

(2010) 07 KAR CK 0052
In the Karnataka High Court
Case No : IT Appeal No. 2861 of 2005

Commissioner of Income Tax

APPELLANT

Vs

K. Raheja Development Corpn.

RESPONDENT

Date of Decision : 21-07-2010

Acts Referred:

Income Tax Act, 1961 — Section 26 (2), 27, 28, 36, 36 (1) (vii)

Citation : (2010) 195 TAXMAN 412

Hon'ble Judges : N. Kumar, J; B.V. Nagarathna, J

Bench : Division Bench

Advocate : M.V. Seshachala, for the Appellant; A. Shankar, for the Respondent

Final Decision : Dismissed

Judgement

N. Kumar, J.—This is an appeal by the revenue, challenging the order passed by the Tribunal, which set aside the order passed by the authorities and granted the benefit of deduction under the heading "bad debts" u/s 36 of the Income Tax Act, 1961 ("the Act").

2. The Assessee entered into an agreement with Vinayaka Enterprises, to develop and handover 84 Acres and 23 Guntas of land in Jakkur and Shivanahalli village around Bangalore, under an agreement dated 1-2-1995. Subsequently, on 27-6-1998, the earlier agreement came to be terminated and yet another agreement of even date came into existence under which, Vinayaka Enterprises agreed to repay Rs. 12 crores and an additional compensation of Rs. 6 crores and out of Rs. 12 crores, a sum of Rs. 2 crores was repaid by Vinayaka Enterprises. The balance amount was not paid. Therefore, the Assessee filed a return of income for the assessment year 2001-02 claiming the following debts as written off:

3. The Assessing Officer who processed the returns disallowed the claim of the Assessee in respect of the bad debt claimed on the ground, that the debtor had not become insolvent and had resources to pay money and had also not stopped

payments as they had made part payment and that they were not disowning the liabilities but on the contrary, they had admitted the liability had issued cheques and were trying for settlement with the Assessee and that civil and criminal proceedings were initiated to recover the said amount. Thus, in the view of the Department, the debt had not become time-barred. Aggrieved by the same, the Assessee preferred an appeal before the Commissioner of Income Tax. The said appeal came to be dismissed upholding the order of the Assessing Officer. It is against these two orders that the Assessee had preferred an appeal before the Tribunal. The Tribunal held that the action of the authorities are contrary to the provisions of Section 36(1)(vii) of the Act and the position has to be looked into as on the date of write off and not on the possibility of recovery of a subsequent uncertain date, since till the date of filing of the return of income, nothing was received, therefore, there was no hope of recovery. The initiation of legal proceedings is not a condition precedent for claim of bad debt. There is no prohibition for initiation of legal proceedings after the debt is written off. The decision has to be arrived at on the common sense and as to what a prudent businessman would arrive at and therefore, it held that in view of the amended provisions to the Income Tax, once the Assessee in his accounts writes off a debt there is sufficient compliance of the legal requirement and the legality or the correctness of the said writing off cannot be gone into in these proceedings. Therefore, it allowed the appeal, set aside that portion of the order, refusing to grant deduction under the heading "bad debts" and the said claim was upheld aggrieved by the said order, the revenue is in appeal.

4. On 23-8-2006, when this appeal was admitted, the following questions of law were framed:

(i) Whether, the Tribunal was correct in holding that a sum of Rs. 19,24,09,280 amount payable by Vinayaka Enterprises to the Assessee should be written off as a bad debt during the current assessment year by allowing the principle sum as a loss u/s 28 read with Section 27 of the Act and the interest component u/s 36(1)(vii) read with Section 36(2) of the Act?

(ii) Whether, the Tribunal took into consideration facts like two agreements not being honoured by Vinayaka Enterprises and some cheques issued by Vinayaka Enterprises being dishonoured and the write off having taken place under a bona fide belief as a prudent businessman by taking a common sense view without actually specifying the specific instances and its correlation to the provisions of the Act and consequently recorded a perverse finding?

(iii) Whether, the Tribunal failed to take into consideration the fact that the Assessee had not even give up the claim for recovery of a sum of Rs. 9,24,09,280 from Vinayaka Enterprises as the Assessee has filed a suit for recovery of this amount and the property which was agreed to be transferred has been standing as a charge for the debt and the Assessee had received post dated cheques some of which are being honoured and the rest of dishonoured cheques the Assessee has initiated criminal proceedings for recovery?

(iv) Whether, the Tribunal after taking into account the provisions for allowing bad debts failed to apply the proposition of law to the facts of the case in the proper prospective?

(v) Whether, the Tribunal was correct in holding that since the Assessee was under a bona fide belief that he has incurred loss he was not under an obligation to pay advance tax as per Section 208 of the Act and therefore no interest u/s 234B of the Act could be levied when these provisions has been held mandatory?

5. Learned Counsel appearing for Appellant-revenue submitted that the material on record clearly discloses that the debtor has repaid a portion of the amount received under the agreement. Further, it has admitted that civil and criminal proceedings were initiated upon the debtor and he has virtually repaid Rs. 11,15,00,000 in those proceedings. Under the agreement, a charge was created on the immovable property. The debtor had the capacity to repay and he committed default because of fall in the real estate market and because of cash crunch and therefore, the Assessee was not justified in writing off this debt if it is done only with an intention of reducing tax liability on that particular assessment year, when the Assessee had made huge profits. In those circumstances, the authorities were justified in disallowing the same and the Tribunal has wrongly interfered with the said orders.

6. Per contra, learned Counsel appearing for the Respondent-Assessee submitted, that a sum of Rs. 12 crores paid to the debtor has been reflected in the statement of accounts after the original agreement was cancelled, it was submitted by the counsel under what circumstances the debtor agreed to pay Rs. 12 crores and Rs. 6 crores as compensation along with interest within the schedule time. The said amount of Rs. 6 crores and interest payable thereof had reflected in their statement of account in their returns for which they have paid tax. When that being the case, when the possibility of recovery was remote, they are justified in claiming deduction as bad debt. It did not come in the way of recovering the money in future and when they recovered money, they have offered it to tax and have paid tax, which is not in dispute. In those circumstances, the Tribunal was justified in setting aside the orders passed by the lower authorities and in upholding the claim of deduction, which is strictly in accordance with law.

7. The material on record discloses that the Assessee has paid Rs. 12 crores under an agreement with the debtor, The said amount is reflected in their records for the previous year. When the said contract was terminated, a fresh agreement was entered into, under which the debtor agreed to repay Rs. 12 crores plus Rs. 6 crores compensation with interest. Though, the amount was not received by the Assessee in terms of the said agreement but received only a sum of Rs. 2 crores which they have shown in their returns for the aforesaid sums and have paid tax for the said amount. It is thereafter, they choose to claim deduction after writing off the said amounts as bad debts.

8. Section 36(1)(vii) of the Act provides 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 accounts of the Assessee for the previous year is liable to be deducted. The condition precedent for claiming such deduction is that the Assessee should write off the said debt as a bad debt and as irrecoverable. Sub-section (2) provides that in making any deduction for bad debt or part thereof, the following condition should be satisfied viz., that no such deduction shall be allowed unless a 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. Once that condition is fulfilled and the Assessee in his accounts writes off a debt as a bad debt, then he has the right to claim deduction u/s 36 of the Act.

9. In the instant case, the material on record discloses that the Assessee has shown in his returns in the previous years Rs. 12 crores plus Rs. 6 crores as compensation plus the interest of Rs. 2 crores and in all Rs. 19,24,09,280 as the amount receivable under the agreement dated 27-6-1998 and he has paid tax on the said amount. It is thereafter, in his accounts he has written off the said amount as bad debt as it was irrecoverable. Therefore, both the conditions contemplated u/s 36(1)(vii) and Sub-section (2)(i) of the Act are complied with and therefore, the Assessee is entitled to deduction. The authorities have proceeded on the assumption that there was a chance of recovery of the said amount and the debtor had not become insolvent and there was a charge created on the property in respect of which, the amount was advanced and criminal and civil proceedings were initiated in which, a sum of Rs. 11,15,00,000 was recovered and therefore, the said debt could not have been treated as a bad debt. In other words, the authorities have taken into consideration the subsequent events after the debt has been declared as a bad debt to decide whether it is a bad debt or not. What the authorities have to taken note of is, on the date the said debt was declared as a bad debt as irrecoverable and written off and claimed deduction, whether all these ingredients on which reliance is placed was in existence. Even otherwise, as the law stands on the date of the return being filed by the Assessee what was required was to write off a debt as a bad debt or irrecoverable in the books of account i.e., conclusive proof of the said debt being a bad debt. The question of the Department going into the legality or correctness of the declaration was impermissible even though after such declaration the Assessee claimed deduction. Subsequently, the Assessee is not prevented from recovering the said amount. In this case, the amount so recovered is offered to tax and tax has been paid and therefore, seen from any angle, the interest of the revenue is in no way affected. It is in that context, the Tribunal keeping in mind the statutory provisions and the said legal position has rightly set aside the order passed by the Assessing Officer as well as the first appellate authority and upheld the claim of deduction.

10. In that view of the matter, the substantial questions of law framed are answered against the revenue and in favour of the Assessee. We do not see any

merit in this appeal and accordingly, dismiss the appeal.