assessment Year 2001-02 of Rs.15,73,952/- was offered and assessed to tax as part of business income and therefore, it was to be understood that the impugned deposits/advances made to MCCL were in the ordinary course of business.

7. Factually, it is not disputed that respondent had made deposits/advances with MCCL in the previous year 2000-01, corresponding to the Assessment Year 2001-02 amounting to Rs. 4,35,00,000/-. The interest accrued on such deposits for the Assessment Year 2001-02 amounted to Rs.15,73,952/- and that was offered to tax in the said Assessment Year.

Subsequently, respondent has not accounted for any interest income on the ground that the aggregate of the principal amount as well as interest accrued to the Assessment Year 2001-02 was doubtful of recovery. It is also not a dispute that upto the Assessment Year 2004-05, the Assessing Officer has accepted that the financial condition of MCCL was poor and therefore no interest income can be said to have accrued for the purpose of taxation. For the Assessment Year in question, i.e., 2005-06 respondent's claim that the principal amount of Rs. 4,35,00,000/- be considered as bad debt which has been rejected by the tax authorities, primarily on the ground that respondent was not engaged in any business of money lending and that non-recovery was a capital loss.

8. We have also considered the judgment of Division Bench of this court in *Pudumjee Pulp and Paper Mills Limited* (Supra) which has been relied upon by ITAT where similar situation had prevailed. In that case the assessee had made inter-corporate deposit with another concern and in some of the years interest was offered to tax. Subsequently, part of the debt was sought to be written off and claimed as bad debts within the meaning of Section 36 (1) (vii) read with Section 36 (2) of the Act. The claim was revised by the tax authority primarily on the ground that the conditions of Section 36 (1) (vii) read with Section 36 (2) of the Act were not applicable in as much as the assessee was not carrying on business of money lending and that the principal amount claimed as bad debts was not in fact offered

to tax either in the relevant Assessment Year or in the earlier Assessment Year. The Division Bench after considering the submissions observed that even if one of the conditions of Section 36 (2) (i) of the Act is satisfied then the bad debts claimed under Section 36 (1) (vii) of the Act has to be allowed. The Division Bench had also followed another decision of this court in *Commissioner of Income Tax vs. Shreyas S. Morakhia*². Paragraph Nos.7 to 13 of *Pudumjee Pulp and Paper Mills Limited* (Supra) reads as under :

7. Mr. Tejveer Singh, learned Counsel appearing for the Appellant submits that the activity of the Respondent-Assessee is of carrying on manufacturing and sale of paper. Consequently, the Respondent-Assessee cannot be said to be engaged in the activity of the money lending or business of banking. Consequently, deduction of bad debts is hit by Section 36(2)(i) of the Act. Thus, the impugned order calls for interference.

8. Mr. Murlidharan, learned Counsel appearing for the Respondent-Assessee points out that the issue arising in the present facts is covered in favour of the Respondent-Assessee by the decision of this Court in *CIT v/s. Shreyas S. Morakhia*. It is further submitted that the Respondent-Assessee is entitled to the benefit of Section 36(2)(i) of the Act – on the ground that the interest income was offered to tax earlier and that the Assessee was engaged in the business of lending money. In the above view, it is submitted that the order of the Tribunal calls for no interference.

9. The CIT(A) as well the Tribunal have considered Sections 36(1) (vii) and 36 (2)(i) of the Act which for the purpose of convenience are reproduced hereunder and read thus:

“Section 36 :

Section (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) to (vi)

(vii) subject to the provisions of sub-section (2), the amount of any bad debts 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 (vii) 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

2. (2012) 342 ITR 285 (Bom)

account made under that clause,

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 provision for bad and doubtful debts made in the accounts of the assessee.

(viii) to (xvii)

(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply -

(i) 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.”

10. So far as Section 36(1)(vii) of the Act is concerned, it is a settled position in law that after 1 st April, 1989, it is not necessary that the debt itself must be proved to be irrecoverable. The only requirement is that the amounts claimed as bad debts should be written off as irrecoverable in the account of the Assessee (see TKF Ltd. v/s. CIT – 323 ITR 397). The satisfaction of the above provision is not disputed by the Revenue. The hub of the controversy is whether the requirement of Section 36(2)(i) of the Act is satisfied.

11. It is noticed that Section 36(2)(i) of the Act allows deduction on account of satisfaction of any of one of the two conditions as under:-

(a) bad debts or part thereof taken into account in computing the income of the assessee for an earlier Assessment Year before such debt or part thereof is written off; or

(b) the debt represents money lent in the ordinary course of business of banking or money-lending which is carried on by the assessee.

Therefore, even if one of the two conditions of Section 36(2) (i) of the Act is satisfied, then bad debts claimed under Section 36(1)(vii) of the Act has to be allowed.

12. So far as first part of Section 36(2)(i) of the Act is concerned, i.e.

(a) above, we find that the Respondent-Assessee had during the earlier Assessment Years offered to tax an amount of Rs.42.65 lakhs received as interest on the deposit made with M/s. GSB Capital Market Ltd. The Appellant had since Assessment Year 1998-99 claimed an amount of Rs.49.82 lakhs as doubtful debts from M/s. GSB Capital Market Ltd. This consisted of the aggregate of principal and interest payable by M/s. GSB Capital Market Ltd. It was in the subject Assessment Year that a settlement was arrived at between the parties and the Respondent-Assessee received Rs.15 lakhs from M/s. GSB Capital Market Ltd. and the balance amount of Rs.34.82 lakhs being non-recoverable was being claimed as bad debts by writing off the same in its books of account. It would thus be noticed the amount of Rs.34.82 lakhs which constitutes partly the principal amount of the inter-corporate deposits and partly the interest which is unpaid on the principal debt. The Assessing Officer's contention that amount of Rs.34.82 lakhs was not offered to tax earlier and, therefore, deduction under Section 36(2)(i) of the Act is not available, is no longer re-integra. This very issue came up for

consideration before this Court in Shreyas S. Morakhia (supra) wherein the assessee was a stock broker and engaged in the business of sale and purchase of shares. The brokerage payable by the client was offered for tax. Subsequently, it was found that the principal amount which was to be received from its clients would not be received. The assessee sought to claim as bad debts not only the brokerage amounts not received but the aggregate of principal and brokerage amounts not received in respect of the shares transacted. This Court held that the debt comprises not only the brokerage which was offered to tax but also principal value of shares which was not received. Therefore, even if a part of debt is offered to tax, Section 36(2)(i) of the Act, stands satisfied. The test under the first part of Section 36(2)(i) of the Act is that where the debt or a part thereof has been taken into account for computing the profits for earlier Assessment Year, it would satisfy a claim to deduction under Section 36(1)(vii) read with Section 36(2)(i) of the Act. In fact, the Revenue also does not dispute the above provisions as no submission in that regard were made during the course of hearing before us.

13. Therefore in view of the above self evident position in Section 36(2)(i) of the Act as well as decision of this Court in Shreyas Morakhia (supra), no substantial question of law arises for our consideration.

9. In the case at hand, the fact that interest income of respondent for the Assessment Year 2001-02 relating to the deposit of Rs.4,35,00,000/- was indeed taxed as business income has not been disputed. Thus, advances of deposit is to be understood as having been done in the ordinary course of business. Therefore, one of the condition required under Section 36 (2) (i) of the Act, i.e., bad debts or part thereof taken into account in computing income of the assessee for an earlier Assessment Year before such debt or part thereof is written off is satisfied.

10. In our view, the Tribunal has not committed any perversity or applied incorrect principles to the given facts and when the facts and circumstances are properly analysed and correct test is applied to decide the issue at hand, then, we do not think that question as pressed raises any

substantial question of law.

The appeal is devoid of merits and it is dismissed with no order as to costs.

11. We will hasten to add that, we have not opined on the second part, i.e., whether or not the assessee is engaged in the business of money lending or banking since we have confirmed that respondent is entitled to deduction on bad debts in view of first part of Section 36 (2) (i) of the Act.

(AMIT B. BORKAR, J.)

(K.R. SHRIRAM, J.)