(1993) 10 RAJ CK 0020

In the Rajasthan High Court

Case No : Income Tax Reference No. 121 of 1982

Commissioner of Income Tax APPELLANT

Vs

Hotel Ram Bagh Palace RESPONDENT

Date of Decision : 08-10-1993

Acts Referred:

Income Tax Act, 1961 — Section 10(2), 28, 36, 36(1), 36(2)

Citation : (1993) 10 RAJ CK 0020

Hon'ble Judges : K.C. Agrawal, C.J;V.K. Singhal, J

Bench : Division Bench

Advocate : G.S. Bapna, for the Appellant; H.P. Gupta, for the Respondent

Judgement

1. The Income Tax Appellate Tribunal has referred the following question of law arising out of its order dated April 29, 1981, in respect of the assessment year 1975-76 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the Commissioner of Income Tax (Appeals) was right in allowing the bad debts of Rs. 42,754 and Rs. 17,944?"

2. The brief facts of the case are that bad debts of Rs. 42,754 and 17,944 were shown by the assessee which were not allowed by the Income Tax Officer on the ground that the assessee-company is the successor to the firm, Messrs. Amber Corporation, and the said bad debts related to the firm, Messrs. Amber Corporation. Relying on the decision in T.N. Shah (P.) Ltd. Vs. Additional Commissioner of Income Tax, the Tribunal allowed the deduction. The Income Tax Officer found that the debts of a purchaser in business cannot be allowed as a deduction in the hands of the successor in business and the contention of the assessee that due to change of ownership of the business the identification of the business is not broken or interrupted and the successor is entitled to write off the trading debts in his own accounts when they became irrecoverable, even though the debts may be due from its customers in respect of dealings of a period prior

to the change of the ownership was rejected.

3. The decisions relied on by the assessee in Expanded Metal Depot Private Ltd. Vs. Commissioner of Income Tax, Bombay City - III, Commissioner of Income Tax, Bombay City-II Vs. Bombay Hing Supply Co., and Commissioner of Income Tax Vs. T. Veerabhadra Rao, K. Koteswara Rao and Co., were held not applicable as the decisions were said to be under the provisions of the Indian Income Tax Act, 1922, and that Act did not contain any provision corresponding to Section 36(2)(i)(a) of the Income Tax Act, 1961, where deduction for bad debts cannot be allowed unless part thereof has been taken into account in computing the income of the assessee of that previous year or of an earlier previous year.

4. In appeal before the Tribunal, the decision of the Allahabad High Court in the case of T.N. Shah (P.) Ltd. Vs. Additional Commissioner of Income Tax, was relied on wherein it was held as under (headnote) :

"There is nothing in Section 36(2) of the Act to indicate that ''assessee'' refers to the original creditor and does not include a transferee or assignee of the debt. The condition which has been expressly incorporated in Section 36 and which did not find a place in Section 10(2)(xi) of the Act of 1922 is that the amount of the debt or part thereof should have been taken into account in computing the income of the assessee in a previous year. The emphasis is not on the assessee being the original creditor but the taking into account of the debt in computing the income of the same business. If, in a given case, the income of a business is computed by taking into account a certain debt, it does not appear reasonable that, in the absence of any statutory prohibition, allowance on account of the debt having become bad should be denied only because the assessee''s identity has changed, though the identity of the business continues."

5. The provisions of Section 36(2)(i)(a) are as under :

"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."

6. In Commissioner of Income Tax, A.P. Vs. T. Veerabhadra Rao, K Koteswara Rao and Co., the apex court has held as under (at page 156) :

"Section 28, referred to in Sub-section (1) of Section 36, provides that income under the head ''Profits and gains of business or profession'', shall be chargeable to Income Tax. The profits and gains of a business are charged to Income Tax. To compute the profits and gains so chargeable Section 36 provides for allowing a number of deductions. Each of the deductions must relate to the business. If the same assessee was carrying on a business and he wrote off a debt relating to the business as irrecoverable, he would without doubt be entitled to a corresponding deduction under Clause (vii) of Sub-section (1) of Section 36 subject to the fulfilment of the conditions set forth in Sub-section (2) of Section 36. If a business, along with its assets and liabilities, is transferred by one owner to another, we see no reason why a debt so transferred should not be entitled to the same treatment in the hands of the successor. The recovery of the debt is a right transferred along with the numerous other rights comprising the subject of the transfer. If the law permits the transferor to treat the whole or part of the debt as irrecoverable and to claim a deduction on that account, it seems difficult to accept that the same right should not be recognised in the transferee. It is merely an incident flowing from the transfer of the business, together with its assets and liabilities, from the previous owner to the transferee. It is a right which should, on a proper appreciation of all that is implied in the transfer of a business, be regarded as belonging to the new owner. Unless the language of the statute plainly and clearly compels a construction to the contrary, the normal rule of the law should be given its proper play. It is true that Clause (i) of Sub-section (2) of Section 36 declares that a deduction can be allowed only if the debt, or part thereof, has been taken into account in computing the income of the assessee of that previous year or an earlier previous year and it has also been written off as irrecoverable in the accounts of the assessee for that previous year. In the present case, the debt was taken into account in the income of the assessee for the assessment year 1963-64 when the interest income accruing thereon was taxed in the hands of the assessee. The interest was taxed as income because it represented an accretion accruing during the earlier year on money owed to the assessee by the debtor. The item constituted income because it represented interest on a loan. The nature of the income indicated the transaction from which it emerged. The transaction was the debt and that debt was taken into account in computing the income of the assessee of the relevant previous year. It is the same assessee who has subsequently, pursuant to a settlement, accepted part payment of the debt in full satisfaction and has written off the balance of the debt as irrecoverable in his accounts. It appears, therefore, that the conditions in both Sub-clauses (a) and (b) of Clause (i) of Sub-section (2) of Section 36 are satisfied in the present case and the High Court as well as the Appellate Tribunal and the Appellate Assistant Commissioner are right in the view which they took.

It seems to us that even if the debt had been taken into account in computing the income of the predecessor firm only and had subsequently been written off as irrecoverable in the accounts of the assessee, the assessee would still have been entitled to a deduction of the amount written off as a bad debt. It is not imperative that the assessee referred to in Sub-clause (a) must necessarily mean the identical assessee referred to in Sub-clause (b). A successor to the pertinent interest of a previous assessee would be covered within the terms of Sub-clause (b). The successor-assessee, in effect, steps into the shoes of his predecessor."

7. In view of the clear interpretation which has been given by the apex court on the basis of the provisions of Section 36 of the Income Tax Act, 1961, we are of the opinion that the Income Tax Appellate Tribunal was justified in coming to the

conclusion that the Commissioner of Income Tax (Appeals) was right in allowing the bad debts of Rs. 42,754 and Rs. 17,944.

8. Accordingly, the reference is answered in favour of the assessee and against the Revenue.