

IN THE HIGH COURT AT CALCUTTA
SPECIAL JURISDICTION [INCOME TAX]
ORIGINAL SIDE

ITA/32/2015

SRI JAHAR MATILAL
VS
THE COMMISSIONER OF INCOME TAX, KOLKATA – XVIII & ANR.

BEFORE :
THE HON'BLE THE CHIEF JUSTICE T.S SIVAGNANAM
-A N D-
HON'BLE JUSTICE CHAITALI CHATTERJEE (DAS)
DATE : 13th August, 2025

Mr. J.P. Khaitan, Sr. Adv.
Mr. Malay Dhar, Adv.
Mr. Bhaskar Sengupta, Adv.
...for appellant

Mr. Soumen Bhattacharjee, Adv.
Mr. Ankan Das, Adv.
Ms. Shradhya Ghosh, Adv.
...for respondents

The Court : This appeal filed by the assessee under Section 260A of the Income Tax Act, 1961 (the Act) is directed against that part of the order passed by the Income Tax Appellate Tribunal, “B” Bench, Kolkata (Tribunal) in I.T.A. No. 531/Kol/2010 dated 18th November, 2014, for the assessment year 2005-06 so far as the second issue in the said order regarding disallowance of bad debts.

The appeal was admitted by order dated 9th October, 2025 on the following substantial question of law :

“Whether the learned Tribunal erred in law in holding that in terms of accounting the bad debt was not written off of Rs.8,97,676/- but provision of bad and doubtful debts was made and as such the bad debts written off as claimed by the appellant is not to be allowed ?”

We have elaborately heard Mr. J.P. Khaitan, learned senior counsel appearing for the appellant/department and Mr. Soumen Bhattacharjee, learned standing counsel for the respondent/assessee.

The assessee filed the return of income for the assessment year under consideration along with tax audit report under Section 44AB of the Act appending the computation of income. In the said return, the assessee had shown a total income of Rs.33,28,170/-. The return was processed and thereafter notice under Section 143(2) and 142(1) was issued to the assessee and the case was discussed by the Assessing Officer with the authorized representative of the assessee. The assessment was completed under Section 143(3) on 31.12.2007 determining the total income at Rs.76,46,460/- after making disallowance of bad debts amounting to Rs.8,97,676/- and Rs.34,20,618/- in aggregate under different heads of income.

As could be seen from the material papers, the assessee had produced all documents and details with regard to the names and addresses of the debtors,

the amounts referred to in their bills and the reasons for treating such sums as bad debts as appeared in the profit and loss account for the year ended 31.3.2005. Furthermore, the assessee demonstrated before the Assessing Officer from the profit and loss account, balance sheet, ledger account for the period 1.4.2004 and 31.3.2005, statement of reserve for bad debts. However, assessment was completed with the said edition.

Aggrieved by the same, the assessee preferred appeal before the Commissioner of Income Tax (Appeals)-XXXIII, Kolkata [CIT(A)]. The appeal was dismissed by order dated 31.12.2009, against which the assessee filed appeal before the learned Tribunal which has been dismissed. The short issue which falls for consideration in the instant case is whether the Assessing Officer was justified in disallowing the bad debts on the ground that it was only a provision. In this regard, we were required to examine the factual position and we have done so, as could be seen from the balance sheet as at 31.3.2005 in the Current Assets, Loans and Advances column. It has been stated as follows :

Sundry debtors (Stated to be good)	19,122,196.99	
Less: Reserve for Bad Debts	<u>13,803,015.64</u>	5,319,181.35

In the Reserve for Bad Debts as on 31.3.2005, from the four columns, namely, the Name of party, the Opening balance, Bad Debts written off during the year and Closing Balance. In the said entry as against Unique Agencies, the Bad debts written off during the year has been shown as Rs.897676.72 and the

total Closing balance is Rs.13,80,30,15.64. When we compare this figure with that of the balance sheet as at 31.3.2005, as noted above, the figures match and it is evidently clear that the Reserve for bad debts as shown in the said tabulated statement has been deducted. It is no doubt true that heading of the format is "Reserve For Bad Debts As On 31.03.2005" but what has actually been shown in the table is the Bad Debts Written off during the year. Thus it appears that the Assessing Officer did not compare this factual situation as shown in the column Bad Debts Written off during the year with that of the balance sheet as at 31.3.2005.

Furthermore, the assessee's case stands strengthened on perusal of the Party Ledger with regard to Unique Agencies, which clearly shows that the cheques which were handed over upto 31.3.2004 for Rs.6,61,000/- and Rs.3,88,000/- were not deposited as per party's advice and reversed. This will clearly show that there has been a bad debts written off and not as a provision. However, the Assessing Officer while completing the assessment appears to have relied upon a statement of one Bijoy Krishna Majhi, who is stated to be the proprietor of Unique Agencies, who has given a statement stating there was no outstanding payable nor any cheque was issued. This statement was never put to the assessee and the assessee had no opportunity to cross-examine the said person. Therefore, the said statement should be held to be inadmissible and could not have been used by the Assessing Officer to complete the assessment.

Apart from that while affirming the order passed by the Assessing Officer and the CIT(A), reference has been made by the Tribunal to the decision in the case of *Commissioner of Income-tax vs. Micromax Systems (P.) Ltd.*, (2005) 148 *Taxman* 486 (Madras).

We have carefully gone through the said decision and we find that the decision is clearly distinguishable on facts. In the said case, the Assessing Officer found that the assessee had not actually written off the bad debts as recoverable in its books of accounts. This was noted by the learned Tribunal and accepted the case of the Department. Before the High Court, the Department contended that mere provisions of a bad debt is not sufficient to get the benefit of the provision and it is only to the debt actually written off as recoverable in the books of accounts that a claim for debt can be allowed as taken. The assessee argued before the High Court that it was only by an inadvertent mistake committed by the assessee that a narration was made in the profit and loss account as provision for bad debts. The Court took note of the amendment to Section 36(1)(vii) and held that it is a mandatory condition that deductions can be allowed as bad debts only when it is actually written off as irrecoverable in the accounts and not on the basis of mere provision and after taking note of several decisions it was held that the plain language of Section 36(1)(vii) of the Act the debt cannot be allowed as bad debt and even though the assessee is stated to have committed an inadvertent mistake, the same cannot be gone into as there is no equity in tax matters and therefore

held that making a provision is not the same as written off as bad debt irrecoverable. In the preceding paragraph we have noted the factual position and we find the assessee had actually written off the bad debts during the year and this has been vividly reflected in the balance sheet as at 31.3.2005, which has not been properly appreciated by the fact finding authorities.

While on this issue it will be beneficial to refer to the decision of the Hon'ble Supreme Court in *Vijaya Bank vs. Commissioner of Income-Tax & Anr.*, (2010) 323 ITR 166 (SC). Two questions arose for consideration in the said case namely, the manner in which the actual write off takes place under the accounting principles. The second question is whether it is imperative for the assessee to close the individual account of each debtor in its books or a mere reduction in the "loans and advances account" or debtors to the extent of the provision for bad and doubtful debt is sufficient. The Hon'ble Supreme Court took note of an earlier decision in the case of *Southern Technologies Ltd. vs. Joint CIT*, (2010) 320 ITR 577 (SC) . In the said decision (Southern Technologies Ltd.) it was held that, to understand the above dichotomy brought in by way of Explanation to Section 36(1)(vii), one must understand as to 'how to write off'. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor's account, it would constitute a write off of an actual debt. However, if an assessee debits provision for doubtful debt to the profit and loss account and makes a corresponding credit to the 'current liabilities and provisions' on the liabilities side of the balance-

sheet then it would constitute a provision for doubtful debts. At this juncture, it would be of utmost importance to quote the relevant paragraphs of the decision in *Southern Technologies (supra)* :

"6. The first question is no more res integra. Recently, a Division Bench of this court in the case of Southern Technologies Ltd. v. Joint CIT reported in [2010] 320 ITR 577, (in which one of us S. H. Kapadia J. was a party) had an occasion to deal with the first question and it has been answered, accordingly, in favour of the assessee, vide paragraph 25, which reads as under (page 604):

"Prior to April 1, 1989, the law, as it then stood, took the view that even in cases in which the assessee (s) makes only a provision in its accounts for bad debts and interest thereon and even though the amount is not actually written off by debiting the profit and loss account of the assessee and crediting the amount to the account of the debtor, the assessee was still entitled to deduction under section 36(1) (vii). (See CIT v. Jwala Prasad Tiwari [1953] 24 ITR 537 (Bom) and Vithaldas H. Dhanjibhai Bardanwala v. CIT [1981] 130 ITR 95 (Guj)). Such state of law prevailed up to and including the assessment year 1988-89. However, by insertion (with effect from April 1, 1989) of a new Explanation in section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before April 1, 1989, even a provision could be treated as a write off. However, after April 1, 1989, a distinct dichotomy is brought in by way of the said Explanation to section 36(1) (vii). Consequently, after April 1, 1989, a mere provision for bad debt would not be entitled to deduction under section 36(1)(vii). To understand the above dichotomy, one must understand 'how to write off. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor's account, it would constitute a write off of an actual debt. However, if an assessee debits 'provision for doubtful debt to the profit and loss account and makes a corresponding credit to the 'current liabilities and provisions' on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt. In the latter case, the assessee would not be entitled to deduction after April 1, 1989."

One point needs to be clarified. According to Shri Bishwajit Bhatta- 7 charya, the learned Additional Solicitor General appearing for the Department, the view expressed by the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala [1981] 130 ITR 95 was prior to the insertion of the Explanation vide the Finance Act, 2001, with effect from April 1, 1989, hence, that law is no more a good law. According to the learned counsel, in view of the insertion of the said Explanation in section 36(1) (vii) with effect from April 1, 1989, a mere debit of the impugned amount of bad debt to the profit and loss account would not amount to actual write off. According to him, the Explanation makes it very clear that there is a dichotomy between actual write off on the one hand and a provision for bad and doubtful debt on the other. He submitted that a mere debit to the profit and loss account would constitute a provision for bad and doubtful debt, it would not constitute actual write off and that was the very reason why the Explanation stood inserted. According to him, prior to the Finance Act, 2001, many assesseees used to take the benefit of deduction under section 36(1) (vii) of the 1961 Act by merely debiting the impugned bad debt to the profit and loss account and, therefore, Parliament stepped in by way of Explanation to say that mere reduction of pro-fits by debiting the amount to the profit and loss account per se would not constitute actual write off. To this extent, we agree with the contentions of Shri Bhattacharya. However, as stated by the Tribunal, in the present case, besides debiting the profit and loss account and creating a provision for bad and doubtful debt, the assessee-bank had correspondingly/simultaneously obliterated the said provision from its accounts by reducing the corresponding amount from loans and advances/debtors on the assets side of the balance-sheet and, consequently, at the end of the year, the figure in the loans and advances or the debtors on the asset side of the balance-sheet was shown as net of the provision "for the impugned bad debt". In the judgment of the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala [1981] 130 ITR 95, a mere debit to the profit and loss account was sufficient to constitute actual write off whereas, after the Explanation, the assessee(s) is now required not only to debit the profit and loss account but simultaneously also reduce loans and advances or the debtors from the assets side of the balance-sheet to the extent of the corresponding amount so that, at the end of the year, the amount of loans and advances/debtors

is shown as net of the provisions for the impugned bad debt. This aspect is lost sight of by the High Court in its impugned judgment. In the circumstances, we hold, on the first question, that the assessee was entitled to the benefit of deduction under section 36(1) (vii) of 1961 Act as there was an actual write off by the assessee in its books, as indicated above.

Coming to the second question, we may reiterate that it is not in dispute that section 36(1) (vii) of the 1961 Act applies both to banking and non-banking businesses. The manner in which the write off is to be carried out has been explained hereinabove. It is important to note that the assessee-bank has not only been debiting the profit and loss account to the extent of the impugned bad debt, it is simultaneously reducing the amount of loans and advances or the debtors at the year-end, as stated hereinabove. In other words, the amount of loans and advances or the debtors at the year-end in the balance-sheet is shown as net of the provisions for the impugned debt. However, what is being insisted upon by the Assessing Officer is that mere reduction of the amount of loans and advances or the debtors at the year-end would not suffice and, in the interest of transparency, it would be desirable for the assessee-bank to close each and every individual account of loans and advances or debtors as a pre-condition for claiming deduction under section 36(1)(vii) of the 1961 Act. This view has been taken by the Assessing Officer because the Assessing Officer apprehended that the assessee-bank might be taking the benefit of deduction under section 36(1) (vii) of the 1961 Act, twice over. (See order of the Commissioner of Income-tax (Appeals) at pages 66, 67 and 72 of the paper book, which refers to the apprehensions of the Assessing Officer). In this context, it may be noted that there is no finding of the Assessing Officer that the assessee had unauthorisedly claimed the benefit of deduction under section 36(1) (vii), twice over. The order of the Assessing Officer is based on an apprehension that, if the assessee fails to close each and every individual account of its debtor, it may result in the assessee claiming deduction twice over. In this case, we are concerned with the interpretation of section 36(1)(vii) of the 1961 Act. We cannot decide the matter on the basis of apprehensions/desirability. It is always open to the Assessing Officer to call for details of individual debtor's account if the Assessing Officer has reasonable grounds to believe that the

assessee has claimed deduction, twice over. In fact, that exercise has been undertaken in subsequent years. There is also a flipside to the argument of the Department. The assessee has instituted recovery suits in courts against its debtors. If individual accounts are to be closed, then the debtor/defendant in each of those suits would rely upon the bank statement and contend that no amount is due and payable in which event the suit would be dismissed.

Before concluding, we may refer to an argument advanced on behalf of 9 the Department. According to the Department, it is necessary to square off each individual account failing which there is likelihood of escapement of income from assessment. According to the Department, in cases where a borrower's account is written off by debiting the profit and loss account and by crediting loans and advances or debtors accounts on the assets side of the balance-sheet, then, as and when in the subsequent years if the borrower repays the loan, the assessee will credit the repaid amount to the loans and advances account and not to the profit and loss account which would result in escapement of income from assessment. On the other hand, if bad debt is written off by closing the borrower's account individually, then the repaid amount in subsequent years will be credited to the profit and loss account on which the assessee-bank has to pay tax. Although, prima facie, this argument of the Department appears to be valid, on a deeper consideration, it is not so for three reasons. Firstly, the head office accounts clearly indicate, in the present case, that, on repayment in subsequent years, the amounts are duly offered for tax. Secondly, one has to keep in mind that, under the accounting practice, the accounts of the rural branches have to tally with the accounts of the head office. If the repaid amount in subsequent years is not credited to the profit and loss account of the head office, which is ultimately what matters, then, there would be a mismatch between the rural branch accounts and the head office accounts. Lastly, in any event, section 41(4) of the 1961 Act, inter alia, lays down that, where a deduction has been allowed in respect of a bad debt or a part thereof under section 36(1) (vii) of the 1961 Act, then, if the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess shall be deemed to be profits and gains of business and, accordingly, chargeable to income tax as the income of the previous

year in which it is recovered. In the circumstances, we are of the view that the Assessing Officer is sufficiently empowered to tax such sub-sequent repayments under section 41(4) of the 1961 Act and, consequently, there is no merit in the contention that, if the assessee succeeds, then it would result in escapement of income from assessment."

The above decision would come to the aid and assistance of the assessee both on facts as well as on law.

Apart from laying down the above legal principle, the Hon'ble Supreme Court has pointed that Section 41(4) of the Act lays down that, where a deduction has been allowed in respect of a bad debt or a part thereof under Section 36(1)(vii) of the Act, then, if the amount subsequently recovered on any such debt is greater than the difference between the debt and amount so allowed, the excess shall be deemed to be profit and gains of business and accordingly, chargeable to income tax as income of the previous year in which it was recovered and therefore, the Assessing Officer is sufficiently empowered to tax such subsequent repayments under Section 41(4) of the Act.

On facts we find from the profit and loss account for the year ended 31.3.2005, the assessee has shown the bad debts which were written off and subsequently recovered which was greater than the debt payable and on the said component tax has been paid by the assessee.

Thus, for all the above reasons we hold that the learned Tribunal committed an error in affirming the orders passed by the Assessing Officer as well as the CIT(A).

For all the above reasons, the appeal is allowed.

The order passed by the learned Tribunal as well as the assessment order and the order passed by the CIT(A) is set aside and the deduction claimed by the assessee for the sum of Rs.8,97,676/- should be allowed on the ground it is bad debt written off and doubtful debts.

(T.S. SIVAGNANAM, C.J.)

(CHAITALI CHATTERJEE (DAS), J.)